

MANAGEMENT DISCUSSION AND ANALYSIS OF FINANCIAL CONDITIONS AND RESULTS OF OPERATIONS

OVERVIEW

In 2019, the Group continued to adhere to its overall roadmap of “value-driven, seeking steady yet progressive growth and high-quality development” and pinpointed its new position of “New Generation Integrated Smart Service Provider” by adapting to the development trend of the industry. The Group’s operations remained stable, with total revenues for the year amounted to RMB117,413 million, representing an increase of 10.6% as compared to 2018; profit attributable to the equity shareholders of the Company was RMB3,049 million, representing an increase of 5.1% as compared to RMB2,901 million in 2018, with basic earnings per share amounted to RMB0.440; free cash flow was RMB4,243 million, representing an increase of 17.4% as compared to RMB3,613 million in 2018. Cash conversion ratio was 157.8%, which continued to remain at a healthy and relatively high level.

TOTAL REVENUES

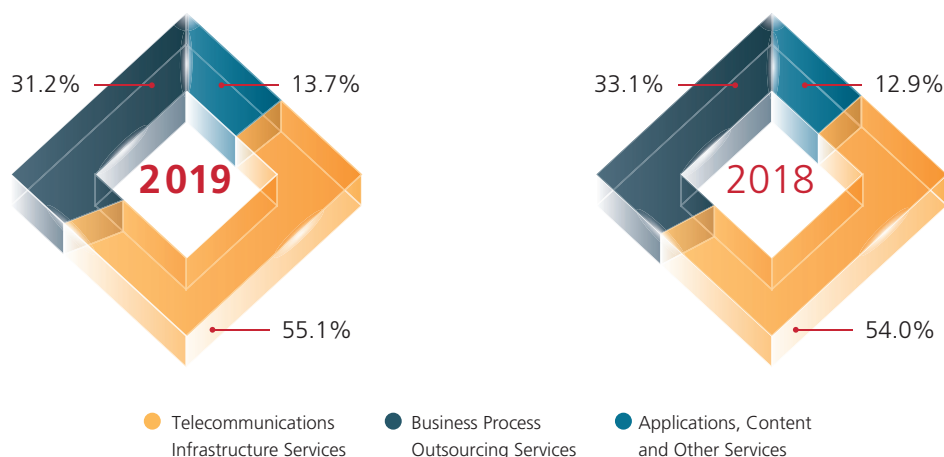
The Group’s total revenues in 2019 amounted to RMB117,413 million, representing an increase of 10.6% as compared to 2018. From the business perspective, the revenue from telecommunications infrastructure (“TIS”) services was RMB64,689 million, representing a year-on-year growth of 12.8%; the revenue from business process outsourcing (“BPO”) services was RMB36,637 million, representing a year-on-year increase of 4.4%, of which the revenues from Core BPO services (i.e. excluding products distribution business) was RMB32,315 million, representing a year-on-year increase of 6.9%; and the revenue from applications, content and other (“ACO”) services was RMB16,087 million, representing a year-on-year growth of 17.3%. Taking full advantage of the opportunities arising from the construction of Digital Economy and Smart Society in China, the Group improved its integrated smart service capabilities to drive rapid growth of businesses relating to digitalization construction, thus TIS services became the major driver of its overall revenue growth. Meanwhile, the Group consolidated the capabilities of research and development and products by increasing its investment in research and development, which in turn stimulated the growth of its businesses such as system integration and software development, making the ACO services continued to be the fastest growing business segment. The Group continued to take advantage of the opportunities arising from the OPEX business of domestic telecommunications operators, so the continuous growth of its Core BPO services provided important support to the overall growth of the Group. Construction, system integration and management of infrastructure for information technology (Network Maintenance) were the three largest contributors to the total incremental revenues of the Group.

From the market perspective, the incremental revenue from the domestic non-operator market surpassed those generated from the domestic telecommunications operator market in 2019, and the revenue from such market amounted to RMB41,727 million, representing a year-on-year increase of 25.2%, in which, revenue from the Core Businesses of such market amounted to RMB38,544 million, representing a rapid year-on-year increase of 29.8%. Revenue from the domestic telecommunications operator market amounted to RMB72,420 million, representing a year-on-year growth of 3.9%; and revenue from the overseas market amounted to RMB3,266 million, representing a year-on-year increase of 3.6%. In 2019, the Group continued to cultivate and upgrade various smart applications in key industries, focused on the development of integrated smart solutions and accelerated the deployment in fields such as Industrial Internet, emergency management and network information security, thus the businesses from the domestic non-operator market sustained a rapid growth and continued to contribute the largest incremental revenue to the Group. Meanwhile, the Group effectively implemented “Dual Growth Drivers+” (i.e. CAPEX and OPEX + Smart Applications) development strategy in the domestic telecommunications operator market. The Group not only fully exploited the traditional infrastructure businesses and continued to vigorously develop OPEX business, but also paid close attention to the demand for transformation and upgrade from domestic telecommunications operators to provide them with informatization support services, thus driving the further increase in contribution from the ACO services. All the above measures enabled the Group to realize steady development in the domestic telecommunications operator market.



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BUSINESS REVENUE MIX



The following table sets forth a breakdown of our total revenues for 2018 and 2019, together with their respective changes:

	2019 RMB'000	2018 RMB'000	Change
Telecommunications Infrastructure Services			
Design services	10,239,043	10,605,020	-3.5%
Construction services	50,734,438	42,862,805	18.4%
Project supervision and management services	3,715,334	3,891,611	-4.5%
	64,688,815	57,359,436	12.8%
Business Process Outsourcing Services			
Management of infrastructure for information technology (Network Maintenance)	15,826,644	14,793,165	7.0%
General facilities management (Property Management)	6,168,074	5,277,821	16.9%
Supply chain	10,320,178	10,148,648	1.7%
Sub-total of Core BPO Services	32,314,896	30,219,634	6.9%
Products distribution	4,322,284	4,883,188	-11.5%
	36,637,180	35,102,822	4.4%
Applications, Content and Other Services			
System integration	9,108,195	7,372,535	23.5%
Software development and system support	2,856,311	2,501,901	14.2%
Value added services	2,035,012	1,934,382	5.2%
Others	2,087,576	1,905,561	9.6%
	16,087,094	13,714,379	17.3%
Total	117,413,089	106,176,637	10.6%

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Telecommunications Infrastructure Services

In 2019, the Group's revenue from TIS services amounted to RMB64,689 million, representing an increase of 12.8% as compared to RMB57,359 million in 2018. Of which, the construction services recorded revenue of RMB50,735 million, representing an increase of 18.4% as compared to 2018, being the largest contributor to the overall incremental revenues. TIS services was the primary source of revenue of the Group and accounted for 55.1% of our total revenues, representing an increase of 1.1 percentage points from 54.0% in 2018. As to the customer structure of the TIS services, the Group's TIS revenue from domestic telecommunications operators amounted to RMB41,153 million and accounted for 63.6% of the total TIS revenues, representing a decrease of 6.7 percentage points from last year. The aggregate TIS revenues from domestic non-operator customers and overseas customers amounted to RMB23,536 million and accounted for 36.4% of the total TIS revenues, representing an increase of 6.7 percentage points from last year, whereas the increase in proportion was driven by domestic non-operator customers.

In 2019, the Group's TIS revenue from domestic telecommunications operators increased by 2.1% over 2018. The Group took advantage of the opportunities arising from the gradually increasing investment in the construction of 5G network by the domestic telecommunications operators, coordinated the allocation of resources and improved delivery capability and service quality, and therefore maintained market share. However, the domestic telecommunications operators have not yet invested in 5G network in scale while adjusting their investment structure at the same time, the Group's TIS revenue from the domestic telecommunications operator customers maintained a steady growth. Meanwhile, the aggregate TIS revenues from domestic non-operator customers and overseas customers increased by 38.2% over 2018, in which the TIS revenue from domestic non-operator customers recorded a significant year-on-year growth of 42.8%, showing a remarkably enhanced growth momentum. With the Group's further penetration into key industries and the enhancement on its integrated smart service capabilities, the business development in the domestic non-operator market played an increasingly prominent role in driving the TIS business.

Business Process Outsourcing Services

In 2019, the Group's revenue from BPO services amounted to RMB36,637 million, representing an increase of 4.4% as compared to RMB35,103 million in 2018, accounting for 31.2% of our total revenues, a decrease of 1.9 percentage points as compared to 33.1% in 2018. Excluding the products distribution business, revenue from the Core BPO services amounted to RMB32,315 million, representing a year-on-year growth of 6.9%. In terms of customer structure of the BPO services, the BPO revenue from the domestic telecommunications operators amounted to RMB24,454 million, representing an increase of 4.0% over 2018, and accounting for 66.7% of the total revenues from the BPO services, representing a decrease of 0.3 percentage point over 2018. The aggregate BPO revenues from the domestic non-operator customers and overseas customers amounted to RMB12,183 million, representing an increase of 5.1% over 2018, accounted for 33.3% of the total revenues from the BPO services, representing an increase of 0.3 percentage point over 2018.

In 2019, among each of the business under the Group's BPO services, revenue from the Network Maintenance business maintained a favourable growth and amounted to RMB15,827 million, representing an increase of 7.0% as compared to 2018. The Network Maintenance business was the third largest contributor to the overall incremental revenues, which was primarily the result of the Group's focus on the OPEX business and continuous maintenance outsourcing demand of domestic telecommunications operators. Revenue from the Property Management business amounted to RMB6,168 million, representing an increase of 16.9% as compared to 2018, maintaining a favourable growth momentum. Revenue from the supply chain business amounted to RMB10,320 million, representing an increase of 1.7% as compared to 2018. The slowdown in growth of the supply chain business was mainly due to the adjustment of marketing strategy by domestic telecommunications operators which led to the subdued growth in marketing agent and after-sale businesses of the Group. Besides, revenue from the products distribution business amounted to RMB4,322 million, representing a decrease of 11.5% as compared to 2018, mainly due to the fact that the Group adhered to the principle of efficient development and continued to proactively contain products distribution business with relatively low efficiency.

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Applications, Content and Other Services

In 2019, the Group's revenue from ACO services amounted to RMB16,087 million, representing an increase of 17.3% as compared to RMB13,715 million in 2018, making it the fastest-growing business segment for the year. Of which, the system integration business recorded revenue of RMB9,108 million, representing an increase of 23.5% as compared to 2018, being the second largest contributor to the overall incremental revenues. The revenue from ACO services accounted for 13.7% of the Group's total revenues, representing an increase of 0.8 percentage point from 12.9% in 2018, and such proportion has been constantly growing in the past five consecutive years. In terms of the customer structure of ACO services, the Group's ACO revenue from domestic telecommunications operators amounted to RMB6,813 million and accounted for 42.4% of the total ACO revenues, representing a decrease of 0.4 percentage point from the corresponding period of last year. Aggregate ACO revenues from domestic non-operator customers and overseas customers amounted to RMB9,274 million, accounting for 57.6% of the total ACO revenues, representing an increase of 0.4 percentage point from the corresponding period of last year, which was driven by the domestic non-operator customers.

In 2019, the development of 5G, Cloud, IoT, Big Data, and Artificial Intelligence further integrated with various industries. The Group took full advantage of such window of opportunities, accelerated deployment in industries to improve its capability to create digital assets. The Group proactively adapted to the national strategies, including "Cyberpower", "Digital China" and "Smart Society", as well as the "Belt and Road" Initiative, and the aggregate ACO revenues from the domestic non-operator customers and overseas customers maintained a rapid growth of 18.2% over 2018. The domestic non-operator customers were the key development focus for the Group, and both the revenue and incremental revenue contribution of such customers from ACO services have surpassed those of the domestic telecommunications operators. The Group's ACO revenue from domestic telecommunications operators increased by 16.2% over 2018, continuing to maintain a rapid growth.

COST OF REVENUES

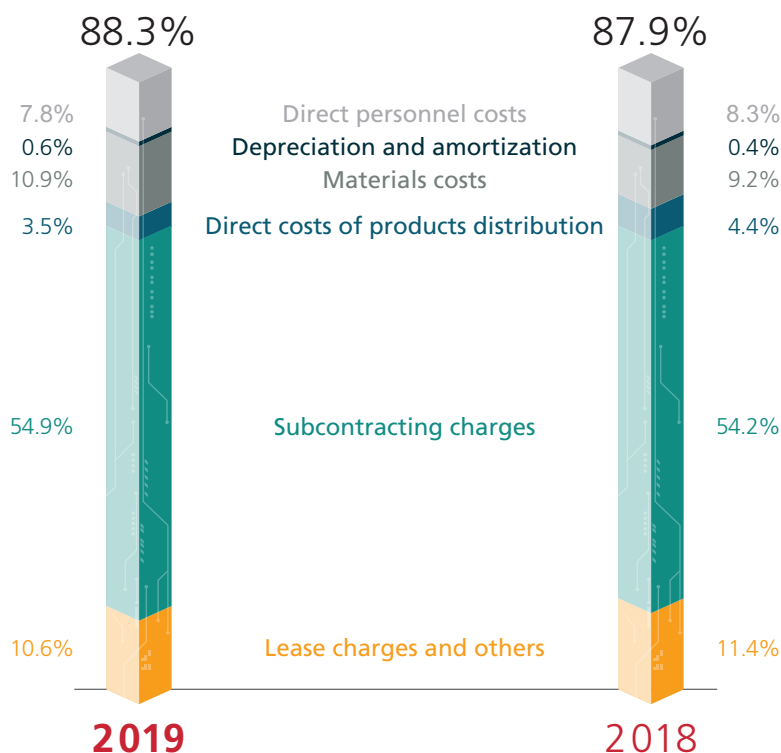
The Group's cost of revenues in 2019 amounted to RMB103,726 million, representing an increase of 11.2% from 2018 and accounting for 88.3% of the total revenues.

The following table sets out a breakdown of the Group's cost of revenues in 2018 and 2019 and their respective changes:

	2019 RMB'000	2018 RMB'000	Change
Direct personnel costs	9,111,016	8,747,317	4.2%
Depreciation and amortization	756,976	466,096	62.4%
Materials costs	12,838,003	9,783,239	31.2%
Direct costs of products distribution	4,167,579	4,629,177	-10.0%
Subcontracting charges	64,462,508	57,555,216	12.0%
Lease charges and others	12,390,048	12,110,626	2.3%
Total cost of revenues	103,726,130	93,291,671	11.2%

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COST OF REVENUES AS A % OF TOTAL REVENUES



Direct Personnel Costs

In 2019, direct personnel costs amounted to RMB9,111 million, representing an increase of 4.2% from RMB8,748 million in 2018. Direct personnel costs accounted for 7.8% of our total revenues, representing a decrease of 0.5 percentage point from 2018. The Group kept a reasonable control over its total headcount and continued to optimize the employee structure to strictly control staff costs. With the growth in its business volume, the Group made use of outsourcing resources reasonably to enhance operating efficiency.

Depreciation and Amortisation

In 2019, depreciation and amortisation amounted to RMB757 million, representing an increase of 62.4% from RMB466 million in 2018. Depreciation and amortisation cost accounted for 0.6% of our total revenues. Significant increase in depreciation and amortisation was due to the application of IFRS 16 (Leases) that certain costs originally credited to lease charges was credited to depreciation and amortisation.

Materials Costs

In 2019, materials costs amounted to RMB12,838 million, representing an increase of 31.2% as compared to RMB9,783 million in 2018. Materials costs accounted for 10.9% of our total revenues, representing an increase of 1.7 percentage points from 2018. The increase in materials costs was mainly attributable to the increase in relevant materials costs caused by the growth of our construction and system integration businesses.



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Direct Costs of Products Distribution

In 2019, the direct costs of products distribution amounted to RMB4,168 million, representing a decrease of 10.0% as compared to RMB4,629 million in 2018. Direct costs of products distribution accounted for 3.5% of our total revenues, representing a decrease of 0.9 percentage point over 2018. The decrease in the direct costs of products distribution was mainly because the Group proactively contained certain relatively low efficiency products distribution business.

Subcontracting Charges

In 2019, subcontracting charges were RMB64,462 million, representing an increase of 12.0% as compared to RMB57,555 million in 2018. Subcontracting charges accounted for 54.9% of our total revenues, representing an increase of 0.7 percentage point over 2018. In 2019, the growth of subcontracting charges slowed down significantly as compared to 2018⁵. The Group continued to transform to technology-intensive operation model and focus on high-end businesses, and promoted subcontracting of low-end businesses. In addition, during the reporting period, the Group undertook more turnkey projects in the domestic non-operator market, which have more needs for subcontracting for certain professional work. Business transformation of the Group instigated the company to have stricter control over the subcontracting costs. Through analysis of data on subcontractors, the Group intensified management and supervision of subcontractors throughout the whole process.

Lease Charges and Others

In 2019, lease charges and others were RMB12,390 million, representing an increase of 2.3% over RMB12,111 million in 2018. Lease charges and others accounted for 10.6% of our total revenues, representing a decrease of 0.8 percentage point over 2018. The decrease in proportion over total revenues was mainly due to the application of IFRS 16 (Leases) that certain costs from lease charges were credited to depreciation and amortisation and finance costs.

GROSS PROFIT

In 2019, the Group recorded gross profit of RMB13,687 million, representing an increase of 6.2% over RMB12,885 million in 2018. The Group's gross profit margin in 2019 was 11.7%, representing a decrease of 0.4 percentage point from 12.1% in 2018. Comparing to 2018, the decrease in gross profit margin in 2019 narrowed⁶. In 2019, the Group continued to face downward pressure on gross profit margin due to various factors, including the general decrease in unit service prices of businesses from domestic telecommunications operators and the increase in certain costs that were characterized as fixed in nature, such as labour-related costs. However, the Group continued to optimize its business and customer structure in 2019, and revenue from the Core Businesses as a proportion to our total revenues was 96.3%, representing an increase of 0.9 percentage point as compared to the previous year. In addition, business value from the domestic non-operator market manifested and the gross profit contribution from such market increased during the year as a result of the synergies achieved through the development of smart businesses in such market and the related businesses growth led by the smart businesses. The above factors alleviated the impacts on gross profit margin brought by the factors of external environment to a certain extent. Through various measures such as transformation and upgrade as well as the synergistic use of resources, the Group will strive to improve its gross profit margin by enhancing its service value and competitiveness.

⁵ In 2018, the Group's subcontracting charges were RMB57,555 million, representing an increase of 22.8% year-on-year, and the proportion to our total revenues increased by 4.7 percentage points over 2017.

⁶ In 2018, the Group's gross profit margin was 12.1%, representing a decrease of 0.8 percentage point as compared to 2017.

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SELLING, GENERAL AND ADMINISTRATIVE EXPENSES

In 2019, the selling, general and administrative expenses of the Group were RMB11,494 million, representing an increase of 8.3% as compared to RMB10,611 million in 2018. The selling, general and administrative expenses accounted for 9.8% of our total revenues, representing a decrease of 0.2 percentage point from 2018. Of which, the research and development costs were RMB3,276 million, representing an increase of 17.1% as compared to RMB2,798 million in 2018, and accounted for 2.8% of our total revenues, representing an increase of 0.2 percentage point from 2018. The main reasons for the increase in selling, general and administrative expenses were the increase in labour costs characterized as fixed in nature and the proactive increase in investment on research and development from the Group during the year.

FINANCE COSTS

In 2019, the finance costs of the Group were RMB69 million, representing a significant increase of 173.6% as compared to RMB25 million in 2018. It was mainly due to additional interest expenses on lease liabilities of RMB36 million resulting from the application of IFRS 16 (Leases).

INCOME TAX

In 2019, the income tax of the Group was RMB464 million and its effective tax rate was 13.3%, representing a decrease of 1.2 percentage points from 14.5% in 2018. 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 2019, 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 Western China benefited from 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 2019, profit attributable to equity shareholders of the Company was RMB3,049 million, representing an increase of 5.1% over RMB2,901 million in 2018. During the year, in order to reinforce its operation fundamentals, the Group made provision based on a prudent principle for two contractual disputes occurred in previous years according to the progress of the events, which impacted profit attributable to equity shareholders of the Company by RMB86 million. Profit attributable to equity shareholders of the Company accounted for 2.6% of our total revenues, which slightly decreased as compared to 2018. Basic earnings per share of the Company were RMB0.440 (2018: RMB0.419).

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CAPITAL EXPENDITURE

The Group implemented stringent budget management over capital expenditure, and made adjustments according to changes in market condition. In 2019, capital expenditure amounted to RMB946 million, representing an increase of 14.9% over RMB824 million in 2018. The capital expenditure in 2019 accounted for 0.8% of the total revenues, which remained at approximately the same level as compared to 2018. 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 inflow of RMB3,115 million in 2019, representing an increase of RMB291 million from RMB2,824 million in 2018. Such change was mainly due to the increase of cash generated from operating activities during the reporting period. As at the end of 2019, the balance of cash and cash equivalents of the Group amounted to RMB19,221 million, of which 95.8% was denominated in Renminbi.

The following table sets out our cash flow positions in 2018 and 2019, respectively:

	2019 RMB'000	2018 RMB'000
Net cash generated from operating activities	4,811,651	4,260,971
Net cash used in investing activities	(311,316)	(550,886)
Net cash used in financing activities	(1,385,133)	(885,710)
Net increase in cash and cash equivalents	3,115,202	2,824,375

In 2019, net cash generated from operating activities was RMB4,811 million, representing an increase of RMB550 million from RMB4,261 million in 2018. Other than the changes due to the classification of cash outflow in certain leasing activities resulting from the adoption of IFRS 16 (Leases), the increase in operating cash flow was mainly due to the fact that the Group persisted in value-driven principle and put more efforts on management of cash flow, accounts receivable and accounts payable with effective clearing and settlement of accounts receivable while expanding business.

In 2019, net cash used in investing activities was RMB311 million, representing a decrease of RMB240 million from RMB551 million in 2018. The decrease was mainly attributable to the decrease in the fund for purchasing short-term wealth management products and structured deposits at banks after considering the Group's overall funding arrangement.

In 2019, net cash used in financing activities was RMB1,385 million, representing an increase of RMB499 million from RMB886 million in 2018. The increase was mainly due to an additional repayment of principal of lease liabilities of RMB350 million resulting from the application of IFRS 16 (Leases).

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WORKING CAPITAL

As at the end of 2019, the Group's working capital (i.e. current assets net of current liabilities) was RMB22,569 million, representing an increase of RMB786 million from RMB21,783 million at the end of 2018. The increase in working capital was mainly due to the expansion of the Group's business and effective fund management which led to an increase in operating cash flow and current assets.

ASSETS AND LIABILITIES

The Group continued to maintain its solid financial position. As at the end of 2019, the Group's total assets was RMB87,541 million, representing an increase of RMB6,615 million from RMB80,926 million in 2018. Total liabilities was RMB52,503 million, representing an increase of RMB4,406 million from RMB48,097 million in 2018. The liabilities-to-assets ratio was 60.0%, which was slightly higher than 59.4% at the end of 2018.

As at the end of 2019, right-of-use assets amounting to RMB1,896 million were included in non-current assets upon the application of IFRS 16 (Leases) by the Group, among which, leased buildings, motor vehicles and other equipment amounted to RMB1,024 million and leasehold lands amounted to RMB872 million. As at the end of 2018, leasehold lands amounting to RMB723 million were classified as lease prepayments.

As at the end of 2019, current portion of lease liabilities of RMB343 million and lease liabilities of RMB690 million were included in current liabilities and non-current liabilities, respectively, upon the application of IFRS 16 (Leases) by the Group. According to the liquidity, lease liabilities were classified as current and non-current.

INDEBTEDNESS

As at the end of 2019, total indebtedness of the Group was RMB511 million, representing an increase of RMB40 million from RMB471 million as at the end of 2018. Indebtedness of the Group was mainly denominated in US dollar, of which Renminbi loan accounted for 2.6% and US dollar loan accounted for 68.6%; and of which 24.9% was the loans with a fixed interest rate and 75.1% was those with a floating interest rate.

As at the end of 2019, our gearing ratio⁷ was 1.5%, which remained at approximately the same level of 1.4% as at the end of 2018.

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.



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CONTRACTUAL OBLIGATIONS

The following table sets out our contractual commitments as at 31 December 2019:

	Total	2020	2021	2022	2023	2024 and after
	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000
Short-term debt	511,234	511,234	–	–	–	–
Long-term debt	–	–	–	–	–	–
Lease commitments	1,519,118	601,725	336,263	163,993	131,018	286,119
Contracted for but not provided capital commitments	543,676	543,676	–	–	–	–
Total of contractual obligations	2,574,028	1,656,635	336,263	163,993	131,018	286,119

EXCHANGE RATE

Most of the Group's revenues and expenses are denominated in Renminbi. As at the end of 2019, the balance of the Group's cash and cash equivalents in foreign currencies accounted for 4.2% of the balance of its total cash and cash equivalents, of which 2.3% and 0.3% were denominated in US dollars and Hong Kong dollars, respectively.