

MANAGEMENT DISCUSSION AND ANALYSIS OF FINANCIAL CONDITIONS AND RESULTS OF OPERATIONS

OVERVIEW

In 2013, the Group persisted to focus on the development in three major markets. Its total revenues reached RMB68,459.10 million, representing an increase of 11.3% from 2012. However, operating performance of the Group was affected by various factors, such as slowdown of revenue growth, decrease in gross profit margin, changes in revenue composition and the implementation of new regulatory policies including the replacement of business tax with value added tax ("VAT Reform") and the amendments to the PRC tender regulations. Profit attributable to equity shareholders of the Company amounted to RMB2,238.35 million, representing a decrease of 7.0% from RMB2,406.79 million in 2012. Basic earnings per share were RMB0.323. Free cash flow was RMB-323.58 million and net cash inflow from operating activities amounted to RMB320.94 million.

TOTAL REVENUES

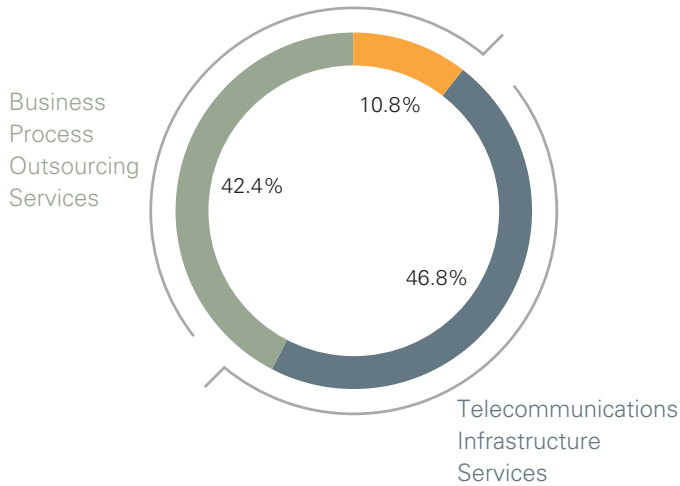
Our total revenues in 2013 were RMB68,459.10 million, representing an increase of 11.3% from 2012. Among our businesses, the revenue from telecommunications infrastructure ("TIS") services was RMB32,036.24 million, representing an increase of 12.8% from 2012; the revenue from business process outsourcing ("BPO") services was RMB29,011.58 million, representing an increase of 10.3% from 2012; the revenue from applications, content and other ("ACO") services was RMB7,411.28 million, representing an increase of 9.0% from 2012. As to business structure, construction services and distribution of telecommunications services and products were the two major businesses that contributed to the Group's overall incremental revenues. As to customer structure, the revenue from the domestic telecommunications operators in 2013 amounted to RMB43,325.98 million, representing 63.3% of the total revenues, an increase of 9.0% from 2012; aggregate revenues from the domestic non-operator customers and overseas customers amounted to RMB25,133.12 million, representing an increase of 15.4% from 2012 and its proportion to total revenues increased to 36.7%. In 2013, the Group saw favourable business development in the domestic non-operator market and overseas market, and the incremental revenues from these two new major markets accounted for 48.4% of the total incremental revenues. These two markets have become a major driving force of the Group's total revenue growth.

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BUSINESS MIX

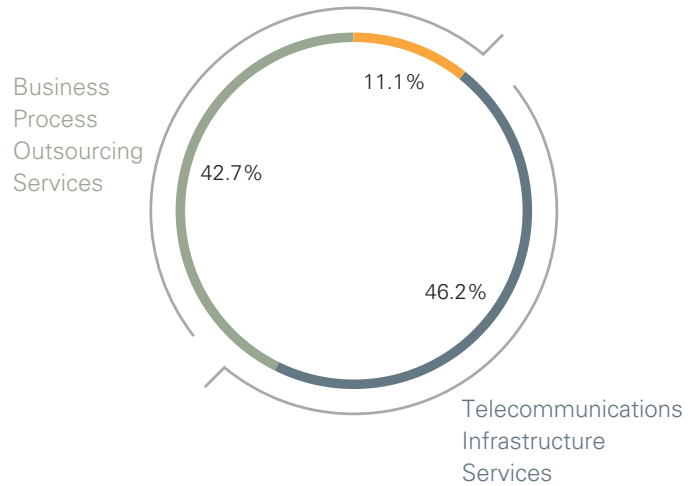
2013

Applications, Content and Other Services



2012

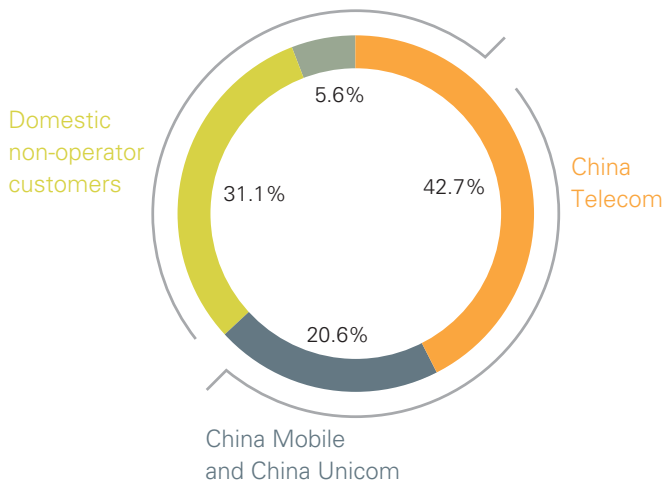
Applications, Content and Other Services



CUSTOMER MIX

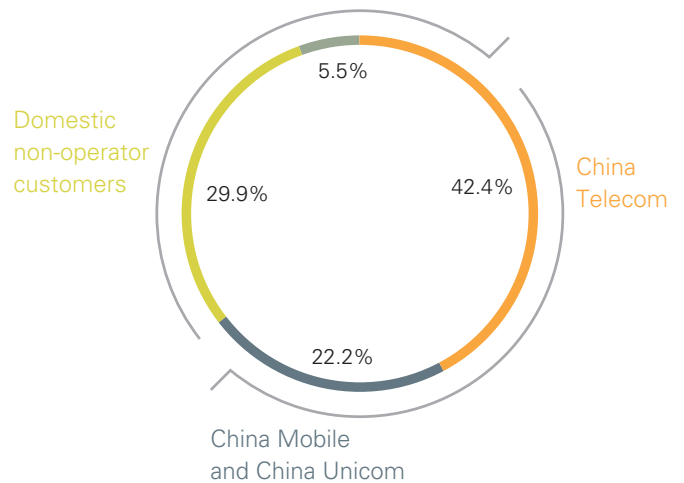
2013

Overseas customers



2012

Overseas customers



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The following table sets forth a breakdown of our total revenues for 2012 and 2013, together with their respective changes:

	2013 RMB'000	2012 RMB'000	Percentage Change
Telecommunications Infrastructure Services			
Design services	6,325,767	5,788,005	9.3%
Construction services	23,426,702	20,638,017	13.5%
Project supervision and management services	2,283,772	1,987,338	14.9%
	32,036,241	28,413,360	12.8%
Business Process Outsourcing Services			
Network maintenance	6,884,291	6,414,319	7.3%
Distribution of telecommunications services and products	18,933,812	16,944,175	11.7%
Facilities management	3,193,474	2,945,643	8.4%
	29,011,577	26,304,137	10.3%
Applications, Content and Other Services⁽¹⁾			
System Integration	3,355,792	2,861,045	17.3%
Software development and system support	1,378,348	1,294,274	6.5%
Value Added Services	1,170,597	1,018,977	14.9%
Others	1,506,541	1,625,582	-7.3%
	7,411,278	6,799,878	9.0%
Total	68,459,096	61,517,375	11.3%

⁽¹⁾ In response to the business development needs of the Group, businesses under applications, content and other services were reclassified starting from 1 January 2013, and historical data for 2012 was restated accordingly. The reclassification has no impact on the total revenue of applications, content and other services.

Telecommunications Infrastructure Services

In 2013, the revenue from TIS services of the Group was RMB32,036.24 million, representing an increase of 12.8% over RMB28,413.36 million in 2012. It was our primary source of revenues and accounted for 46.8% of our total revenues, representing an increase of 0.6 percentage points from 46.2% in 2012. During the year, TIS revenue from domestic telecommunications operators amounted to RMB24,903.22 million, representing an increase of 11.3% over RMB22,375.06 million in 2012. The slowdown of growth from last year was mainly attributable to the back-end loaded capital expenditure ("CAPEX") of domestic telecommunications operators and the change in CAPEX structure due to 4G development, thereby affecting the growth of the Group's TIS business to certain extent. Nevertheless, the Group achieved new breakthroughs in the TIS business development in the domestic non-operator market and overseas market, and TIS revenue from these markets amounted to RMB7,133.02 million, representing an increase of 18.1% over RMB6,038.30 million in 2012. Aggregate revenues from the domestic non-operator market and overseas market as a percentage of the total TIS revenue increased to 22.3%, driving the rapid growth of TIS business.

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Business Process Outsourcing Services

In 2013, the revenue from BPO services of the Group was RMB29,011.58 million, representing an increase of 10.3% over RMB26,304.14 million in 2012. The revenue from BPO services accounted for 42.4% of our total revenues, representing a decrease of 0.3 percentage points from 42.7% in 2012. Among BPO services, the revenue from distribution of telecommunications services and products ("Distribution Business") was RMB18,933.81 million, representing an increase of 11.7% over 2012. The growth rate was lower than that of the previous year because the Group adhered to the principle of efficient development and effectively controlled the development of certain Distribution Businesses with relatively low operating efficiency. Moreover, the promulgation of new regulatory policies made certain network maintenance business becoming increasingly competitive. As such, the Group proactively exited from certain businesses with decreasing operating efficiency, and the revenue from network maintenance was RMB6,884.29 million with its growth rate moderated to 7.3%.

Applications, Content and Other Services

In 2013, the revenue from ACO services of the Group was RMB7,411.28 million, representing an increase of 9.0% over RMB6,799.88 million in 2012. The revenue from ACO services accounted for 10.8% of our total revenues, representing a decrease of 0.3 percentage points from 11.1% in 2012. During the year, the Group pursued openness and innovation, and strived to grasp opportunities brought by the informatization in China. The Group continued to develop the business of system integration projects for domestic non-operators customers. The revenue from system integration reached RMB3,355.79 million, representing an increase of 17.3% over 2012, which was the major driving force for the revenue growth of ACO services.

COST OF REVENUES

Our cost of revenues in 2013 was RMB58,081.11 million, representing an increase of 12.3% from 2012 and accounting for 84.8% of our total revenues.

The following table sets out a breakdown of our cost of revenues in 2012 and 2013 and their respective changes:

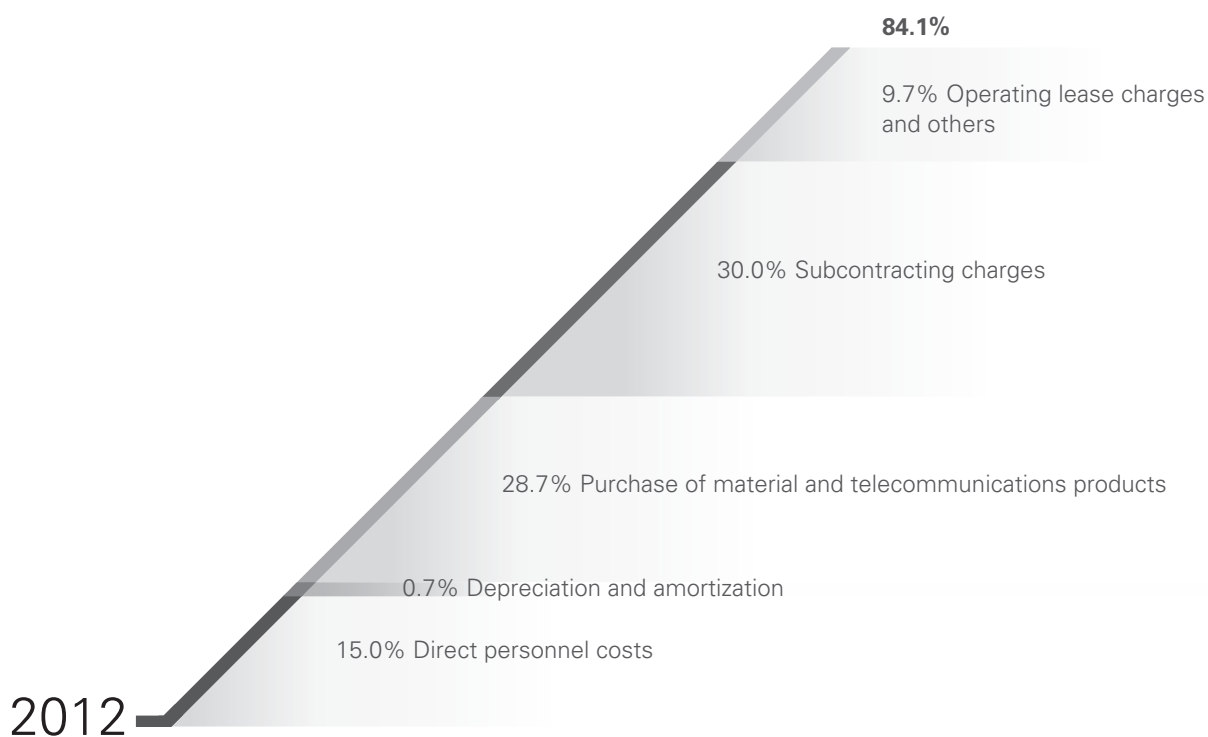
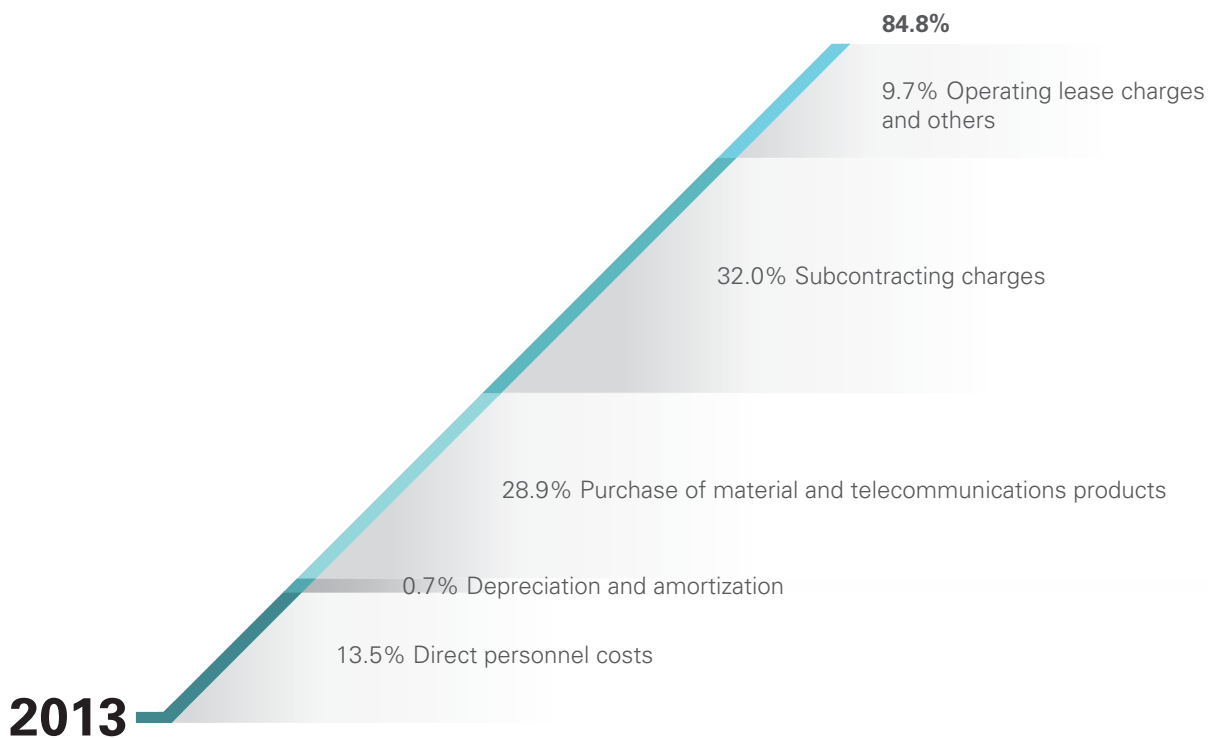
	2013 RMB'000	2012 RMB'000	Percentage Change
Direct personnel costs	9,251,872	9,229,460	0.2%
Depreciation and amortisation	462,103	439,095	5.2%
Purchase of material and telecommunications products	19,804,087	17,645,654	12.2%
Subcontracting charges	21,873,785	18,447,867	18.6%
Operating lease charges and others	6,689,260	5,969,932	12.0%
Total cost of revenues	58,081,107	51,732,008	12.3%

Direct Personnel Costs

In 2013, direct personnel costs were RMB9,251.87 million, representing an increase of 0.2% over RMB9,229.46 million in 2012. With the growth in business volume in 2013, the Group consistently applied reasonable control over its total headcount and subcontracted its low-end tasks, thereby minimizing the staff costs. The Group also strictly complied with the amended PRC Labour Contract Law, and employed dispatch workers in accordance with the relevant regulations to avoid related risks. Direct personnel costs as a proportion to our total revenues was 13.5%, representing a decrease of 1.5 percentage points compared to 2012.

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COST OF REVENUES AS A % OF TOTAL REVENUES



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Depreciation and Amortisation

In 2013, depreciation and amortisation were RMB462.10 million, representing an increase of 5.2% over RMB439.10 million in 2012. Depreciation and amortisation as a proportion to our total revenues was 0.7%, which remained stable as compared with 2012.

Purchase of Materials and Telecommunications Products

In 2013, the costs of materials and telecommunications products purchase were RMB19,804.09 million, representing an increase of 12.2% over RMB17,645.65 million in 2012. The increase in costs of materials and telecommunications products was mainly attributable to the growth of Distribution Business of the Group, which drove a corresponding increase in the cost of telecommunications products purchase, including the telecommunications machineries and handsets. Cost of materials and telecommunications products as a proportion to our total revenues was 28.9%, representing an increase of 0.2 percentage points compared to 2012.

Subcontracting Charges

In 2013, subcontracting charges were RMB21,873.79 million, representing an increase of 18.6% over RMB18,447.87 million in 2012. Such increase was mainly resulted from our TIS services and network maintenance services. 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 to our total revenues was 32.0%, representing an increase of 2.0 percentage points compared to 2012.

Operating Lease Charges and Others

In 2013, operating lease charges and others were RMB6,689.26 million, representing an increase of 12.0% over RMB5,969.93 million in 2012. Operating lease charges and others as a proportion to our total revenues was 9.7%, which remained stable as compared with 2012.

GROSS PROFIT

In 2013, the Group's gross profit amounted to RMB10,377.99 million, representing an increase of 6.1% over RMB9,785.37 million in 2012. The Group's gross profit margin in 2013 was 15.2%, representing a decrease of 0.7 percentage points from 15.9% in 2012. The decrease in gross profit margin was due to various factors, including the slowdown of revenue growth, the decrease in price tariff in the domestic telecommunications operator market, the changes in revenue composition of the Group and the implementation of new regulatory policies such as the VAT Reform and the amendments to the PRC tender regulations.

SELLING, GENERAL AND ADMINISTRATIVE EXPENSES

Our selling, general and administrative expenses in 2013 were RMB8,288.16 million, representing an increase of 10.3% over RMB7,514.88 million in 2012. In 2013, the Group strengthened cost control on selling and administrative expense. Selling, general and administrative expenses as a proportion to our total revenues was 12.1%, representing a decrease of 0.1 percentage point compared to 2012.

FINANCE COSTS

In 2013, the Group's finance costs were RMB11.23 million and decreased by 56.8% over RMB26.03 million in 2012. In 2013, the Group reduced finance costs by implementing effective centralized fund management and repaying interest-bearing borrowings.

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INCOME TAX

The income tax of the Group in 2013 was RMB493.12 million and our effective tax rate was 17.8%, representing a decrease of 1.5 percentage points compared to 19.3% in 2012. The difference between our effective tax rate and the statutory tax rate was mainly due to the preferential income tax rate treatment enjoyed by certain subsidiaries, which are classified as key software enterprises and new and high-technology enterprises the preferential policy of tax deduction before income tax for research and development expenses. In 2013, certain subsidiaries of us were newly recognized as key software enterprises and were entitled to a preferential income tax rate of 10%. Certain subsidiaries of us were recognized as new and high-technology enterprises and were entitled to a preferential income tax rate of 15%. Certain enterprises of us in Western China could also enjoy the preferential policies for Western Development Program. Apart from these subsidiaries, the Company and other domestic subsidiaries of the Group were mainly subject to an income tax rate of 25%. The overseas subsidiaries of the Group were subject to different tax rates in various countries.

PROFIT ATTRIBUTABLE TO EQUITY SHAREHOLDERS OF THE COMPANY AND BASIC EARNINGS PER SHARE

In 2013, profit attributable to equity shareholders of the Company was RMB2,238.35 million, representing a decrease of 7.0% over RMB2,406.79 million in 2012. Profit attributable to equity shareholders of the Company accounted for 3.3% of our total revenues, representing a decrease of 0.6 percentage points as compared with 2012. Basic earnings per share of the Company were RMB0.323.

CAPITAL EXPENDITURE

We implement stringent budget management over capital expenditure, and adjust our capital expenditure plan according to changes in market condition. In 2013, our capital expenditure amounted to RMB705.23 million, representing a decrease of 24.1% from RMB929.05 million in 2012. The capital expenditure in 2013 accounted for 1.0% of our total revenues. Our capital expenditure included the purchases of production facilities and equipments, machinery and meters, plant and office buildings, intangible assets and other operating assets.

CASH FLOW

Our net cash outflow in 2013 amounted to RMB2,086.36 million as compared to the net cash inflow of RMB1,507.10 million in 2012. As at the end of 2013, our cash and cash equivalents amounted to RMB6,760.24 million, of which 93.4% was denominated in Renminbi.

The following table sets out our cash flow positions in 2012 and 2013, respectively:

	2013 RMB'000	2012 RMB'000
Net cash generated from operating activities	320,943	952,233
Net cash used in investing activities	(1,009,334)	(1,046,434)
Net cash (used in)/generated from financing activities	(1,397,967)	1,601,298
Net (decrease)/increase in cash and cash equivalents	(2,086,358)	1,507,097

In 2013, net cash generated from operating activities was RMB320.94 million, representing a decrease of RMB631.29 million from RMB952.23 million in 2012. The decrease in net cash generated from operating activities was mainly caused by the prolonged repayment cycle by major customers of the Group.

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In 2013, net cash used in investing activities was RMB1,009.33 million, representing a decrease of RMB37.10 million from RMB1,046.43 million in 2012. Cash used in investing activities mainly comprised capital expenditure such as equipments purchases.

In 2013, net cash used in financing activities was RMB1,397.97 million as compared with the net cash generated from financing activities of RMB1,601.30 million in 2012. The change in cash flow from financing activities was mainly due to the completion of the Group's rights issue in 2012.

WORKING CAPITAL

As at the end of 2013, working capital (i.e. current assets minus current liabilities) was RMB14,415.74 million, representing an increase of RMB992.58 million from RMB13,423.16 million in 2012. The increase in working capital was mainly due to the expansion of our business and the prolonged repayment cycle by major customers of the Group.

INDEBTEDNESS

As at the end of 2013, total indebtedness of the Group was RMB105.48 million, representing a decrease of RMB394.21 million from RMB499.69 million at the year end of 2012. Indebtedness of the Group were mainly denominated in US dollar, of which Renminbi loan accounted for 12.6% and US dollar loan accounted for 87.4%, and of which 34.7% was fixed interest rate loans and 65.3% was floating interest rate loans.

As at the end of 2013, our gearing ratio¹ was 0.5%, representing a decrease of 1.9 percentage points from 2.4% in 2012.

CONTRACTUAL OBLIGATIONS

The following table sets out our contractual obligations as at 31 December 2013:

	Total	2014	2015	2016	2017	2018 and after
	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000
Short-term debt	53,901	53,901	-	-	-	-
Long-term debt	51,580	-	17,315	17,315	16,950	-
Operating lease commitments	689,093	276,463	144,204	91,711	45,995	130,720
Capital commitments	618,461	618,461	-	-	-	-
Of which:						
Authorized and contracted for	283,654	283,654	-	-	-	-
Authorized but not contracted for	334,807	334,807	-	-	-	-
Total of contractual obligations	1,413,035	948,825	161,519	109,026	62,945	130,720

EXCHANGE RATE

Most of our revenues and expenses are settled in Renminbi. As at the end of 2013, the balance of our cash and cash equivalents in foreign currencies accounted for 6.6% of our total cash and cash equivalents, of which 2.4% and 0.4% were denominated in US dollars and Hong Kong dollars, respectively.

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.