

# MANAGEMENT DISCUSSION AND ANALYSIS OF FINANCIAL CONDITIONS AND RESULTS OF OPERATIONS

## OVERVIEW

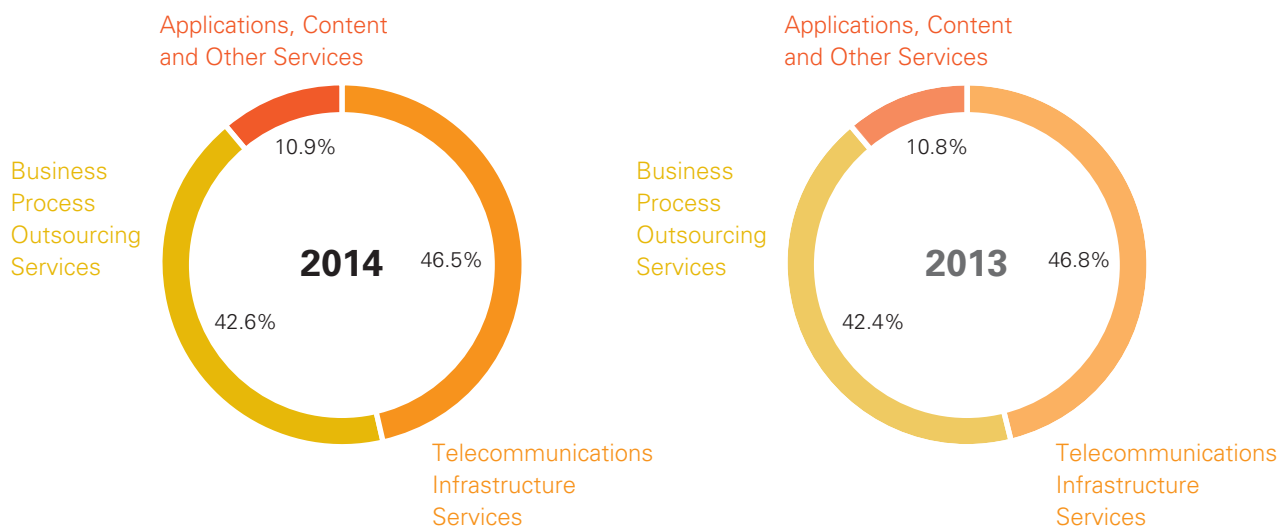
In 2014, the Group adhered to its market-oriented approach and allocated its resources in an adaptive way for the expansion of the three major customer markets. The Group's total revenues reached RMB73,176.25 million, representing an increase of 6.9% from 2013. However, the reduction of service charge and the implementation of the "VAT Reform", Labour Contract Law and other new industry policies imposed extra pressure on the Group in terms of competition and costs. In addition, the Group adopted a more prudent approach in financial management in 2014. As a result of the aforementioned factors, profit attributable to equity shareholders of the Company amounted to RMB2,150.26 million, representing a decrease of 3.9% from RMB2,238.35 million in 2013, and such decrease was lower as compared with that of 2013. Basic earnings per share were RMB0.310. Free cash flow was RMB833.22 million in 2014, representing a significant improvement from RMB-323.58 million of last year.

## TOTAL REVENUES

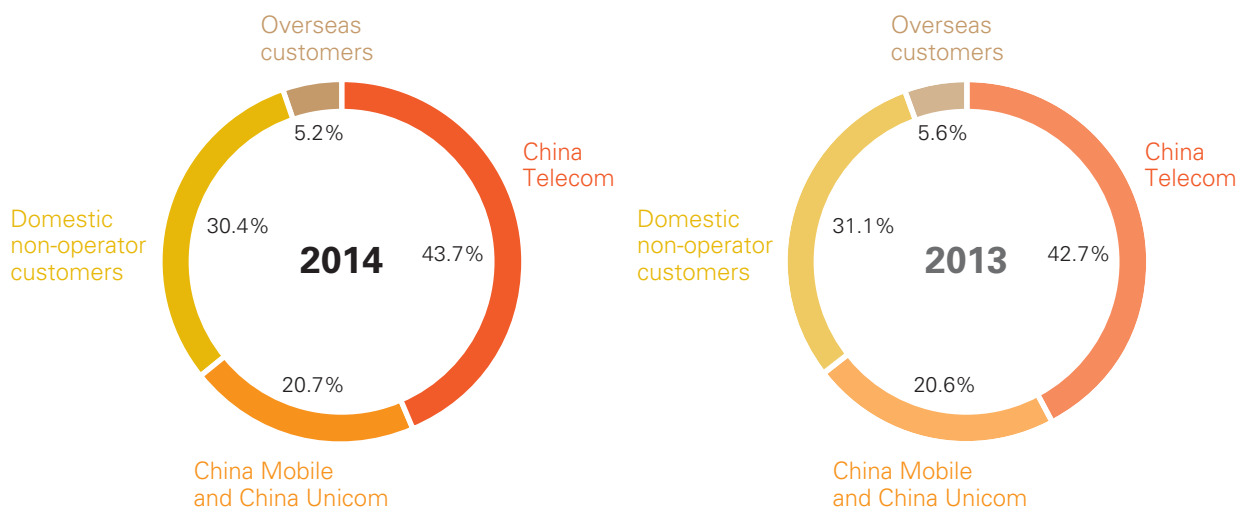
Our total revenues in 2014 were RMB73,176.25 million, representing an increase of 6.9% from 2013. Among our businesses, the revenue from telecommunications infrastructure ("TIS") services was RMB34,008.08 million, representing an increase of 6.2% from 2013; the revenue from business process outsourcing ("BPO") services was RMB31,215.42 million, representing an increase of 7.6% from 2013; the revenue from applications, content and other ("ACO") services was RMB7,952.75 million, representing an increase of 7.3% from 2013. As to business structure, construction services and network maintenance services 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 2014 amounted to RMB47,117.25 million, representing 64.4% of the total revenues and an increase of 8.8% from 2013; the aggregate revenues from the domestic non-operator customers and overseas customers amounted to RMB26,059.00 million, representing an increase of 3.7% from 2013 and 35.6% of the total revenues. In 2014, the Group adopted a market-oriented approach and allocated its resources adaptively to grasp the opportunities from the network construction investment by domestic telecommunications operators after the issuance of 4G licenses. The Group saw favorable business development in the domestic telecommunications operator market and the incremental revenue from such market accounted for 80.4% of the total incremental revenues. This market was a major driving force of the Group's total revenues growth.

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## BUSINESS MIX



## CUSTOMER MIX



## MANAGEMENT DISCUSSION AND ANALYSIS OF FINANCIAL CONDITIONS AND RESULTS OF OPERATIONS

The following table sets forth a breakdown of our total revenues for 2013 and 2014, together with their respective changes:

	2014 RMB'000	2013 RMB'000	Percentage Change
<b>Telecommunications Infrastructure Services</b>			
Design services	6,664,097	6,325,767	5.3%
Construction services	24,875,087	23,426,702	6.2%
Project supervision and management services	2,468,893	2,283,772	8.1%
	<b>34,008,077</b>	32,036,241	6.2%
<b>Business Process Outsourcing Services<sup>1</sup></b>			
Management of infrastructure for information technology	8,146,213	6,884,291	18.3%
Distribution of telecommunications services and products	19,599,256	18,933,812	3.5%
General facilities management	3,469,954	3,193,474	8.7%
	<b>31,215,423</b>	29,011,577	7.6%
<b>Applications, Content and Other Services</b>			
System Integration	3,574,294	3,355,792	6.5%
Software development and system support	1,447,777	1,378,348	5.0%
Value Added Services	1,285,250	1,170,597	9.8%
Others	1,645,431	1,506,541	9.2%
	<b>7,952,752</b>	7,411,278	7.3%
<b>Total</b>	<b>73,176,252</b>	68,459,096	6.9%

### Telecommunications Infrastructure Services

In 2014, the revenue from TIS services of the Group was RMB34,008.08 million, representing an increase of 6.2% over RMB32,036.24 million in 2013. TIS services were our primary source of revenues and accounted for 46.5% of our total revenues, representing a decrease of 0.3 percentage point from 46.8% in 2013. In light of the progress of 4G licenses issuance, domestic telecommunications operators showed imbalanced pace of network construction investment between the first half and second half of the year. The Group closely followed the pace of network construction investment by domestic telecommunications operators. TIS revenue from domestic telecommunications operators amounted to RMB26,547.76 million, representing an increase of 6.6% over RMB24,903.22 million in 2013. The aggregate TIS revenues from domestic non-operator market and overseas market amounted to RMB7,460.31 million, representing an increase of 4.6% over RMB7,133.02 million in 2013. Aggregate revenues from the domestic non-operator market and overseas market accounted for 21.9% of the total TIS revenues, representing a decrease of 0.4 percentage point over 2013.

<sup>1</sup> In consideration of the business development, the Group renamed its network maintenance business and facility management business in business process outsourcing services business as management of infrastructure for information technology business ("network maintenance") and general facilities management business ("facilities management") from 1 January 2014. Such changes do not affect the historical data.

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### Business Process Outsourcing Services

In 2014, the revenue from BPO services of the Group was RMB31,215.42 million, representing an increase of 7.6% over RMB29,011.58 million in 2013. The revenue from BPO services accounted for 42.6% of our total revenues, representing an increase of 0.2 percentage point from 42.4% in 2013. Among BPO services, the revenue from network maintenance amounted to RMB8,146.21 million, representing an increase of 18.3% from 2013, more than doubled in terms of the growth rate as compared with last year, and incremental revenue from network maintenance accounted for 26.8% of the total incremental revenues. Such favorable development was mainly because the Group focused and captured the opportunities arising from the continuously increasing operating expenditure of the domestic telecommunications operators and their continuous demands for maintenance outsourcing. The revenue from distribution of telecommunications services and products ("Distribution Business") was RMB19,599.26 million, representing an increase of 3.5% over 2013. The growth rate was significantly lower than that of last year<sup>2</sup> because the Group adhered to the principle of efficient development and proactively controlled the development of certain Distribution Businesses with relatively low operating efficiency.

### Applications, Content and Other Services

In 2014, the revenue from ACO services of the Group was RMB7,952.75 million, representing an increase of 7.3% over RMB7,411.28 million in 2013. The revenue from ACO services accounted for 10.9% of our total revenues, representing an increase of 0.1 percentage point from 10.8% in 2013. During the year, by pursuing openness and innovation, the Group strived to grasp opportunities brought by the informatisation in China, and continuously promoted competitive products and solutions in key areas such as "Smart City" and "Safe City".

## COST OF REVENUES

Our cost of revenues in 2014 was RMB62,494.55 million, representing an increase of 7.6% from 2013 and accounting for 85.4% of our total revenues.

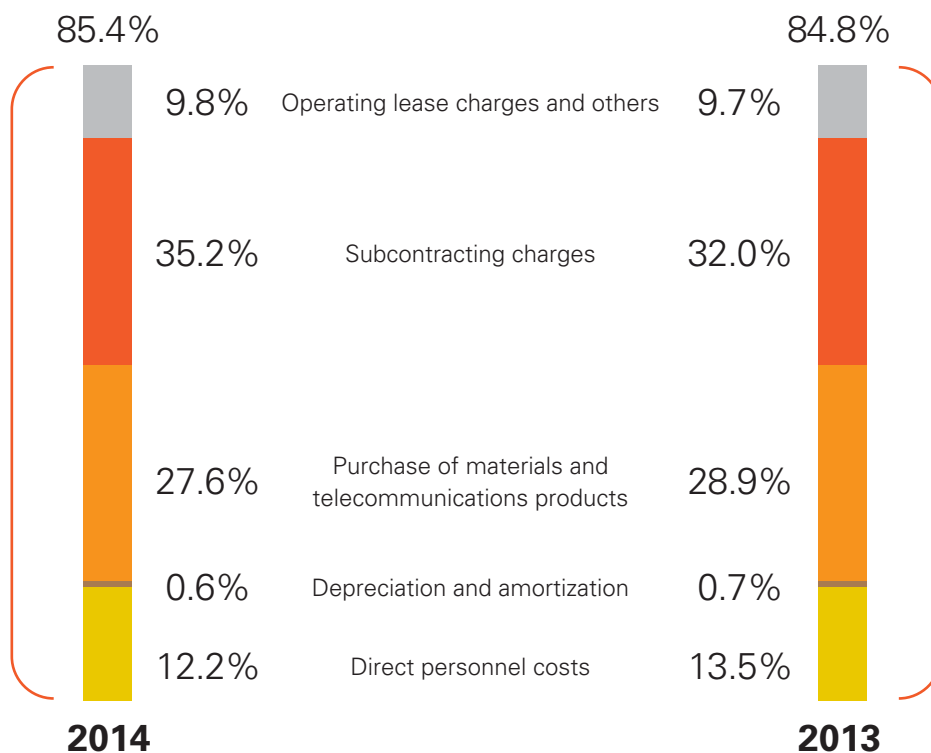
The following table sets out a breakdown of our cost of revenues in 2013 and 2014 and their respective changes:

	2014 RMB'000	2013 RMB'000	Percentage Change
Direct personnel costs	8,892,965	9,251,872	-3.9%
Depreciation and amortisation	450,741	462,103	-2.5%
Purchase of materials and telecommunications products	20,190,921	19,804,087	2.0%
Subcontracting charges	25,763,190	21,873,785	17.8%
Operating lease charges and others	7,196,732	6,689,260	7.6%
<b>Total cost of revenues</b>	<b>62,494,549</b>	<b>58,081,107</b>	<b>7.6%</b>

<sup>2</sup> In 2013, the Group's revenue from Distribution Business was RMB18,933.81 million, representing a year-on-year increase of 11.7%.

## MANAGEMENT DISCUSSION AND ANALYSIS OF FINANCIAL CONDITIONS AND RESULTS OF OPERATIONS

### COST OF REVENUES AS A % OF TOTAL REVENUES



#### Direct Personnel Costs

In 2014, direct personnel costs were RMB8,892.97 million, representing a decrease of 3.9% over RMB9,251.87 million in 2013. With the growth in business volume in 2014, the Group consistently applied reasonable control over its total headcount and subcontracted its low-end businesses, and thereby minimized the staff costs. The Group also strictly complied with the 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 12.2%, representing a decrease of 1.3 percentage points compared to 2013.

## MANAGEMENT DISCUSSION AND ANALYSIS OF FINANCIAL CONDITIONS AND RESULTS OF OPERATIONS

### Depreciation and Amortisation

In 2014, depreciation and amortisation were RMB450.74 million, representing a decrease of 2.5% over RMB462.10 million in 2013. Depreciation and amortisation as a proportion to our total revenues was 0.6%, representing a decrease of 0.1 percentage point compared to 2013.

### Purchase of Materials and Telecommunications Products

In 2014, the costs of materials and telecommunications products purchase were RMB20,190.92 million, representing an increase of 2.0% from RMB19,804.09 million in 2013. The significant decrease in the growth rate of costs of materials and telecommunications products<sup>3</sup> was mainly because the Group effectively controlled the development of certain low-end Distribution Businesses. Cost of materials and telecommunications products as a proportion to our total revenues was 27.6%, representing a decrease of 1.3 percentage points compared to 2013.

### Subcontracting Charges

In 2014, subcontracting charges were RMB25,763.19 million, representing an increase of 17.8% over RMB21,873.79 million in 2013. 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-end businesses and outsource certain low-end tasks, and the Group believed that engaging subcontractors could facilitate a more flexible utilization of external resources. As a result of the rapid growth in network maintenance business, which is labour-intensive in nature and demands for more subcontracts, subcontracting charges grew rapidly during the year. Subcontracting charges as a proportion to our total revenues was 35.2%, representing an increase of 3.2 percentage points compared to 2013.

### Operating Lease Charges and Others

In 2014, operating lease charges and others were RMB7,196.73 million, representing an increase of 7.6% over RMB6,689.26 million in 2013. Operating lease charges and others as a proportion to our total revenues was 9.8%, which remained stable as compared with 2013.

## GROSS PROFIT

In 2014, the Group's gross profit amounted to RMB10,681.70 million, representing an increase of 2.9% over RMB10,377.99 million in 2013. The Group's gross profit margin in 2014 was 14.6%, representing a decrease of 0.6 percentage point from 15.2% in 2013. The decrease in gross profit margin was due to various factors, including the decrease in service charge, higher subcontracting charges, low profit margin in the initial stage of expansion into new markets and the change in the pricing of our design services and project supervision and management services resulting from the implementation of the "VAT Reform" in the telecommunications industry from 1 June 2014.

## SELLING, GENERAL AND ADMINISTRATIVE EXPENSES

Our selling, general and administrative expenses in 2014 were RMB8,777.03 million, representing an increase of 5.9% over RMB8,288.16 million in 2013. In 2014, the Group strengthened cost control on selling and administrative expense. Selling, general and administrative expenses as a proportion to our total revenues was 12.0%, representing a decrease of 0.1 percentage point compared to 2013.

<sup>3</sup> In 2013, the Group's purchase of materials and telecommunications products was RMB19,804.09 million, representing a year-on-year increase of 12.2%.

## MANAGEMENT DISCUSSION AND ANALYSIS OF FINANCIAL CONDITIONS AND RESULTS OF OPERATIONS

### FINANCE COSTS

In 2014, the Group's finance costs were RMB20.43 million and increased by 81.9% over RMB11.23 million in 2013. In 2014, the Group introduced a strategic investor for overseas market expansion. While increasing the financial resources to support business development, finance costs also increased accordingly.

### INCOME TAX

The income tax of the Group in 2014 was RMB463.09 million and our effective tax rate was 17.6%, representing a decrease of 0.2 percentage point compared to 17.8% in 2013. 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. Certain key software enterprises were entitled to a preferential income tax rate of 10%. Certain new and high-technology enterprises and enterprises which could enjoy the preferential policies for Western Development Program were entitled to a preferential income tax rate of 15%. Several subsidiaries of the Group were subject to an income tax rate of 20%. 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 tax rates in various countries.

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

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In 2014, profit attributable to equity shareholders of the Company was RMB2,150.26 million, representing a decrease of 3.9% over RMB2,238.35 million in 2013. Profit attributable to equity shareholders of the Company accounted for 2.9% of our total revenues, representing a decrease of 0.4 percentage point as compared with 2013. Basic earnings per share of the Company were RMB0.310.

### CAPITAL EXPENDITURE

We implement stringent budget management over capital expenditure, and adjust our capital expenditure plan according to changes in market condition. In 2014, our capital expenditure amounted to RMB645.60 million, representing a decrease of 8.4% from RMB705.23 million in 2013. The capital expenditure in 2014 accounted for 0.9% 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 inflow in 2014 amounted to RMB576.13 million as compared to the net cash outflow of RMB2,086.36 million in 2013. As at the end of 2014, our cash and cash equivalents amounted to RMB7,313.52 million, of which 89.1% was denominated in Renminbi.

## MANAGEMENT DISCUSSION AND ANALYSIS OF FINANCIAL CONDITIONS AND RESULTS OF OPERATIONS

The following table sets out our cash flow positions in 2013 and 2014, respectively:

	2014 RMB'000	2013 RMB'000
Net cash generated from operating activities	1,608,854	320,943
Net cash used in investing activities	(876,674)	(1,009,334)
Net cash used in financing activities	(156,051)	(1,397,967)
Net increase/(decrease) in cash and cash equivalents	576,129	(2,086,358)

In 2014, net cash generated from operating activities was RMB1,608.85 million, representing an increase of RMB1,287.91 million from RMB320.94 million in 2013. The increase in net cash generated from operating activities was mainly due to the Group continuously strengthened its cash flow and accounts receivable management, and initiated accounts receivable settlement and collection work effectively.

In 2014, net cash used in investing activities was RMB876.67 million, representing a decrease of RMB132.66 million from RMB1,009.33 million in 2013. Cash used in investing activities mainly comprised capital expenditure such as equipment purchases.

In 2014, net cash used in financing activities was RMB156.05 million, representing a decrease of RMB1,241.92 million from RMB1,397.97 million in 2013. The change in cash flow from financing activities was mainly due to the increased liability by the Group after introducing a strategic investor for overseas expansion.

### WORKING CAPITAL

As at the end of 2014, working capital (i.e. current assets minus current liabilities) was RMB15,829.97 million, representing an increase of RMB1,414.23 million from RMB14,415.74 million in 2013. 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 2014, total indebtedness of the Group was RMB897.43 million, representing an increase of RMB791.95 million from RMB105.48 million at the end of 2013. Indebtedness of the Group were mainly denominated in US dollar, of which Renminbi loan accounted for 1.5% and US dollar loan accounted for 98.5%, and of which 31.3% was fixed interest rate loans and 68.7% was floating interest rate loans.

As at the end of 2014, our gearing ratio<sup>4</sup> was 3.8%, representing an increase of 3.3 percentage points from 0.5% in 2013.

<sup>4</sup> 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.



## MANAGEMENT DISCUSSION AND ANALYSIS OF FINANCIAL CONDITIONS AND RESULTS OF OPERATIONS

### CONTRACTUAL OBLIGATIONS

The following table sets out our contractual obligations as at 31 December 2014:

	<b>Total</b>	<b>2015</b>	<b>2016</b>	<b>2017</b>	<b>2018</b>	<b>2019</b>
	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	and after RMB'000
Short-term debt	246,818	246,818	–	–	–	–
Long-term debt	38,708	–	17,378	21,330	–	–
Convertible preference shares and preference shares	611,900	–	–	–	–	611,900
Operating lease commitments	786,911	304,985	161,318	98,425	64,345	157,838
Capital commitments	449,925	449,925	–	–	–	–
Of which:						
Authorized and contracted for	118,586	118,586	–	–	–	–
Authorized but not contracted for	331,339	331,339	–	–	–	–
Total of contractual obligations	2,134,262	1,001,728	178,696	119,755	64,345	769,738

### EXCHANGE RATE

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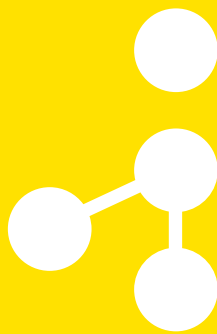
Most of our revenues and expenses are settled in Renminbi. As at the end of 2014, the balance of our cash and cash equivalents in foreign currencies accounted for 10.9% of our total cash and cash equivalents, of which 7.5% and 0.2% were denominated in US dollars and Hong Kong dollars, respectively.



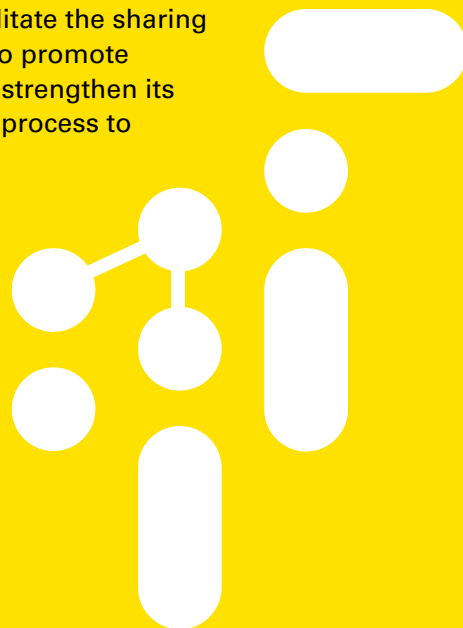
Strengthening  
**Management**  
for Efficiency







The Group will strengthen precise management to promote cost reduction and enhance efficiency. The Group will have tight control over its headcount growth and optimise its staff structure to control its labour cost. The Group will enhance cash centralization and promote operational efficiency of funds. The Group will tighten non-operational capital expenditure as well as administration and management expenses. The Group will facilitate the sharing of resources and synergistic development to promote business development. The Group will also strengthen its risk management by improving the system process to promote efficient management.



# Strengthening Management for Efficiency



