

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITIONS AND RESULTS OF OPERATIONS

Overview

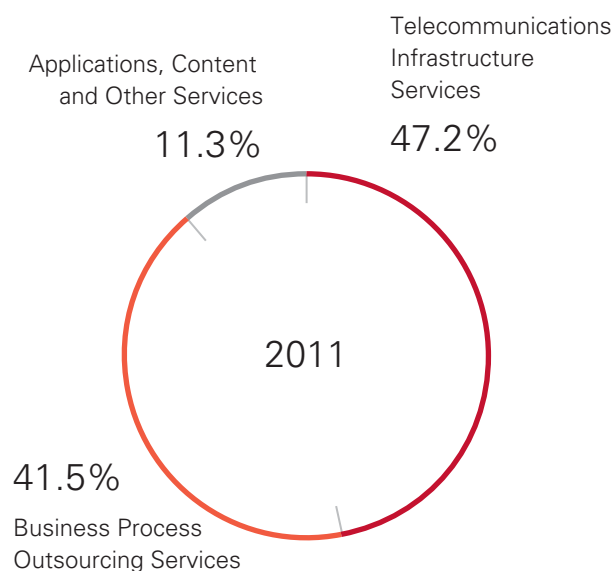
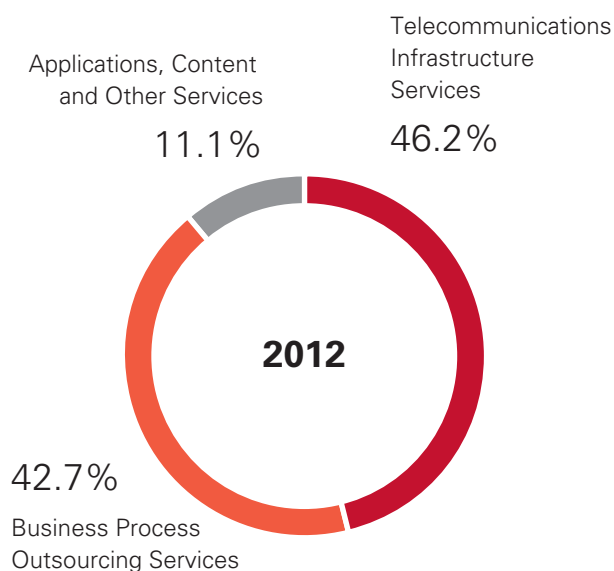
In 2012, against a backdrop of the unstable macro-economic environment in China and the world, the Group overcame such challenges and persisted to focus on three major markets and allocated its resources in an adaptive manner to bolster the Company's sustained and stable development. Our total revenues amounted to RMB61,517.38 million, representing an increase of 14.4% from 2011. Profit attributable to equity shareholders of the Company amounted to RMB2,406.79 million, representing an increase of 13.0% from RMB2,129.21 million⁽¹⁾ of 2011. Basic earnings per share were RMB0.353. Free cash flow amounted to RMB165.60 million.

Total Revenues

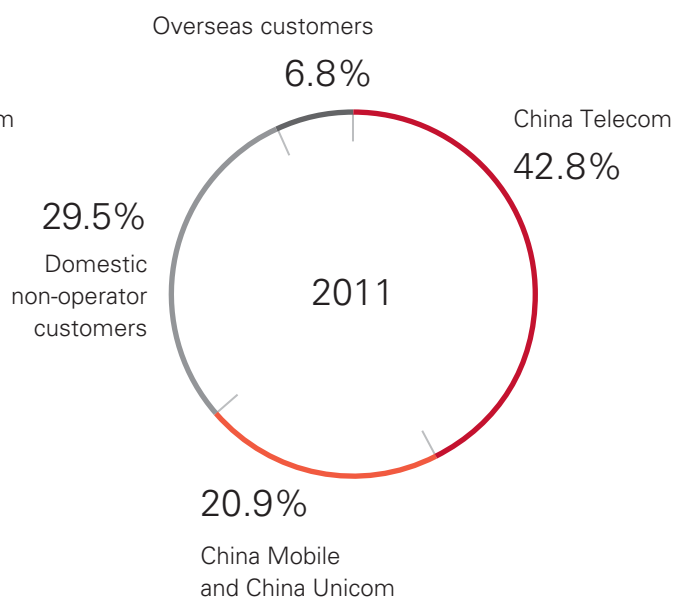
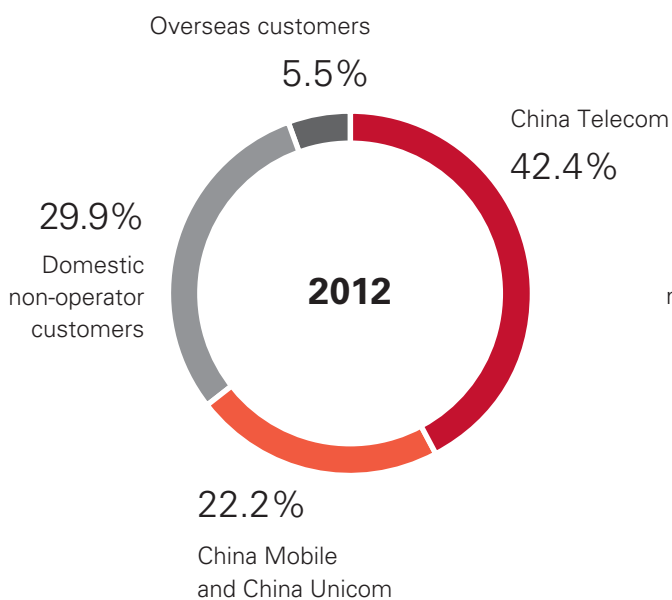
Our total revenues in 2012 were RMB61,517.38 million, representing an increase of 14.4% from 2011. Among our businesses, revenues from telecommunications infrastructure ("TIS") services were RMB28,413.36 million, representing an increase of 12.0% from 2011; revenues from business process outsourcing ("BPO") services were RMB26,304.14 million, representing an increase of 17.8% from 2011; revenues from applications, content and other ("ACO") services were RMB6,799.88 million, representing an increase of 11.9% from 2011. In terms of business structure, construction services and distribution of telecommunications services and products were the two major businesses that contributed to the Group's overall incremental total revenues. In terms of customer structure, revenues from the domestic telecommunications operators amounted to RMB39,744.73 million, representing 64.6% of the total revenues, an increase of 16.2% from 2011; revenues from the domestic non-operator customers and overseas customers amounted to RMB21,772.65 million and its proportion of total revenues decreased slightly to 35.4%, representing an increase of 11.3% from 2011. Domestic telecommunications operators were the major driving force of the Group's total revenues growth in 2012.

⁽¹⁾ On 20 June 2012, the Company published an announcement, in relation to the acquisitions on equity interest and assets of certain telecommunications infrastructure services companies, including 100% equity interest in Ningxia Communications Constructions Co., Ltd., 100% equity interest in Ningxia Telecom Constructions Supervision Consultancy Co., Ltd., 100% equity interest in Xinjiang Communications Planning & Designing Institute Co., Ltd., and 51% equity interest in Sino-British Submarine System Co., Ltd., etc. Relevant results were consolidated into the consolidated financial statements in accordance with the accounting standards and any historical figures preceding the acquisitions were also restated. Details of which are set out in the note to the audited financial statements for the year.

Business Mix



Customer Mix



The following table sets forth a breakdown of our total revenues for 2011 and 2012, together with their respective rates of change:

	2012 RMB'000	2011 RMB'000 (Restated)	Percentage Change
Telecommunications Infrastructure Services			
Design services	5,788,005	5,129,299	12.8%
Construction services	20,638,017	18,558,778	11.2%
Project supervision and management services	1,987,338	1,689,770	17.6%
	28,413,360	25,377,847	12.0%
Business Process Outsourcing Services			
Network maintenance	6,414,319	5,276,067	21.6%
Distribution of telecommunications services and products	16,944,175	14,442,791	17.3%
Facilities management	2,945,643	2,606,326	13.0%
	26,304,137	22,325,184	17.8%
Applications, Content and Other Services			
IT applications	3,877,499	3,105,890	24.8%
Internet service	544,250	537,218	1.3%
Voice VAS	752,547	746,429	0.8%
Others	1,625,582	1,687,559	-3.7%
	6,799,878	6,077,096	11.9%
Total	61,517,375	53,780,127	14.4%

Telecommunications Infrastructure Services

In 2012, revenues from TIS services of the Group were RMB28,413.36 million, representing an increase of 12.0% over RMB25,377.85 million in 2011, which was our primary source of revenues, and accounted for 46.2% of our total revenues, representing a decrease of 1.0 percentage points from 47.2% in 2011. During the year, driven by the accelerating development in mobile Internet and the "Broadband China" strategy, the domestic telecommunications operators increased their capital expenditure moderately. Under this circumstance, the Group adopted more proactive and effective measures, TIS revenues from domestic telecommunications operators grew rapidly and amounted to RMB22,375.06 million in 2012, representing an increase of 18.1% over RMB18,951.28 million in 2011. At the same time, the Group exerted more effort in the expansion of domestic non-operator market and overseas market. However, due to the factors such as the changes in market demand in certain regions in China and the delay in progress of certain overseas turnkey project, TIS revenues from such markets decreased by 6.0% to RMB6,038.30 million over RMB6,426.57 million in 2011.

Business Process Outsourcing Services

In 2012, revenues from BPO services of the Group were RMB26,304.14 million, representing an increase of 17.8% over RMB22,325.18 million in 2011. Revenues from BPO services accounted for 42.7% of our total revenues, representing an increase of 1.2 percentage points from 41.5% in 2011. Among BPO services, revenues from network maintenance were RMB6,414.32 million, representing an increase of 21.6% from 2011 and kept growing strongly. Rapid revenue growth was mainly attributable to the increased spending in network optimization and maintenance due to 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 RMB16,944.18 million, representing an increase of 17.3% from 2011.

Applications, Content and Other Services

In 2012, revenues from ACO services of the Group were RMB6,799.88 million, representing an increase of 11.9% over RMB6,077.10 million from 2011. Revenues from ACO services accounted for 11.1% of our total revenues, representing a decrease of 0.2 percentage points from 11.3% in 2011. During the 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 RMB3,877.50 million, representing an increase of 24.8% from 2011.

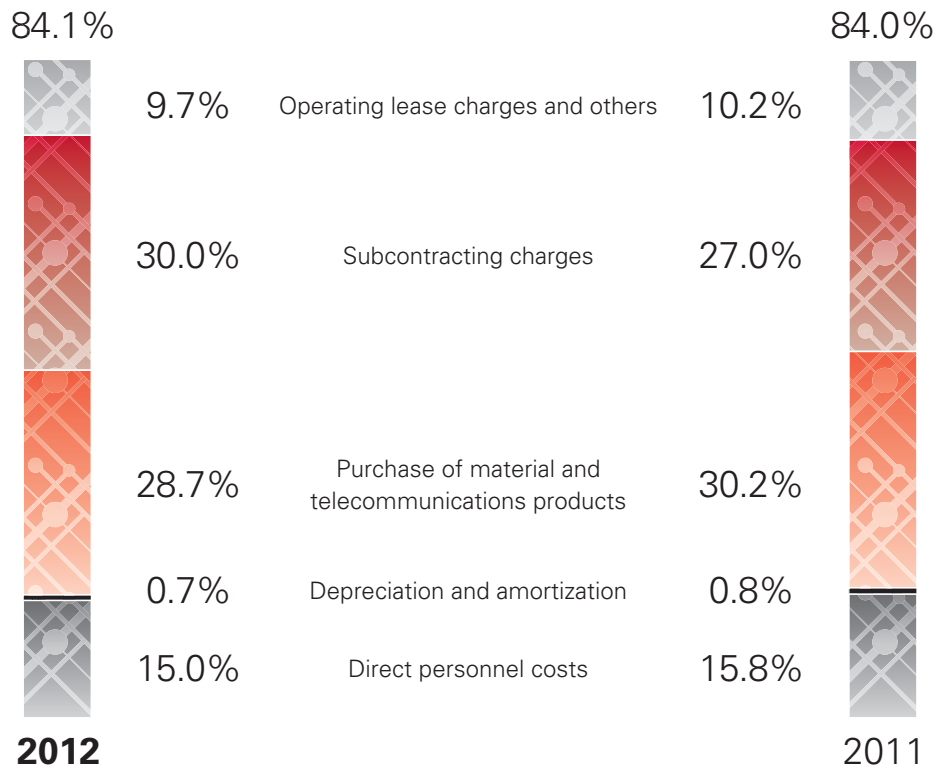
Cost of Revenues

Our cost of revenues in 2012 was RMB51,732.01 million, representing an increase of 14.5% from 2011 and accounting for 84.1% of our total revenues.

The following table sets out a breakdown of our cost of revenues in 2011 and 2012 and their respective rates of change:

	2012	2011	Percentage
	RMB'000	RMB'000	Change
		(Restated)	
Direct personnel costs	9,229,460	8,517,004	8.4%
Depreciation and amortization	439,095	430,290	2.0%
Purchase of material and telecommunications products	17,645,654	16,253,237	8.6%
Subcontracting charges	18,447,867	14,528,052	27.0%
Operating lease charges and others	5,969,932	5,470,054	9.1%
Total cost of revenues	51,732,008	45,198,637	14.5%

Cost of Revenues as a % of Total Revenues



Direct Personnel Costs

In 2012, direct personnel costs were RMB9,229.46 million, representing 15.0% of our total revenues and an increase of 8.4% over RMB8,517.00 million in 2011. With the rapid growth in business volume in 2012, the Group consistently applied reasonable control over its total headcount and subcontracted our low-end tasks, thereby minimizing the staff costs and avoiding related risk. The proportion of direct personnel costs of our total revenues decreased by 0.8 percentage points compared to 2011.

Depreciation and Amortization

In 2012, depreciation and amortization were RMB439.10 million, representing 0.7% of our total revenues and an increase of 2.0% over RMB430.29 million in 2011. Its proportion of our total revenues decreased by 0.1 percentage points compared to 2011.

Purchase of Materials and Telecommunications Products

In 2012, the costs of materials and telecommunications products purchase were RMB17,645.65 million, representing 28.7% of our total revenues and an increase of 8.6% over RMB16,253.24 million in 2011. The increase in costs of materials and telecommunications products was mainly attributable to the favorable development of the Group's distribution of telecommunications services and products business, which drove a corresponding increase in the cost of telecommunications products purchase, including the telecommunications machineries and handsets. The cost of materials and telecommunications products as a percentage of our total revenues decreased by 1.5 percentage points compared to 2011.

Subcontracting Charges

In 2012, subcontracting charges were RMB18,447.87 million, representing 30.0% of our total revenues and an increase of 27.0% over RMB14,528.05 million in 2011. Such increase was mainly resulted from our TIS services. The Group's business volume increased rapidly in 2012, and having considered its strategic development, effectiveness and efficiency, the Group continued to focus on high-value businesses and outsource certain low-end tasks, resulting in a rapid growth in subcontracting charges. Subcontracting charges as a proportion of our total revenues increased by 3.0 percentage points compared to 2011.

Operating Lease Charges and Others

In 2012, operating lease charges and others were RMB5,969.93 million, representing 9.7% of our total revenues and an increase of 9.1% over RMB5,470.05 million in 2011. Its proportion of our total revenues decreased by 0.5 percentage points compared to 2011.

Gross Profit

In 2012, the Group's gross profit amounted to RMB9,785.37 million, representing an increase of 14.0% over RMB8,581.49 million in 2011. The Group's gross profit margin in 2012 was 15.9%, representing a slight decrease of 0.1 percentage points over 16.0% in 2011. In 2012, the Group's effort in the enhancement of project management and cost control alleviated the challenges arising from the changes in market conditions to certain extent, resulting in a fairly stable operational efficiency and overall gross profit margin.

Selling, General and Administrative Expenses

Our selling, general and administrative expenses in 2012 were RMB7,514.88 million, representing an increase of 16.2% over RMB6,464.57 million in 2011, and accounting for 12.2% of our total revenues. In 2012, the Group strengthened cost control on selling and administrative expense. However, due to the factors such as the increase in research and development by the Group from a strategic perspective, selling, general and administrative expenses as a percentage of total revenues increased by 0.2 percentage points compared to 2011.

Finance Costs

In 2012, the Group's finance costs were RMB26.03 million and decreased by 59.7% over RMB64.56 million in 2011. In 2012, the Group reduced finance costs by implementing effective centralized fund management and repaying interest-bearing borrowings.

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%. Certain of western enterprise could also enjoy the Preferential Policies for Western Development Program. 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 rates. The income tax of the Group in 2012 was RMB585.51 million and our effective tax rate was 19.3%, decreased by 0.9 percentage points compared to 20.2% in 2011. 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 and Basic Earnings per Share

In 2012, profit attributable to equity shareholders of the Company was RMB2,406.79 million, representing an increase of 13.0% over RMB2,129.21 million in 2011. Profit attributable to equity shareholders of the Company accounted for 3.9% of our total revenues, remaining at a relative stable level as compared with 2011. Basic earnings per share⁽²⁾ were RMB0.353, decreased by 1.4% over the last year. The decrease in basic earnings per share was due to the Company's enlarged share capital arising from the rights issue conducted in early 2012.

Capital Expenditure

We implement stringent budget management over capital expenditure, and adjust our capital expenditure plan according to the changes of market condition. In 2012, our capital expenditure amounted to RMB929.05 million, a decrease of 15.0% from RMB1,093.32 million in 2011. The capital expenditure in 2012 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.

⁽²⁾ As described in the note 16 of the audited financial statements, the Company completed the rights issue in February 2012. In calculating earnings per share, the weighted average number of shares outstanding during the years ended 31 December 2012 and 2011 were calculated as if the bonus elements without consideration included in the rights issue had been existed from the beginning of the comparative year.

Cash Flow

Our net cash inflow in 2012 increased to RMB1,507.10 million over the net cash outflow of RMB1,175.80 million in 2011. As at the end of 2012, our cash and cash equivalents amounted to RMB8,879.49 million, of which 89.3% was denominated in Renminbi.

The following table sets out our cash flow positions in 2011 and 2012, respectively:

	2012	2011
	RMB'000	RMB'000
		(Restated)
Net cash generated from operating activities	952,233	1,261,132
Net cash used in investing activities	(1,046,434)	(1,070,264)
Net cash generated from/(used in) financing activities	1,601,298	(1,366,669)
Net increase/(decrease) in cash and cash equivalents	1,507,097	(1,175,801)

In 2012, net cash generated from operating activities was RMB952.23 million, representing a decrease of RMB308.90 million from RMB1,261.13 million in 2011. 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.

In 2012, net cash used in investing activities was RMB1,046.43 million, representing a decrease of RMB23.83 million from RMB1,070.26 million in 2011. Cash used in investing activities in 2012 mainly comprised of capital expenditure including the purchase of equipment.

In 2012, net cash generated from financing activities was RMB1,601.30 million, representing an increase of RMB2,967.97 million from the outflow of RMB1,366.67 million in 2011. The increase in net cash generated from financing activities was mainly due to the successful completion of the Group's rights issue.

Working Capital

As at the end of 2012, working capital (i.e. current assets minus current liabilities) was RMB13,423.16 million, while working capital was RMB9,262.12 million in 2011. The increase in working capital was mainly due to an increase in monetary assets arising from the rights issue, and certain customers of the Group delayed their payments.

Indebtedness

As at the end of 2012, total indebtedness of the Group was RMB499.69 million and decreased by RMB630.02 million from RMB1,129.71 million at the year end of 2011. Indebtedness of the Group were mainly fixed interest rate loans and denominated in US dollar, of which Renminbi loan accounted for 2.7%, US dollar loan accounted for 60.2% and HK dollar loan accounted for 37.1%, and of which 73.4% was fixed interest rate loans and 26.6% was floating interest rate loans.

As at the end of 2012, our gearing ratio⁽³⁾ was 2.4%, a decrease of 4.1 percentage points from 6.5% in 2011.

⁽³⁾ 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 2012:

	Total	2013	2014	2015	2016	2017 and after
	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000
Short-term debt	409,805	409,805	–	–	–	–
Long-term debt	89,883	–	17,851	17,851	17,851	36,330
Operating lease commitments	669,567	233,698	142,337	87,886	79,167	126,479
Capital commitments	190,657	190,657	–	–	–	–
Of which:						
Authorized and contracted for	96,168	96,168	–	–	–	–
Authorized but not contracted for	94,489	94,489	–	–	–	–
Total of contractual obligations	1,359,912	834,160	160,188	105,737	97,018	162,809

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 2012, the balance of our cash and cash equivalents in foreign currencies accounted for 10.7% of our total cash and cash equivalents, of which 2.3% and 6.4% were denominated in US dollars and Hong Kong dollars, respectively.