

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

## OVERVIEW

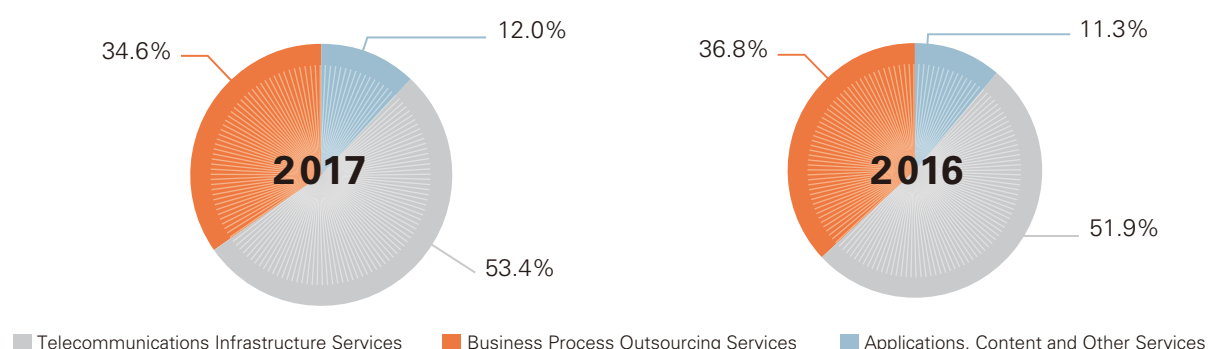
In 2017, the Group upheld the principal philosophy of “value-driven, seeking steady yet progressive growth and efficient development”, firmly captured the opportunities from the domestic telecommunications operators market in network construction and upgrade, optimization of broadband quality and speed, tower construction and maintenance, and also continued to focus on domestic non-telecom operator market, thereby achieving continuous growth in the total revenues and net profit. Our business saw a “steady yet progressive growth with quality enhancement”. Total revenues for the year amounted to RMB94,572 million, representing an increase of 6.9% as compared to 2016. Profit attributable to equity shareholders of the Company was RMB2,714 million, representing an increase of 7.0% as compared to RMB2,536 million in 2016. Basic earnings per share were RMB0.392. Free cash flow amounted to RMB6,118 million, representing an increase of 40.3% as compared to RMB4,361 million in 2016.

## TOTAL REVENUES

The Group’s total revenues in 2017 amounted to RMB94,572 million, representing an increase of 6.9% as compared to 2016. Among that, the revenue from telecommunications infrastructure (“TIS”) services was RMB50,511 million, representing a year-on-year growth of 10.1%; the revenue from business process outsourcing (“BPO”) services was RMB32,763 million, representing a year-on-year increase of 0.7%, of which the revenues from Core BPO services (i.e. excluding products distribution business) was RMB25,808 million, representing a year-on-year increase of 17.0%. The revenue from applications, content and other (“ACO”) services was RMB11,298 million, representing a year-on-year growth of 12.7%. Core BPO services was the fastest-growing business of the Group. From business perspective, construction, management of infrastructure for information technology (“Network Maintenance”) and supply chain were the three major businesses that contributed most to the Group’s overall incremental revenues.

From customer perspective, the long-existing development pattern of the Group had been changed from being driven by domestic telecommunications operator customers to being driven by the domestic non-telecom operator market, and the business from the domestic non-telecom operator market grew at the fastest rate with its revenue increased by 12.4% year-on-year to RMB26,656 million in 2017. Revenues from the Core Businesses of such market had a rapid year-on-year increase by 26.5% to RMB22,185 million. The revenue from the domestic telecommunications operators (including China Tower) amounted to RMB65,080 million, representing a year-on-year growth of 6.9%; the revenue from the overseas customers amounted to RMB2,836 million, representing a year-on-year decrease of 26.2%. In 2017, the Group seized opportunities arising from digital economy and informatization construction to establish the series of our smart-typed products. On the basis of satisfying the informatization need of domestic non-telecom operator customers including government, enterprises, the Group created new demand and formed new growth drivers. Businesses from such market became the main growth momentum of the Group’s total revenues. At the same time, the Group captured the opportunities for network construction and upgrade as well as the upgrade of fiber optic broadband networks from 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 effectively alleviated the impact brought by the decrease in the telecommunications operators’ CAPEX on the development of the Group. The three major customers contributing to incremental revenue of such market were China Mobile, China Tower and China Telecom, respectively.

## BUSINESS REVENUE MIX



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The following table sets forth a breakdown of our total revenues for 2016 and 2017, together with their respective changes:

	2017 RMB'000	2016 RMB'000	Change
<b>Telecommunications Infrastructure Services</b>			
Design services	10,239,148	9,071,584	12.9%
Construction services	36,668,312	33,710,753	8.8%
Project supervision and management services	3,603,528	3,104,613	16.1%
	50,510,988	45,886,950	10.1%
<b>Business Process Outsourcing Services</b>			
Management of infrastructure for information technology (Network Maintenance)	12,829,513	10,685,045	20.1%
General facilities management	4,554,889	4,160,068	9.5%
Supply chain	8,424,053	7,209,334	16.8%
<b>Sub-total of Core BPO Services</b>	25,808,455	22,054,447	17.0%
Products distribution	6,955,230	10,479,155	-33.6%
	32,763,685	32,533,602	0.7%
<b>Applications, Content and Other Services</b>			
System integration	5,789,503	4,808,799	20.4%
Software development and system support	2,048,496	1,687,084	21.4%
Value added services	1,570,458	1,654,394	-5.1%
Others	1,889,281	1,878,527	0.6%
	11,297,738	10,028,804	12.7%
<b>Total</b>	94,572,411	88,449,356	6.9%

### Telecommunications Infrastructure Services

In 2017, the Group's revenue from TIS services amounted to RMB50,511 million, representing an increase of 10.1% as compared to RMB45,887 million in 2016. TIS services was the primary source of revenue and accounted for 53.4% of our total revenues, representing an increase of 1.5 percentage points from 51.9% in 2016. As to the customer structure of the TIS services, the Group's TIS revenue from domestic telecommunications operator customers amounted to RMB38,649 million and accounted for 76.5% of the total TIS revenues, representing a decrease of 1.6 percentage points from last year. The aggregate TIS revenues from domestic non-telecom operator customers and overseas customers amounted to RMB11,862 million and accounted for 23.5% of the total TIS revenues, representing an increase of 1.6 percentage points from last year, whereas the increase in proportion was driven by domestic non-telecom operator customers.

In 2017, the Group firmly captured the opportunities arising from the network construction and upgrade and the upgrade of fiber optic broadband networks of domestic telecommunications operators and the construction demand from China Tower, and endeavoured to increase its market share. The TIS revenue from domestic telecommunications operator customers increased by 7.9% over 2016. The aggregate TIS revenues from domestic non-telecom operator customers and overseas customers increased by 18.0% over 2016, in which the TIS revenue from domestic non-telecom operator customers recorded a significant year-on-year growth of 30.3%,

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showing a strong growth momentum. With the refinement of its sale and marketing mechanism and product and service portfolio, the Group's business development of domestic non-telecom operator market played a more significant role in accelerating the growth of TIS business, which effectively alleviated the impacts from changes in network investments of the domestic telecommunications operator customers.

### Business Process Outsourcing Services

In 2017, the Group's revenue from BPO services amounted to RMB32,763 million, representing an increase of 0.7% as compared to RMB32,533 million in 2016. Excluding the products distribution business, revenue from the Core BPO businesses amounted to RMB25,808 million, representing a year-on-year growth of 17.0%. Core BPO businesses achieved rapid growth mainly because the Group focused on the OPEX-driven businesses of customers and successfully transformed the momentum of growth. The revenue from BPO services accounted for 34.6% of the total revenues, representing a decrease of 2.2 percentage points from 36.8% in 2016. As to the customer structure of BPO services, the Group's BPO revenue from the domestic telecommunications operator customers amounted to RMB21,372 million, representing an increase of 5.8% as compared to 2016, and accounted for 65.2% of the total BPO revenues, representing an increase of 3.1 percentage points from the corresponding period of last year. As the Group proactively scaled down the products distribution business for domestic non-telecom operator customers, the aggregate BPO revenues from domestic non-telecom operator customers and overseas customers amounted to RMB11,391 million, representing a decrease of 7.7% from 2016 and accounting for 34.8% of total BPO revenues, representing a decrease of 3.1 percentage points from the corresponding period of last year.

In 2017, the Group's revenue from Network Maintenance business amounted to RMB12,829 million, representing an increase of 20.1% as compared to 2016. The Group focused on opportunities arising from OPEX and continuous maintenance outsourcing from domestic telecommunications operators, and therefore Network Maintenance business maintained favourable growth and was the second largest contributor to total incremental revenues among all businesses. Besides, the Group's revenue from products distribution business amounted to RMB6,955 million, representing a decrease of 33.6% as compared to 2016, which was mainly because of the Group's principle of efficient development and proactive control of products distribution business with low efficiency. China Comservice Supply Chain Management Company Limited, established in 2016 by the Group, promoted the favourable development of the supply chain business. Revenue from supply chain business amounted to RMB8,424 million, representing an increase of 16.8% as compared to 2016 and was the third largest contributor to total incremental revenues among all businesses. The Group's revenue from general facilities management service amounted to RMB4,555 million, representing an increase of 9.5% as compared to 2016 and maintaining a favourable growth momentum.

### Applications, Content and Other Services

In 2017, the Group's revenue from ACO services amounted to RMB11,298 million, representing an increase of 12.7% as compared to RMB10,029 million in 2016. The revenue from ACO services accounted for 12.0% of the total revenues, representing an increase of 0.7 percentage point from 11.3% in 2016. As to the customer structure of ACO services, the Group's ACO revenue from domestic telecommunications operator customers amounted to RMB5,059 million and accounted for 44.8% of the total ACO revenues, representing a decrease of 3.6 percentage points from the corresponding period of last year. Aggregate ACO revenues from domestic non-telecom operator customers and overseas customers amounted to RMB6,239 million, and accounted for 55.2% of the total ACO revenues, representing an increase of 3.6 percentage points from the corresponding period of last year, in which the increase in proportion was driven by domestic non-telecom operator customers.

In 2017, 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 management and continued to promote competitive products and solutions focusing on key areas such as industrial applications, mobile applications, Cloud Computing, Big Data and Information Security. Aggregate ACO revenues from domestic non-telecom operator customers and overseas customers had a rapid increase of 20.7% over 2016. With the Group's greater effort in developing businesses from domestic non-telecom operator customers, both the revenue and the incremental revenue contribution of those customers surpassed those of the domestic telecommunications operator customers. ACO revenue from domestic telecommunications operator customers increased by 4.1% over 2016 and remained a steady growth.

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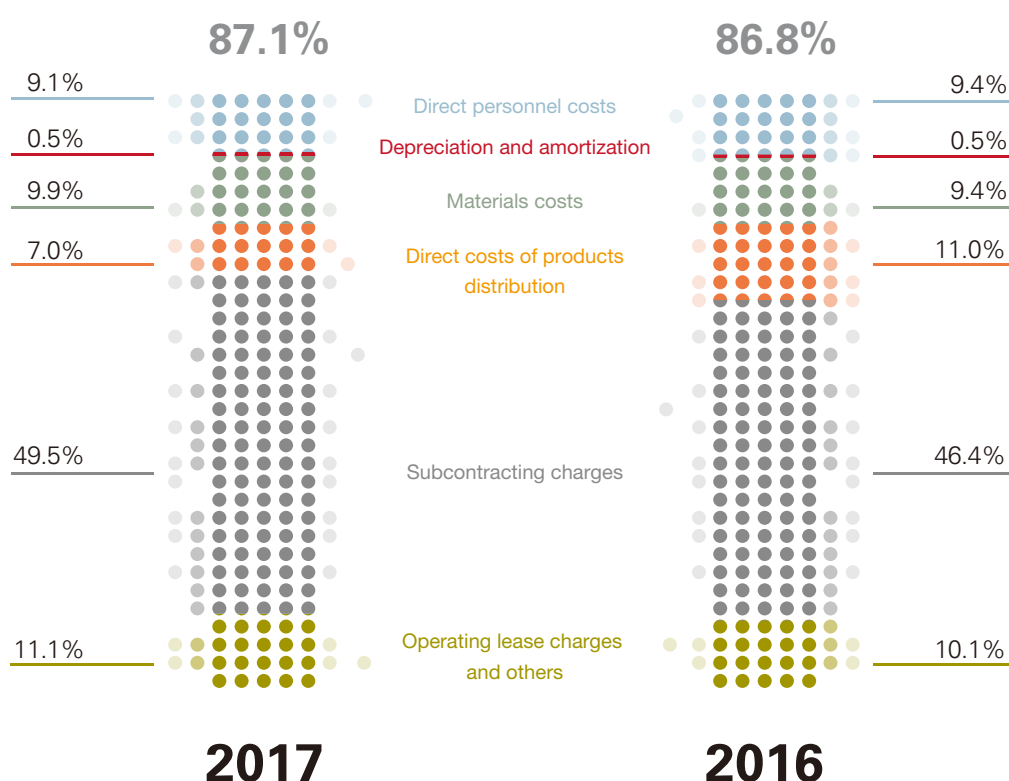
### COST OF REVENUES

The Group's cost of revenues in 2017 amounted to RMB82,360 million, representing an increase of 7.3% from 2016 and accounting for 87.1% of the total revenues.

The following table sets out a breakdown of the Group's cost of revenues in 2016 and 2017 and their respective changes:

	2017 RMB'000	2016 RMB'000	Change
Direct personnel costs	8,647,493	8,316,693	4.0%
Depreciation and amortization	472,621	455,215	3.8%
Materials costs	9,327,654	8,281,024	12.6%
Direct costs of products distribution	6,594,772	9,764,598	-32.5%
Subcontracting charges	46,858,020	41,016,647	14.2%
Operating lease charges and others	10,459,491	8,925,014	17.2%
<b>Total cost of revenues</b>	<b>82,360,051</b>	<b>76,759,191</b>	<b>7.3%</b>

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



#### Direct Personnel Costs

In 2017, direct personnel costs amounted to RMB8,647 million, representing an increase of 4.0% from RMB8,317 million in 2016. Direct personnel costs as a proportion to our total revenues was 9.1%, representing a decrease of 0.3 percentage point from 2016. With the growth in business volume in 2017, 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 amended Labour Contract Law and employed dispatch workers in accordance with the relevant regulations to avoid related risks.

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### Depreciation and Amortisation

In 2017, depreciation and amortisation were RMB473 million, representing an increase of 3.8% from RMB455 million in 2016. Depreciation and amortisation as a proportion to our total revenues was 0.5%.

### Materials Costs

In 2017, materials costs amounted to RMB9,328 million, representing an increase of 12.6% as compared to RMB8,281 million in 2016. Materials costs as a proportion to our total revenues was 9.9%, representing an increase of 0.5 percentage point from 2016. The increase in materials costs was mainly attributable to the increase in relevant material costs caused by the growth of our system integration and construction services.

### Direct Costs of Products Distribution

In 2017, direct costs of products distribution amounted to RMB6,595 million, representing a decrease of 32.5% as compared to RMB9,764 million in 2016. Direct costs of products distribution as a proportion to our total revenues was 7.0%, representing a decrease of 4.0 percentage points over 2016. The significant decrease in the direct costs of products distribution was mainly because the Group effectively controlled the development of certain low efficiency products distribution business.

### Subcontracting Charges

In 2017, subcontracting charges were RMB46,858 million, representing an increase of 14.2% as compared to RMB41,017 million in 2016 and a moderate growth<sup>10</sup> as compared to past years. Subcontracting charges as a proportion to our total revenues was 49.5%, representing an increase of 3.1 percentage points over 2016. 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 rapid development in Network Maintenance business, which are labour-intensive in nature and demand for more subcontracting, 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 led to a more rapid growth in the Group's subcontracting charges.

### Operating Lease Charges and Others

In 2017, operating lease charges and others were RMB10,459 million, representing an increase of 17.2% over RMB8,925 million in 2016. Operating lease charges and others as a proportion to our total revenues was 11.1%, representing an increase of 1.0 percentage point over 2016. The cost increase was mainly due to the Group's enhanced external cooperation for business development during the reporting period, and the corresponding increase of development and cooperation expenses in others.

## GROSS PROFIT

The Group achieved a gross profit of RMB12,212 million in 2017, representing an increase of 4.5% over RMB11,690 million in 2016. The Group's gross profit margin in 2017 was 12.9%, representing a decrease of 0.3 percentage point from 13.2% in 2016 and a moderate decrease as compared with past years. In 2017, 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. At the same time, the Group strived to optimize its business and customer structure, and achieved remarkable results. Revenue from Core Businesses as a proportion to our total revenues was 92.7%, representing an increase of 4.5 percentage points and 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 2017 were RMB9,885 million, representing an increase of 4.0% as compared to RMB9,501 million in 2016. 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 10.5%, representing a decrease of 0.2 percentage point from 2016.

<sup>10</sup> The subcontracting charges of the Group increased by 28.9% year-on-year in 2016.

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### FINANCE COSTS

In 2017, the Group's finance costs were RMB47 million (2016: RMB47 million), representing a similar level with 2016.

### INCOME TAX

The income tax of the Group in 2017 was RMB483 million and our effective tax rate was 14.9%, representing a decrease of 1.6 percentage points from 16.5% in 2016. 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 2017, 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 2017, profit attributable to equity shareholders of the Company was RMB2,714 million, representing an increase of 7.0% over RMB2,536 million in 2016. Profit attributable to equity shareholders of the Company accounted for 2.9% of our total revenues, which remained stable as compared to 2016. Basic earnings per share of the Company were RMB0.392 (2016: RMB0.366).

### CAPITAL EXPENDITURE

The Group implemented stringent budget management over capital expenditure, and made adjustments according to changes in market condition. In 2017, capital expenditure amounted to RMB921 million, representing an increase of 27.7% over RMB721 million in 2016. The capital expenditure in 2017 accounted for 1.0% of the total revenues, representing an increase of 0.2 percentage point over 2016. 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 recorded a net cash outflow in 2017 amounted to RMB21 million, and recorded a net cash inflow of RMB3,712 million in 2016. Such change was mainly due to the increase of cash used in investing activities in the reporting period. As at the end of 2017, the cash and cash equivalents of the Group amounted to RMB13,267 million, of which 94.7% was denominated in Renminbi.

The following table sets out our cash flow positions in 2016 and 2017, respectively:

	2017 RMB'000	2016 RMB'000
Net cash generated from operating activities	6,964,245	5,265,248
Net cash used in investing activities	(5,683,712)	(604,352)
Net cash used in financing activities	(1,301,884)	(949,172)
Net (decrease)/increase in cash and cash equivalents	(21,351)	3,711,724

In 2017, net cash generated from operating activities was RMB6,964 million, representing an increase of RMB1,699 million from RMB5,265 million in 2016. 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, accounts receivable and accounts payable, and effective accounts receivable settlement and collection work during the course of business expansion.

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In 2017, net cash used in investing activities was RMB5,683 million, representing an increase of RMB5,079 million from RMB604 million in 2016. The increase was mainly attributable to the flexible utilization of part of the fund to purchase short-term principal-protected wealth management products and structured deposits issued by banks after considering the cash position and large projects development needs of the Group in that year.

In 2017, net cash used in financing activities was RMB1,302 million, representing an increase of RMB353 million from RMB949 million in 2016. The increase was mainly because one of the subsidiaries of the Group had redeemed the convertible preference shares.

### WORKING CAPITAL

As at the end of 2017, the Group's working capital (i.e. current assets net of current liabilities) was RMB20,778 million, increased by RMB811 million from RMB19,967 million in 2016. The increase in working capital was mainly due to the expansion of the Group's business and effective management of accounts receivable and accounts payable which led to an increase in net cash generated from operating activities and current assets.

### ASSETS AND LIABILITIES

The Group continued to maintain a solid financial position. As at the end of 2017, the Group's total assets was RMB70,735 million, representing an increase of RMB8,141 million from RMB62,594 million in 2016; total liabilities was RMB41,915 million, representing an increase of RMB6,369 million from RMB35,546 million in 2016. The liabilities-to-assets ratio was 59.3%, increased from 56.8% in 2016.

### INDEBTEDNESS

As at the end of 2017, total indebtedness of the Group was RMB327 million, decreased by RMB431 million from RMB758 million as at the end of 2016. Indebtedness of the Group was mainly denominated in US dollar, of which Renminbi loan accounted for 4.1% and US dollar loan accounted for 92.4%, and of which 30.0% was fixed interest rate loans and 70.0% was floating interest rate loans.

As at the end of 2017, our gearing ratio<sup>11</sup> was 1.1%, representing a decrease of 1.7 percentage points from 2.8% as at the end of 2016.

### CONTRACTUAL OBLIGATIONS

The following table sets out our contractual commitments as at 31 December 2017:

	Total	2018	2019	2020	2021	2022
	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	and after RMB'000
Short-term debt	308,876	308,876	–	–	–	–
Long-term debt	17,642	–	9,148	8,494	–	–
Operating lease commitments	963,125	430,716	222,424	103,917	68,868	137,200
Contracted for but not provided capital commitments	421,950	421,950	–	–	–	–
<b>Total of contractual obligations</b>	<b>1,711,593</b>	<b>1,161,542</b>	<b>231,572</b>	<b>112,411</b>	<b>68,868</b>	<b>137,200</b>

### EXCHANGE RATE

Most of the Group's revenues and expenses are denominated in Renminbi. As at the end of 2017, the balance of our cash and cash equivalents in foreign currencies accounted for 5.3% of the Group's total cash and cash equivalents, of which 2.9% and 0.4% were denominated in US dollars and Hong Kong dollars, respectively.

<sup>11</sup> 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.