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

Overview

In 2011, the Group put more efforts in executing its customer-oriented service innovation strategy and allocated resources deliberately in an increasingly competitive market. By capturing the opportunity of increasing capital expenditure by domestic telecommunications operators and vigorously expanding businesses in the domestic non-operator market and overseas market, the Group maintained rapid growth momentum in all businesses. Our total revenues amounted to RMB53,507.40 million, representing an increase of 17.8% from 2010. Profit attributable to equity shareholders of the Company amounted to RMB2,114.86 million, representing an increase of 17.2% from RMB1,803.75 million[1] of 2010. Basic earnings per share was RMB0.366, representing an increase of 17.2% from 2010. Free cash flow amounted to RMB413.87 million, representing a decrease of 34.1% over the same period last year.

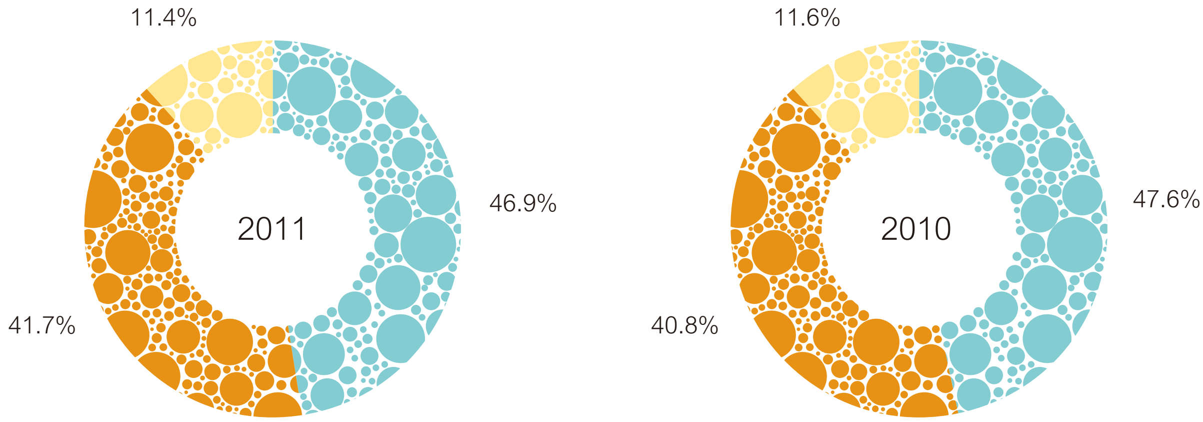
Revenues

Our total revenues in 2011 were RMB53,507.40 million, representing an increase of 17.8% from 2010. Among our businesses, revenues from telecommunications infrastructure ("TIS") services were RMB25,114.96 million, representing an increase of 16.1% from 2010; revenues from business process outsourcing ("BPO") services were RMB22,315.34 million, representing an increase of 20.6% from 2010; revenues from applications, content and other ("ACO") services were RMB6,077.10 million, representing an increase of 15.3% from 2010. BPO services were the major source of our revenues growth in 2011, while network maintenance and distribution of telecommunications services and products in BPO services were the two major businesses which experienced a relatively faster growth in revenues. In terms of customer structure, the Group's revenues from the domestic telecommunications operators amounted to RMB34,151.06 million, representing 63.8% of the total revenues, an increase of 15.9% from 2010; revenues from the domestic non-operator customers and overseas customers amounted to RMB19,356.34 million and its proportion of total revenues increased to 36.2%, representing an increase of 21.3% from 2010. Domestic telecommunications operators were the major driving force of the Group's revenues growth in 2011.

[1] In 2011, the Group retrospectively adopted the amendment to IFRS 1. Please refer to note 3 of the audited financial statements for details.

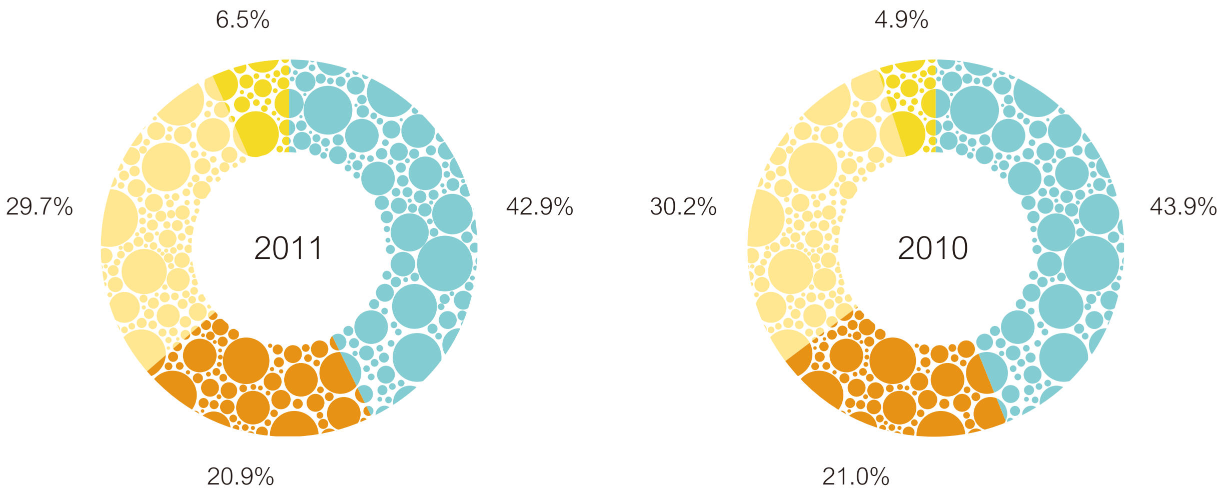
Business Mix

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



Customer Mix

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



The following table sets forth a breakdown of our total revenues for 2010 and 2011, together with their respective rates of change:

	2011 RMB'000	2010 RMB'000	Percentage Change
Telecommunications Infrastructure Services			
Design services	**5,110,320**	4,453,627	14.7%
Construction services	**18,329,463**	15,796,460	16.0%
Project supervision and management services	**1,675,179**	1,386,458	20.8%
	25,114,962	21,636,545	16.1%
Business Process Outsourcing Services			
Network maintenance	**5,276,067**	4,269,869	23.6%
Distribution of telecommunications services and products	**14,442,791**	11,956,698	20.8%
Facilities management	**2,596,481**	2,281,857	13.8%
	22,315,339	18,508,424	20.6%
Applications, Content and Other Services			
IT applications	**3,105,892**	2,637,849	17.7%
Internet service	**537,218**	483,862	11.0%
Voice VAS	**746,427**	706,264	5.7%
Others	**1,687,559**	1,444,288	16.8%
	6,077,096	5,272,263	15.3%
Total	**53,507,397**	45,417,232	17.8%

Telecommunications Infrastructure Services

In 2011, revenues from TIS services of the Group were RMB25,114.96 million, representing an increase of 16.1% over RMB21,636.55 million from 2010, which was our primary source of revenues, and accounted for 46.9% of our total revenues, representing a decrease of 0.7 percentage points from 47.6% in 2010. During the period, driven by the increasing popularity of smart phones, mobile Internet development and the "Broadband China" strategy, the domestic telecommunications operators increased their capital expenditure steadily. Under this circumstance, the Group adopted more proactive and effective measures, TIS revenues from domestic telecommunications operators grew rapidly and amounted to RMB18,889.00 million in 2011, representing an increase of 15.1% over RMB16,409.25 million from 2010. Meanwhile, the Group further expanded into the domestic non-operator market and overseas market, and TIS revenues from such markets grew rapidly and amounted to RMB6,225.96 million, representing an increase of 19.1% over RMB5,227.30 million in 2010.

Business Process Outsourcing Services

In 2011, revenues from BPO services of the Group were RMB22,315.34 million, representing an increase of 20.6% over RMB18,508.42 million in 2010. BPO services accounted for 41.7% of our total revenues, representing an increase of 0.9 percentage points from 40.8% in 2010. Among BPO services, revenues from network maintenance were RMB5,276.07 million, representing an increase of 23.6% from 2010 and kept growing strongly. Rapid revenue growth was mainly attributable to the increased spending in network optimization and maintenance on the enlarged network and subscriber base of domestic telecommunications operators. In addition, by leveraging the advantages of our integrated services, the Group provided ancillary services such as the distribution of telecommunications machineries according to the requirements of the customers. Meanwhile, the rapid growth of mobile subscribers in China and their demand for handsets also promoted the handsets distribution business of the Group. Revenues from distribution of telecommunications services and products amounted to RMB14,442.79 million, representing an increase of 20.8% from 2010.

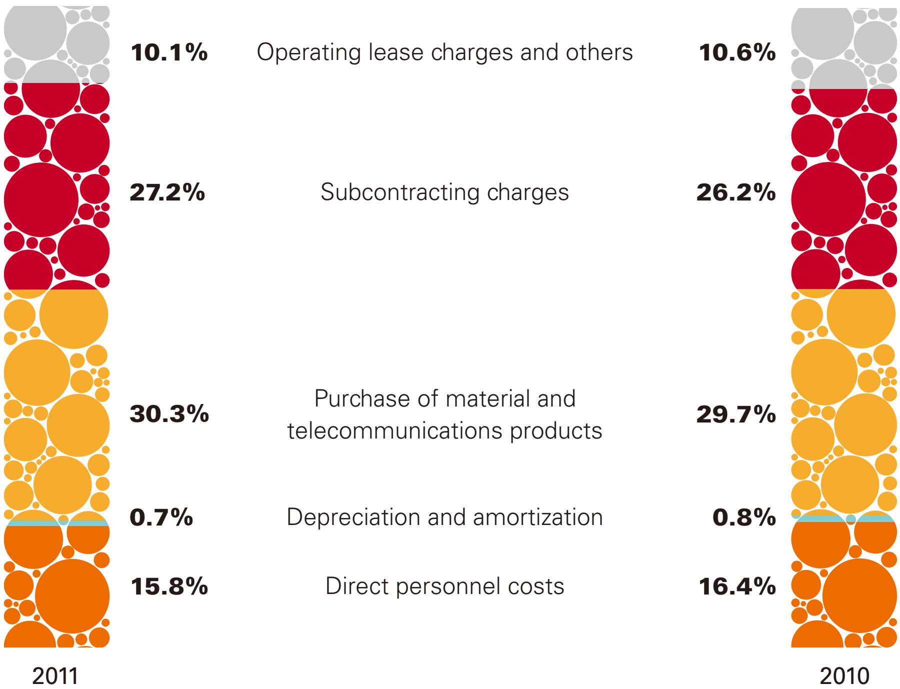
Applications, Content and Other Services

In 2011, revenues from ACO services of the Group were RMB6,077.10 million, representing an increase of 15.3% over RMB5,272.26 million from 2010. ACO services accounted for 11.4% of our total revenues, representing a decrease of 0.2 percentage points from 11.6% in 2010. During this year, the Group further expanded the informatization services to government and enterprise customers and the Internet application service to telecommunications operators, which led to a rapid increase in revenues from IT applications and became a major revenue generator for ACO services. The revenues from IT applications were RMB3,105.89 million, representing an increase of 17.7% from 2010.

Cost of Revenues

Our cost of revenues in 2011 was RMB44,998.32 million, representing an increase of 18.3% from 2010 and accounting for 84.1% of our total revenues.

Cost of Revenues as a % of Total Revenues



The following table sets out a breakdown of our cost of revenues in 2010 and 2011 and their respective rates of change:

	2011 RMB'000	2010 RMB'000 (Restated)	Percentage Change
Direct personnel costs	**8,473,657**	7,459,665	13.6%
Depreciation and amortization	**393,152**	364,743	7.8%
Purchase of material and telecommunications products	**16,195,976**	13,506,740	19.9%
Subcontracting charges	**14,525,988**	11,883,574	22.2%
Operating lease charges and others	**5,409,545**	4,809,168	12.5%
Total cost of revenues	**44,998,318**	38,023,890	18.3%

Direct Personnel Costs

In 2011, direct personnel costs were RMB8,473.66 million, representing 15.8% of our total revenues and an increase of 13.6% over RMB7,459.67 million in 2010. With the rapid growth in business volume in 2011, the Group consistently applied reasonable control over its total headcount and subcontracted our low-end tasks, thereby minimizing the staff costs, avoiding related risks and effectively mitigating the impact of wage increase in the society. The proportion of direct personnel costs of our total revenues decreased by 0.6 percentage points compared to 2010.

Depreciation and Amortization

In 2011, depreciation and amortization amounted to RMB393.15 million, representing 0.7% of our total revenues and an increase of 7.8% over RMB364.74 million in 2010. Its proportion of our total revenues was maintained at the relatively similar level as in 2010.

Purchase of Materials and Telecommunications Products

In 2011, the cost of materials and telecommunications products purchase was RMB16,195.98 million, representing 30.3% of our total revenues and an increase of 19.9% over RMB13,506.74 million in 2010. In 2011, the distribution of telecommunications services and products business of the Group grew rapidly, and so the corresponding cost of telecommunications products purchase, including the telecommunications machineries and handsets, also grew in a faster pace. Cost of construction materials in respect of our telecommunications infrastructure business remained relatively stable over last year. The cost of materials and telecommunications products as a percentage of our total revenues increased by 0.6 percentage points compared to 2010.

Subcontracting Charges

In 2011, subcontracting charges were RMB14,525.99 million, representing 27.2% of our total revenues and an increase of 22.2% over RMB11,883.57 million in 2010. The increase in subcontracting charges was mainly derived from the telecommunications infrastructure services. As the business volume increased significantly in 2011, 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 total revenues increased by 0.9 percentage points compared to 2010.

Operating Lease Charges and Others

In 2011, operating lease charges and others were RMB5,409.55 million, representing 10.1% of our total revenues and an increase of 12.5% over RMB4,809.17 million in 2010. Its proportion of our total revenues decreased by 0.5 percentage points compared to 2010.

Gross Profit

In 2011, the Group's gross profit amounted to RMB8,509.08 million, representing an increase of 15.1% over RMB7,393.34 million in 2010. The Group's gross profit margin in 2011 was 15.9%, representing a decrease of 0.4 percentage points over 16.3% in 2010. Due to the market competition and costs increase for certain businesses and expenses, the Group's gross profit margin was affected to certain extent. However, operational efficiency on most of our businesses remained stable as a result of our strengthened management over business collaboration and costs control.

Selling, General and Administrative Expenses

Our selling, general and administrative expenses in 2011 were RMB6,401.10 million, representing an increase of 13.6% over RMB5,637.14 million in 2010, and accounting for 12.0% of our total revenues. In 2011, the Group strengthened cost control on selling and administrative expense and realized economies of scale while its business grew rapidly. Selling, general and administrative expenses as a percentage of total revenues decreased by 0.4 percentage points compared to 2010.

Finance Costs

In 2011, the Group's finance costs were RMB60.31 million and increased slightly by 4.5% over RMB57.73 million in 2010. In 2011, the tightening macroeconomic policy in China led to a rising loan interest rate and our corresponding finance costs. However, the Group also reduced finance costs by implementing effective centralized fund management. As a result of the two factors above, the finance costs of the Group remained relatively stable during the year.

Income Tax

Certain of our domestic 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 24%. Apart from these subsidiaries, the Company and other domestic subsidiaries of the Group were subject to an income tax rate of 25%. The overseas subsidiaries of the Group were subject to different countries' tax rate. The income tax of the Group in 2011 was RMB534.19 million and our effective tax rate was 20.2%, remaining relatively stable compared to 20.3% in 2010. The difference between our effective tax rate and the statutory tax rate was mainly due to the preferential income tax treatment for new and high-technology enterprises and the preferential policy of deduction for research and development expenses before income tax enjoyed by certain of our subsidiaries.

Profit Attributable to Equity Shareholders of the Company

In 2011, profit attributable to equity shareholders of the Company was RMB2,114.86 million, representing an increase of 17.2% over RMB1,803.75 million in 2010. Profit attributable to equity shareholders of the Company accounted for 4.0% of our total revenues, remaining at a stable level as in 2010.

Capital Expenditure

We implemented stringent budget management over capital expenditure, and adjusted our capital expenditure plan according to the changes of market condition. In 2011, our capital expenditure amounted to RMB823.14 million, a decrease of 1.2% from RMB832.96 million in 2010. The capital expenditure in 2011 accounted for 1.5% of our total 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 2011 increased to RMB1,158.74 million over RMB390.06 million in 2010. As at the end of 2011, our cash and cash equivalents amounted to RMB7,298.23 million, of which 95.7% was denominated in Renminbi.

The following table sets out our cash flow positions in 2010 and 2011, respectively:

	2011 **RMB'000**	2010 RMB'000
Net cash generated from operating activities	**1,223,642**	1,526,412
Net cash used in investing activities	**(860,541)**	(1,055,364)
Net cash used in financing activities	**(1,521,836)**	(861,103)
Net decrease in cash and cash equivalents	**(1,158,735)**	(390,055)

In 2011, net cash generated from operating activities was RMB1,223.64 million, representing a decrease of RMB302.77 million from RMB1,526.41 million in 2010. 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, and certain customers of the Group delayed their payment due to credit tightening in China.

In 2011, net cash used in investing activities was RMB860.54 million, representing a decrease of RMB194.82 million from RMB1,055.36 million in 2010. Cash used in investing activities in 2011 mainly comprised of capital expenditure including the purchase of facilities.

In 2011, net cash used in financing activities was RMB1,521.84 million, representing an increase of RMB660.74 million from RMB861.10 million in 2010. The increase in net cash used in financing activities was mainly because the Group repaid the short-term entrust loan.

Working Capital

As at the end of 2011, working capital (i.e. current assets minus current liabilities) was RMB9,189.05 million, while working capital was RMB7,945.82 million in 2010. The increase in working capital was mainly due to the rapid development of the Group's domestic and overseas businesses, and certain customers of the Group delayed their payment due to credit tightening in China.

Indebtedness

As at the end of 2011, total indebtedness of the Group was RMB998.34 million and decreased by RMB782.18 million from RMB1,780.52 million at the year end of 2010. Indebtedness of the Group were mainly fixed interest rate loans and denominated in Renminbi, of which Renminbi loan accounted for 82.3% and US dollar loan accounted for 17.7%, and 94.5% was fixed interest rate loans and 5.5% was floating interest rate loans.

As at the end of 2011, our gearing ratio[1] was 5.9%, a decrease of 5.0 percentage points from 10.9% in 2010.

[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.

Contractual Obligations

The following table sets out our contractual obligations as at 31 December 2011:

	Total RMB'000	2012 RMB'000	2013 RMB'000	2014 RMB'000	2015 RMB'000	2016 and after RMB'000
Short-term debt	998,335	998,335	–	–	–	–
Operating lease commitments	468,696	185,647	92,143	63,215	38,284	89,407
Capital commitments	154,947	154,947	–	–	–	–
Of which:						
Authorized and contracted for	93,431	93,431	–	–	–	–
Authorized but not contracted for	61,516	61,516	–	–	–	–
Total of contractual obligations	1,621,978	1,338,929	92,143	63,215	38,284	89,407

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 2011, the balance of our cash and cash equivalents in foreign currencies accounted for 4.3% of our total cash and cash equivalents, of which 2.5% and 0.6% were denominated in US dollars and Hong Kong dollars, respectively.