

MANAGEMENT DISCUSSION AND ANALYSIS OF FINANCIAL CONDITIONS AND RESULTS OF OPERATIONS

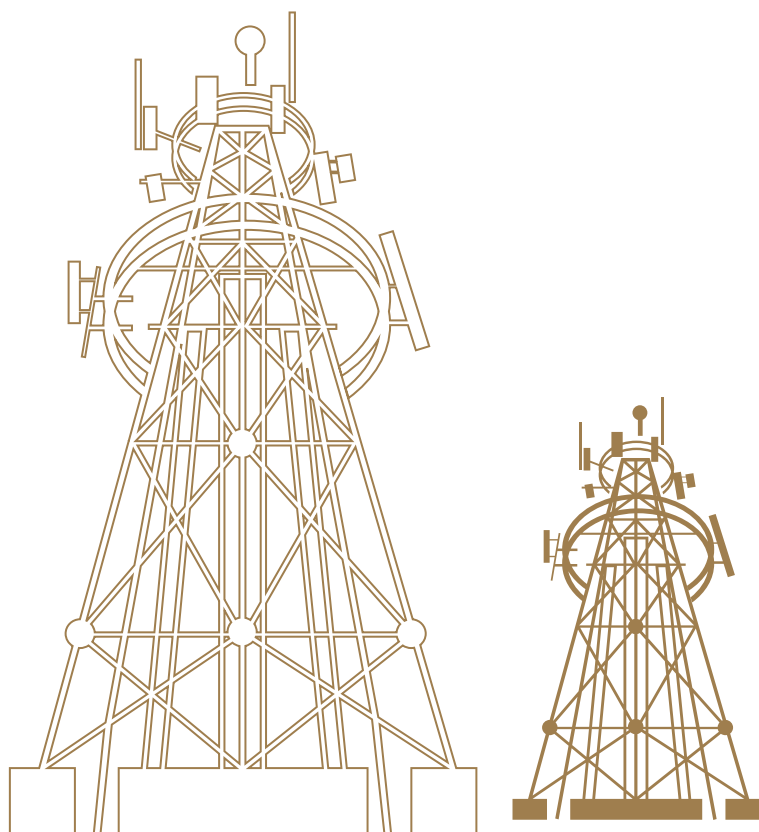
OVERVIEW

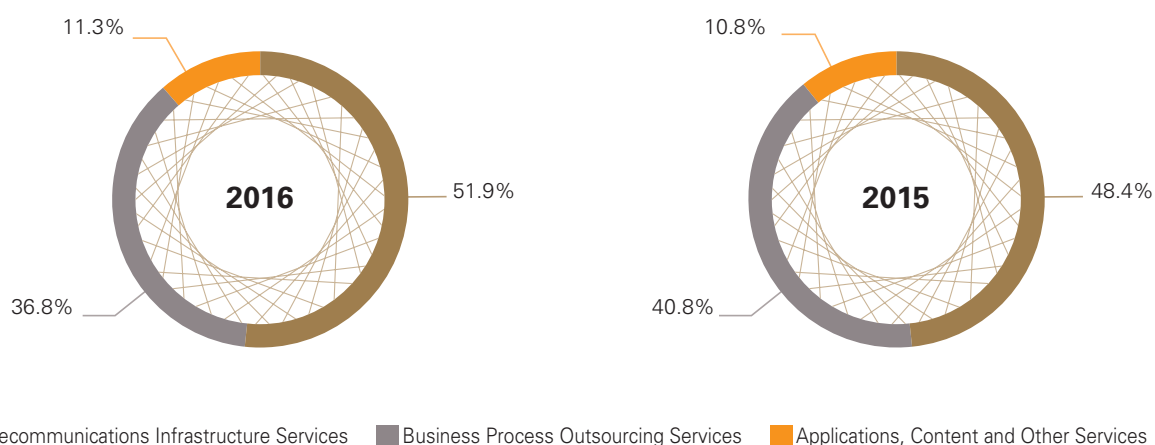
In 2016, the Group upheld the management philosophy of “value-driven, seeking steady yet progressive growth and efficient development”, firmly captured the opportunities from the domestic telecommunications operators market in network construction and upgrade, optimization of broadband quality and speed, tower construction and maintenance, and also continued to focus on the two new markets – domestic non-operator market and overseas market, thereby achieving continuous growth in revenue and net profit. Our business saw a “steady yet progressive growth with quality enhancement”. Total revenues for the year amounted to RMB88,449 million, representing an increase of 9.3% as compared to 2015. Profit attributable to equity shareholders of the Company was RMB2,536 million, representing an increase of 8.6% as compared to RMB2,334 million in 2015. Basic earnings per share were RMB0.366. Free cash flow amounted to RMB4,361 million, representing an increase of 22.1% as compared to RMB3,573 million in 2015.

TOTAL REVENUES

The Group’s total revenues in 2016 amounted to RMB88,449 million, representing an increase of 9.3% as compared to 2015. The revenue from telecommunications infrastructure (“TIS”) services was RMB45,887 million, representing a year-on-year growth of 17.0%; the revenue from business process outsourcing (“BPO”) services was RMB32,533 million, representing a year-on-year decrease of 1.5%, the revenue from applications, contents and other (“ACO”) services was RMB10,029 million, representing a year-on-year growth of 14.8%. TIS services remained as the fastest-growing business of the Group. The decrease in revenue from BPO services was mainly attributable to the Group’s proactive control of the products distribution business with lower efficiency and its increasing focus on transforming towards high-end businesses. As to business structure, construction, design and management of infrastructure for information technology (“Network Maintenance”) were the three major businesses that contributed to the Group’s overall incremental revenues.

As to customer structure, the revenue from the domestic telecommunications operators (including China Tower) in 2016 amounted to RMB60,889 million, representing a year-on-year growth of 11.1%. The revenue from the domestic non-operator customers amounted to RMB23,714 million, representing a year-on-year growth of 3.4% whereas the revenue from the overseas customers amounted to RMB3,846 million, representing a year-on-year growth of 19.3%. In 2016, the Group exerted greater effort to capture opportunities from the CAPEX investment for transformation and upgrade of domestic telecommunications operators and endeavoured to increase its market share. The Group also captured the opportunities arising from the construction and maintenance work of China Tower and the OPEX-driven businesses for telecommunications operators. As a result, the Group maintained favourable business development momentum in the domestic telecommunications operator market and the incremental revenue from such market accounted for 81.4% of the total incremental revenues. The three major customers contributing to such incremental revenue were China Tower, China Telecom and China Mobile, respectively. Excluding products distribution business, the Core Businesses revenues from domestic non-operator customers amounted to RMB17,535 million, representing a year-on-year growth of 28.7%, which was the major driving force of growth for the Group’s total revenues.



BUSINESS REVENUE MIX


The following table sets forth a breakdown of our total revenues for 2015 and 2016, together with their respective changes:

	2016 RMB'000	2015 RMB'000	Change
Telecommunications Infrastructure Services			
Design services	9,071,584	7,638,658	18.8%
Construction services	33,710,753	28,783,754	17.1%
Project supervision and management services	3,104,613	2,786,855	11.4%
	45,886,950	39,209,267	17.0%
Business Process Outsourcing Services			
Management of infrastructure for information technology (Network Maintenance)	10,685,045	9,755,886	9.5%
General facilities management	4,160,068	3,768,734	10.4%
Supply chain ⁵	7,209,334	6,394,092	12.7%
Sub-total of Core BPO Services	22,054,447	19,918,712	10.7%
Products distribution ⁵	10,479,155	13,095,318	-20.0%
	32,533,602	33,014,030	-1.5%
Applications, Content and Other Services			
System integration	4,808,799	3,916,704	22.8%
Software development and system support	1,687,084	1,493,757	12.9%
Value added services	1,654,394	1,497,005	10.5%
Others	1,878,527	1,829,183	2.7%
	10,028,804	8,736,649	14.8%
Total	88,449,356	80,959,946	9.3%

⁵ Since 2016, the Group sub-divided the former distribution of telecommunications services and products business under the BPO services into supply chain business and products distribution business. For ease of comparison, the historical data of these two businesses have been segregated accordingly.

MANAGEMENT DISCUSSION AND ANALYSIS OF FINANCIAL CONDITIONS AND RESULTS OF OPERATIONS

Telecommunications Infrastructure Services

In 2016, the Group's revenue from TIS services amounted to RMB45,887 million, representing an increase of 17.0% as compared to RMB39,209 million in 2015. TIS services was the primary source of revenue and accounted for 51.9% of our total revenues, representing an increase of 3.5 percentage points from 48.4% in 2015. TIS services was the fastest-growing business of the year. As to the customer structure of the TIS services, the Group's TIS revenue from domestic telecommunications operator customers amounted to RMB35,832 million and accounted for 78.1% of the total TIS revenues, representing a decrease of 2.6 percentage points from last year. The aggregate TIS revenues from domestic non-operator customers and overseas customers amounted to RMB10,055 million and accounted for 21.9% of the total TIS revenues, representing an increase of 2.6 percentage points from last year.

In 2016, the Group firmly captured the opportunities arising from the construction demand from China Tower, network construction and upgrade and the upgrade of optic fiber broadband of domestic telecommunications operators, and endeavoured to increase its market share. The TIS revenue from domestic telecommunications operator customers increased by 13.3% over 2015. The aggregate TIS revenues from domestic non-operator customers and overseas customers increased by 32.6% over 2015, in which the TIS revenue from domestic non-operator customers recorded a significant year-on-year growth of 46.8%, showing a strong growth momentum. With the refinement of its sale and marketing mechanism and product portfolio, the Group's business development of domestic non-operator market played a more significant role in accelerating the growth of TIS business, which effectively alleviated the impacts from changes in investments of the domestic telecommunications operator customers.

Business Process Outsourcing Services

In 2016, the Group's revenue from BPO services amounted to RMB32,533 million, representing a decrease of 1.5% as compared to RMB33,014 million in 2015. Excluding the products distribution business, revenue from the Core Businesses amounted to RMB22,054 million, representing a year-on-year growth of 10.7%. The revenue from BPO services accounted for 36.8% of the total revenues, representing a decrease of 4.0 percentage points from 40.8% in 2015. As to the customer structure of BPO services, the Group's BPO revenue from the domestic telecommunications operator customers amounted to RMB20,198 million, representing an increase of 8.0% as compared to 2015, and accounted for 62.1% of the total BPO revenues, representing an increase of 5.5 percentage points from the corresponding period of last year. As the Group proactively scaled down the products distribution business for domestic non-operator customers, the aggregate BPO revenues from domestic non-operator customers and overseas customers amounted to RMB12,335 million, representing a decrease of 13.8% from 2015 and accounting for 37.9% of total BPO revenues, representing a decrease of 5.5 percentage points from the corresponding period of last year.

In 2016, the Group's revenue from Network Maintenance business amounted to RMB10,685 million, representing an increase of 9.5% as compared to 2015. The Group focused on and captured the opportunities arising from OPEX spending and continuous maintenance outsourcing from domestic telecommunications operators, and therefore Network Maintenance business maintained favourable growth and was the third largest contributor to total incremental revenues among all businesses. Besides, the Group's revenue from products distribution business amounted to RMB10,479 million, representing a decrease of 20.0% as compared to 2015, which was mainly attributable to the Group's principle of efficient development and proactive control of the development of certain products distribution business with low profitability and relatively high risks. China Comservice Supply Chain Management Company Limited ("Supply Chain Company"), newly established by the Group, promoted the favourable development of the supply chain business. Revenue from supply chain business amounted to RMB7,209 million, representing an increase of 12.7% as compared to 2015. The Group's revenue from general facilities management amounted to RMB4,160 million, representing an increase of 10.4% as compared to 2015, and maintaining favourable growth momentum.



Applications, Content and Other Services

In 2016, the Group's revenue from ACO services amounted to RMB10,029 million, representing an increase of 14.8% as compared to RMB8,737 million in 2015. The revenue from ACO services accounted for 11.3% of the total revenues, representing an increase of 0.5 percentage point from 10.8% in 2015. As to the customer structure of ACO services, the Group's ACO revenue from domestic telecommunications operator customers amounted to RMB4,859 million and accounted for 48.4% of the total ACO revenues, representing a decrease of 2.8 percentage points from the corresponding period of last year. Aggregate ACO revenues from domestic non-operator customers and overseas customers amounted to RMB5,170 million, and accounted for 51.6% of the total ACO revenues, representing an increase of 2.8 percentage points from the corresponding period of last year.

In 2016, the Group continued to pursue innovative development and proactively capitalized on the domestic opportunities of "Internet +" and informatization construction. The Group strengthened its resources integration and product development and continued to promote competitive products and solutions focusing on key areas such as industrial applications, mobile applications, cloud computing, big data and information securities. The Group's ACO revenue from domestic telecommunications operator customers increased by 8.7% over 2015, while aggregate ACO revenues from domestic non-operator customers and overseas customers had a more rapid increase of 21.2% over 2015. With the Group's greater effort in developing businesses from domestic non-operator customers, both the revenue and the incremental revenue contribution of such customer surpassed those of the domestic telecommunications operator customers.



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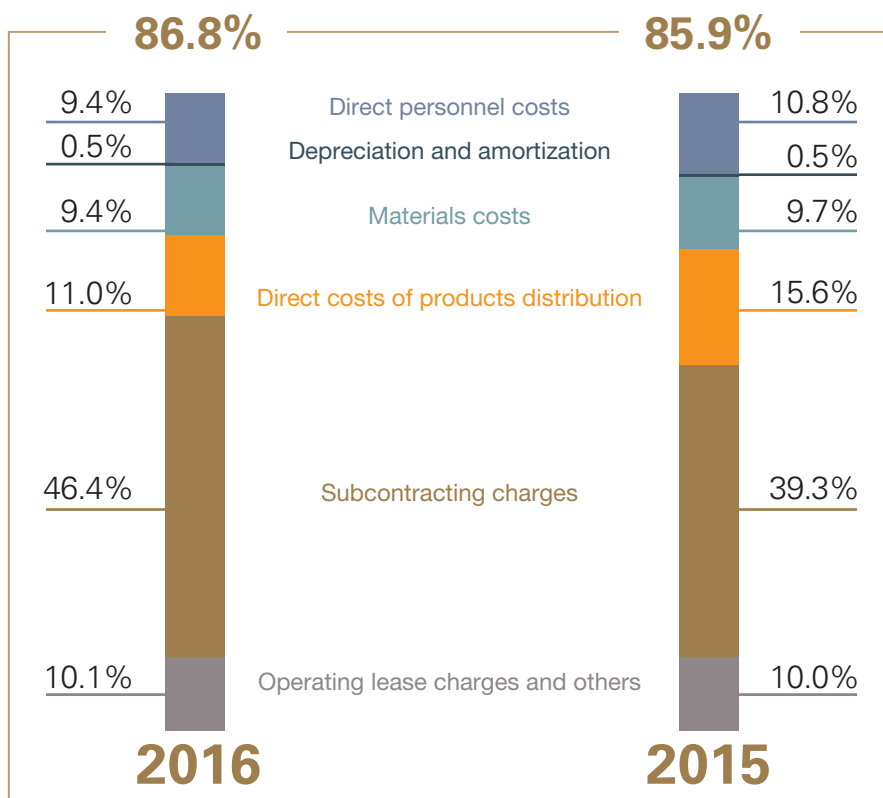
COST OF REVENUES

The Group's cost of revenues in 2016 amounted to RMB76,759 million, representing an increase of 10.3% from 2015 and accounting for 86.8% of the total revenues.

The following table sets out a breakdown of the Group's cost of revenues in 2015 and 2016 and their respective changes:

	2016 RMB'000	2015 RMB'000	Change
Direct personnel costs	8,316,693	8,731,020	-4.7%
Depreciation and amortization	455,215	447,031	1.8%
Materials costs ⁶	8,281,024	7,799,871	6.2%
Direct costs of products distribution ⁶	9,764,598	12,652,927	-22.8%
Subcontracting charges	41,016,647	31,811,771	28.9%
Operating lease charges and others	8,925,014	8,129,685	9.8%
Total cost of revenues	76,759,191	69,572,305	10.3%

COST OF REVENUES AS A % OF TOTAL REVENUES



Direct Personnel Costs

In 2016, direct personnel costs amounted to RMB8,317 million, representing a decrease of 4.7% from RMB8,731 million in 2015. Direct personnel costs as a proportion to our total revenues was 9.4%, representing a decrease of 1.4 percentage points from 2015. With the growth in business volume in 2016, 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 newly-amended Labour Contract Law and employed dispatch workers in accordance with the relevant regulations to avoid related risks.

⁶ Since 2016, the Group sub-divided the former distribution of telecommunications services and products business under the BPO services into supply chain business and products distribution business. Accordingly, the former cost of purchase of materials and telecommunication products is sub-divided into materials costs and direct costs of products distribution. For ease of comparison, the historical data of these two costs have been segregated accordingly.

Depreciation and Amortisation

In 2016, depreciation and amortisation were RMB455 million, representing an increase of 1.8% from RMB447 million in 2015. Depreciation and amortisation as a proportion to our total revenues was 0.5%.

Materials Costs

In 2016, materials costs amounted to RMB8,281 million, representing an increase of 6.2% as compared to RMB7,800 million in 2015. Materials costs as a proportion to our total revenues was 9.4%, representing a decrease of 0.3 percentage point from 2015. The increase in materials costs were mainly attributable to the growth of our infrastructure construction and system integration businesses.

Direct Costs of Products Distribution

In 2016, direct costs of products distribution amounted to RMB9,764 million, representing a decrease of 22.8% as compared to RMB12,653 million in 2015. Direct costs of products distribution as a proportion to our total revenues was 11.0%, representing a decrease of 4.6 percentage points over 2015. The significant decrease in the direct costs of products distribution was mainly because the Group effectively controlled the development of certain low-end products distribution business with relatively high risks.

Subcontracting Charges

In 2016, subcontracting charges were RMB41,017 million, representing an increase of 28.9% as compared to RMB31,812 million in 2015. Subcontracting charges as a proportion to our total revenues was 46.4%, representing an increase of 7.1 percentage points over 2015. The increase in subcontracting charges was mainly derived from the TIS and Network Maintenance businesses. Having considered its strategic development, effectiveness and efficiency, the Group continued to focus on high-end businesses and outsourced certain low-end tasks. Besides, as a result of the rapid growth in TIS business, and the sound development in Network Maintenance business, which is labour-intensive in nature and demands for more subcontracts, subcontracting charges grew rapidly during the year. As the scale of the Group's business continued to expand, the engagement of subcontractors enabled a more flexible utilization of external resources for the Group, and at the same time will lead to a more rapid growth in the Group's subcontracting charges.

Operating Lease Charges and Others

In 2016, operating lease charges and others were RMB8,925 million, representing an increase of 9.8% over RMB8,129 million in 2015. Operating lease charges and others as a proportion to our total revenues was 10.1%, representing an increase of 0.1 percentage point over 2015.

GROSS PROFIT

The Group achieved a gross profit of RMB11,690 million in 2016, representing an increase of 2.7% over RMB11,388 million in 2015. The Group's gross profit margin in 2016 was 13.2%, representing a decrease of 0.9 percentage point from 14.1% in 2015. In 2016, the decrease in gross profit margin of the Group was due to various factors, including the decrease in service charge in certain businesses, the increase in labour-related costs, and low profit margin in the initial stage of expansion into new markets. At the same time, the Group also strived to optimize its business and customer structure and control its costs, thereby alleviating the impacts brought by the external environment on gross profit margin to a certain extent.

SELLING, GENERAL AND ADMINISTRATIVE EXPENSES

The selling, general and administrative expenses of the Group in 2016 were RMB9,501 million, representing an increase of 2.1% as compared to RMB9,306 million in 2015. Benefited from the economies of scale in business development and effective cost control, the selling, general and administrative expenses as a proportion of our total revenues was 10.7%, representing a decrease of 0.8 percentage point from 2015.

FINANCE COSTS

In 2016, the Group's finance costs were RMB46.7 million, representing a decrease of 9.2% as compared to RMB51.4 million in 2015. Benefiting from the effective centralised cash management, the debts of the Group decreased during the year, leading to a decrease in the Group's finance costs.



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INCOME TAX

The income tax of the Group in 2016 was RMB503 million and our effective tax rate was 16.5%, representing a decrease of 0.8 percentage point from 17.3% in 2015. The difference between the Group's 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 new and high-technology enterprises, and the preferential policy of tax deduction before income tax for research and development expenses. In 2016, certain subsidiaries of the Group that fall under the scope of new and high-technology enterprises were entitled to a preferential income tax rate of 15%. Certain enterprises in the western China were entitled to 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 2016, profit attributable to equity shareholders of the Company was RMB2,536 million, representing an increase of 8.6% over RMB2,334 million in 2015. Profit attributable to equity shareholders of the Company accounted for 2.9% of our total revenues, which remained stable as compared to 2015. Basic earnings per share of the Company were RMB0.366 (2015: RMB0.337).

CAPITAL EXPENDITURE

The Group implemented stringent budget management over capital expenditure, and made adjustments according to changes in market condition. In 2016, capital expenditure amounted to RMB721 million, representing an increase of 1.3% over RMB712 million in 2015. The capital expenditure in 2016 accounted for 0.8% of the total revenues, representing a decrease of 0.1 percentage point over 2015. The capital expenditure of the Group included the purchases of production facilities and equipment, machinery and meters, plant and office buildings, intangible assets and other operating assets.

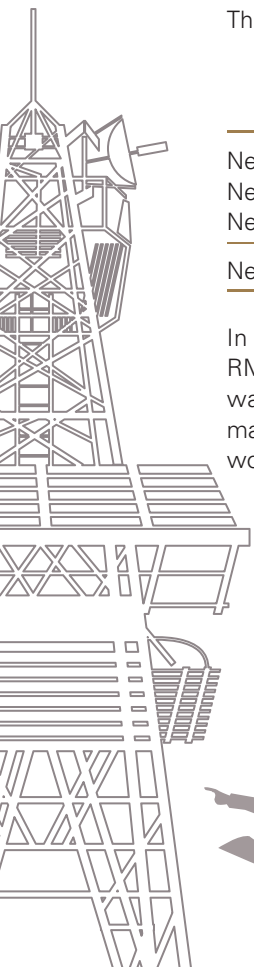
CASH FLOW

The Group's net cash inflow in 2016 amounted to RMB3,712 million, an increase of 68.0% over RMB2,209 million in 2015. As at the end of 2016, the cash and cash equivalents of the Group amounted to RMB13,324 million, of which 92.8% was denominated in Renminbi.

The following table sets out our cash flow positions in 2015 and 2016, respectively:

	2016 RMB'000	2015 RMB'000
Net cash generated from operating activities	5,265,248	4,687,811
Net cash used in investing activities	(604,352)	(1,686,164)
Net cash used in financing activities	(949,172)	(792,831)
Net increase in cash and cash equivalents	3,711,724	2,208,816

In 2016, net cash generated from operating activities was RMB5,265 million, representing an increase of RMB577 million from RMB4,688 million in 2015. The increase in net cash generated from operating activities was mainly attributable to the Group's "value-driven" principle and appraisal system, the strengthening of management of cash flow and accounts receivable, and effective accounts receivable settlement and collection work during the course of business expansion.



In 2016, net cash used in investing activities was RMB604 million, representing a decrease of RMB1,082 million from RMB1,686 million in 2015 which was mainly term deposits for over three months.

In 2016, net cash used in financing activities was RMB949 million, representing an increase of RMB156 million from RMB793 million in 2015, which was mainly due to the increase of dividend payment to the Company's shareholders.

WORKING CAPITAL

As at the end of 2016, the Group's working capital (i.e. current assets net of current liabilities) was RMB19,967 million, increased by RMB2,387 million from RMB17,580 million in 2015. The increase in working capital was mainly due to the expansion of the Group's business and effective management of accounts receivable which led to an increase in cash.

INDEBTEDNESS

As at the end of 2016, total indebtedness of the Group was RMB758 million, decreased by RMB103 million from RMB861 million as at the end of 2015. Indebtedness of the Group was mainly denominated in US dollar, of which Renminbi loan accounted for 1.8% and US dollar loan accounted for 98.2%, and of which 8.2% was fixed interest rate loans and 91.8% was floating interest rate loans.

As at the end of 2016, our gearing ratio⁷ was 2.8%, representing a decrease of 0.6 percentage point from 3.4% as at the end of 2015.

CONTRACTUAL OBLIGATIONS

The following table sets out our contractual commitments as at 31 December 2016:

	Total	2017	2018	2019	2020	2021 and after
	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000
Short-term debt	46,697	46,697	–	–	–	–
Long-term debt	17,343	–	17,343	–	–	–
Convertible preference shares and preference shares	693,700	–	–	–	–	693,700
Operating lease commitments	851,281	347,316	182,691	96,794	68,330	156,150
Contracted for but not provided capital commitments	347,842	347,842	–	–	–	–
Total of contractual obligations	1,956,863	741,855	200,034	96,794	68,330	849,850

EXCHANGE RATE

Most of the Group's revenues and expenses are denominated in Renminbi. As at the end of 2016, the balance of our cash and cash equivalents in foreign currencies accounted for 7.2% of the Group's total cash and cash equivalents, of which 3.7% and 1.2% were denominated in US dollars and Hong Kong dollars, respectively.

⁷ Gearing ratio equals to total interest-bearing debts at the end of the financial year divided by the sum of equity attributable to equity shareholders of the Company and interest-bearing debts.

