

MANAGEMENT DISCUSSION AND ANALYSIS OF FINANCIAL CONDITIONS AND RESULTS OF OPERATIONS

OVERVIEW

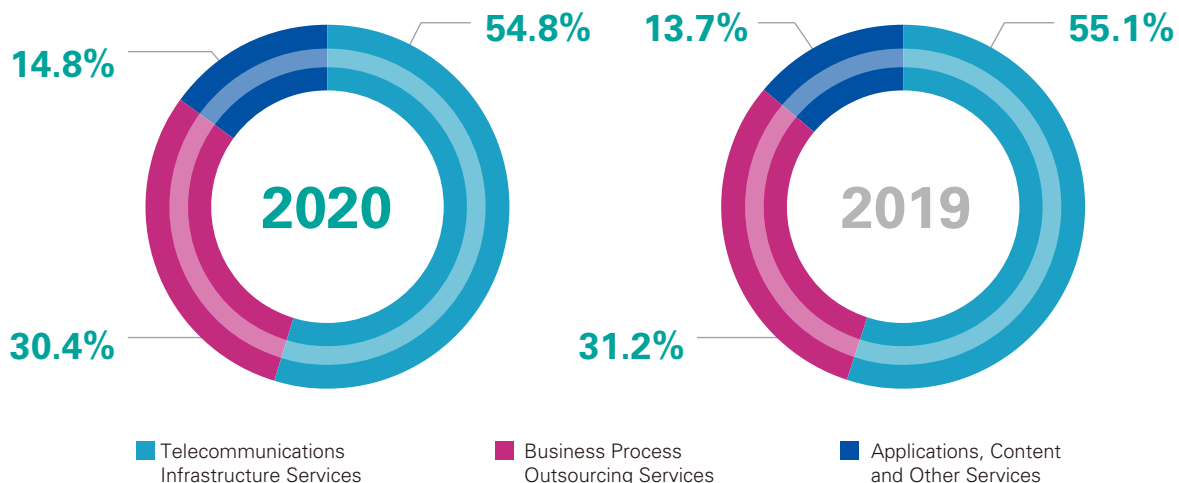
In 2020, by adhering to its overall roadmap of “value-driven, seeking steady yet progressive growth and high-quality development” and positioning itself as the “New Generation Integrated Smart Service Provider”, the Group overcame the adverse effect brought by the pandemic and its overall results maintained positive growth. Total revenues for the year amounted to RMB122,649 million, representing an increase of 4.5% as compared to 2019; profit attributable to the equity shareholders of the Company was RMB3,081 million, representing an increase of 1.1% as compared to RMB3,049 million in 2019, with basic earnings per share amounted to RMB0.445. Free cash flow was RMB2,630 million with cash conversion ratio⁴ being 177.0%, which continued to remain at a healthy and relatively high level.

TOTAL REVENUES

The Group’s total revenues in 2020 amounted to RMB122,649 million, representing an increase of 4.5% as compared to 2019. From the business perspective, the revenue from telecommunications infrastructure (“TIS”) services was RMB67,165 million, representing a year-on-year growth of 3.8%; the revenue from business process outsourcing (“BPO”) services was RMB37,277 million, representing a year-on-year increase of 1.7%, of which the revenue from Core BPO services (excluding products distribution business) was RMB33,022 million, representing a year-on-year increase of 2.2%; and the revenue from applications, content and other (“ACO”) services was RMB18,207 million, representing a year-on-year growth of 13.2%. In 2020, in order to overcome the impact of the pandemic, the Group adopted measures of focusing “key companies, key projects, major customers, tender volume, new contracts, and production volume since work resumption”, seized the opportunities arising from 5G, New Infrastructure and social digitalization, improved integrated comprehensive smart service capabilities, thus maintaining the continuous and steady growth of the TIS services. The Group is committed to technological innovation through stepping up its own research and development efforts continuously, which in turn stimulated the growth of its businesses such as system integration and software development, making the ACO services continue to be the fastest-growing business segment.

From the market perspective, the revenue from the domestic non-operator market was the main driver for business growth in 2020, and the revenue from such market amounted to RMB49,578 million, representing a year-on-year increase of 18.8%. Revenue from the domestic telecommunications operator market amounted to RMB69,976 million, representing a year-on-year decrease of 3.4%; and revenue from the overseas market amounted to RMB3,095 million, representing a year-on-year decrease of 5.2%. By focusing on the opportunities arising from the digital upgrade of the society, the Group optimized its internal mechanism construction such as research and development, accelerated its market deployment and continued to penetrate into key industries and fields, thus the businesses from the domestic non-operator market sustained a rapid growth and continued to be the largest contributor to revenue growth of the Group. Meanwhile, the Group effectively implemented the “CAPEX and OPEX + Smart Applications” development strategy in the domestic telecommunications operator market to seize the new opportunities arising from cloud-network integration, 5G and data center construction. The Group focused on cultivating its “Cloud + 5G + DICT” service capabilities to capture the potential market in areas such as the industrial applications of 5G, operators’ transformation business and network information security. All of the above measures enabled the Group’s revenue from the domestic telecommunications operator market to remain relatively stable despite the impact of the pandemic.

BUSINESS REVENUE MIX



⁴ Cash conversion ratio = net cash generated from operating activities/profit attributable to equity shareholders of the Company

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The following table sets forth a breakdown of our total revenues for 2019 and 2020, together with their respective changes:

	2020 RMB'000	2019 RMB'000	Change
Telecommunications Infrastructure Services			
Design services	10,372,327	10,239,043	1.3%
Construction services	52,952,530	50,734,438	4.4%
Project supervision and management services	3,839,714	3,715,334	3.3%
	67,164,571	64,688,815	3.8%
Business Process Outsourcing Services			
Management of infrastructure for information technology (Network Maintenance)	15,794,043	15,826,644	-0.2%
General facilities management (Property Management)	6,357,245	6,168,074	3.1%
Supply chain	10,870,747	10,320,178	5.3%
Sub-total of Core BPO Services	33,022,035	32,314,896	2.2%
Products distribution	4,254,844	4,322,284	-1.6%
	37,276,879	36,637,180	1.7%
Applications, Content and Other Services			
System integration	11,179,619	9,108,195	22.7%
Software development and system support	3,107,772	2,856,311	8.8%
Value added services	1,963,321	2,035,012	-3.5%
Others	1,956,782	2,087,576	-6.3%
	18,207,494	16,087,094	13.2%
Total	122,648,944	117,413,089	4.5%

Telecommunications Infrastructure Services

In 2020, the Group's revenue from TIS services amounted to RMB67,165 million, representing an increase of 3.8% as compared to RMB64,689 million in 2019. Of which, the construction services recorded revenue of RMB52,953 million, representing an increase of 4.4% as compared to 2019, being the largest contributor to the growth of total revenues. TIS services was the primary source of revenue of the Group and accounted for 54.8% of our total revenues, representing a decrease of 0.3 percentage point from 55.1% in 2019. As to the customer structure of the TIS services, the Group's TIS revenue from domestic telecommunications operators amounted to RMB38,879 million and accounted for 57.9% of the total TIS revenues, representing a decrease of 5.7 percentage points from last year. The aggregate TIS revenues from domestic non-operator customers and overseas customers amounted to RMB28,286 million and accounted for 42.1% of the total TIS revenues, representing an increase of 5.7 percentage points from last year, whereas the increase in proportion was driven by domestic non-operator customers.

In 2020, the aggregate TIS revenues from domestic non-operator customers and overseas customers increased by 20.2% over 2019, in which the TIS revenue from domestic non-operator customers recorded a significant year-on-year growth of 23.2%, which was the main growth driver of the TIS business. With the Group's expansion into key fields and improvement of the development mechanism for domestic non-operator market, the business development in such market has played an increasingly prominent role in driving the TIS business. The Group's TIS revenue from domestic telecommunications operators decreased by 5.5% over 2019 mainly due to the factors such as the impact from the pandemic. During the year, the Group seized the opportunities arising from 5G and New Infrastructure, and explored the demand of operators. The Group undertook 5G construction projects using the general contracting model, improved its business value and accelerated its market expansion, thus mitigating the impact of the pandemic and other factors.

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Business Process Outsourcing Services

In 2020, the Group's revenue from BPO services amounted to RMB37,277 million, representing an increase of 1.7% as compared to RMB36,637 million in 2019, accounting for 30.4% of our total revenues, a decrease of 0.8 percentage point as compared to 31.2% in 2019. Excluding the products distribution business, revenue from the Core BPO services amounted to RMB33,022 million, representing a year-on-year growth of 2.2%. In terms of customer structure of the BPO services, the BPO revenue from domestic telecommunications operators amounted to RMB24,237 million, representing a decrease of 0.9% over 2019, and accounting for 65.0% of the total revenues from the BPO services, representing a decrease of 1.7 percentage points over 2019. The aggregate BPO revenues from the domestic non-operator customers and overseas customers amounted to RMB13,040 million, representing an increase of 7.0% over 2019, accounted for 35.0% of the total revenues from the BPO services, representing an increase of 1.7 percentage points over 2019.

In 2020, among each of the businesses under the Group's BPO services, revenue from the Network Maintenance business amounted to RMB15,794 million, representing a decline of 0.2% as compared to 2019, mainly due to the market competition and the impact of the pandemic. Revenue from the Property Management business amounted to RMB6,357 million, representing an increase of 3.1% as compared to 2019. Revenue from the supply chain business amounted to RMB10,871 million, representing an increase of 5.3% as compared to 2019 (a year-on-year increase of 1.7% was recorded in 2019). The accelerated growth of the supply chain business was mainly due to the increase in retail sales of terminals driven by 5G. Besides, revenue from the products distribution business amounted to RMB4,255 million, representing a decrease of 1.6% as compared to 2019, 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.

Applications, Content and Other Services

In 2020, the Group's revenue from ACO services amounted to RMB18,207 million, representing an increase of 13.2% as compared to RMB16,087 million in 2019, making it the fastest-growing business segment for the year. Of which, the system integration business recorded revenue of RMB11,180 million, representing an increase of 22.7% as compared to 2019, being the second largest contributor to the growth of the overall revenues. The revenue from ACO services accounted for 14.8% of the Group's total revenues, representing an increase of 1.1 percentage points from 13.7% in 2019, and such proportion has been growing in the past five years. In terms of the customer structure of ACO services, the Group's ACO revenue from domestic telecommunications operators amounted to RMB6,860 million and accounted for 37.7% of the total ACO revenues, representing a decrease of 4.7 percentage points from the corresponding period of last year. Aggregate ACO revenues from domestic non-operator customers and overseas customers amounted to RMB11,347 million, accounting for 62.3% of the total ACO revenues, representing an increase of 4.7 percentage points from the corresponding period of last year, which was driven by the domestic non-operator customers.

The pandemic in 2020 further accelerated the progress of digital transformation across the whole society, the Group paid close attention to the business opportunities arising from informatization construction such as digital government, smart emergency management and smart city upgrade, and the ACO revenue from the domestic non-operator customers maintained a rapid growth of 24.1% over 2019. Domestic non-operator market is the key development focus of the Group, and both the revenue size and contribution to revenue growth of ACO services from such market have surpassed those of the domestic telecommunications operators market.

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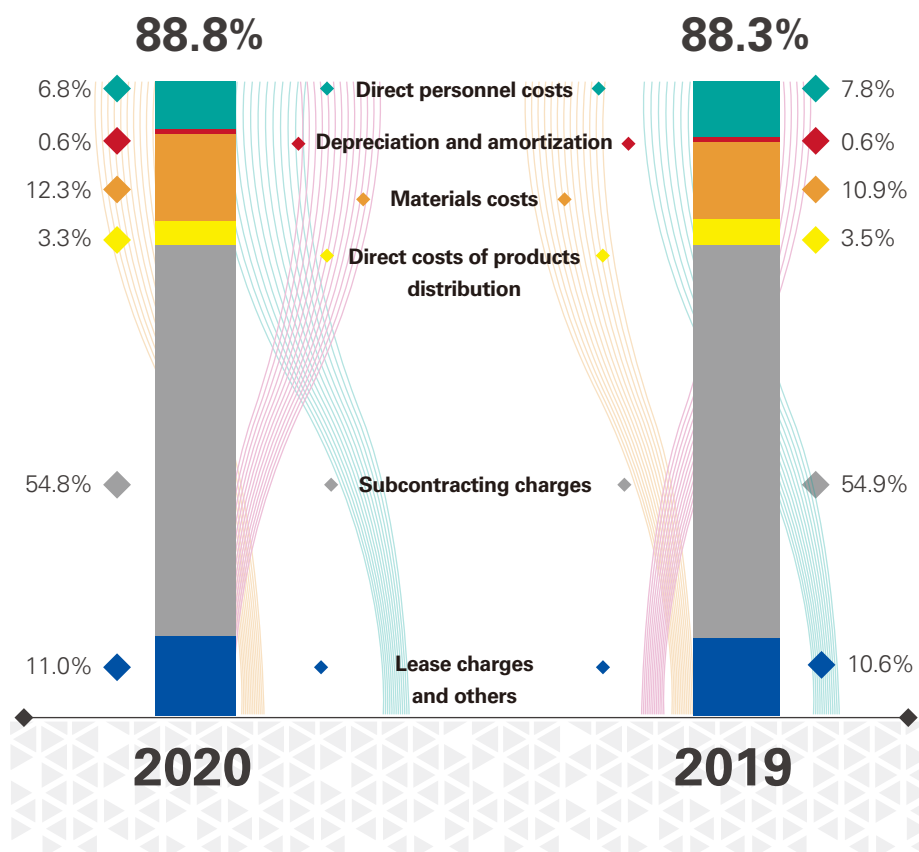
COST OF REVENUES

The Group's cost of revenues in 2020 amounted to RMB108,911 million, representing an increase of 5.0% from 2019 and accounting for 88.8% of the total revenues.

The following table sets out a breakdown of the Group's cost of revenues in 2019 and 2020 and their respective changes:

	2020 RMB'000	2019 RMB'000	Change
Direct personnel costs	8,300,338	9,111,016	-8.9%
Depreciation and amortization	827,413	756,976	9.3%
Materials costs	15,057,234	12,838,003	17.3%
Direct costs of products distribution	4,067,599	4,167,579	-2.4%
Subcontracting charges	67,166,028	64,462,508	4.2%
Lease charges and others	13,492,696	12,390,048	8.9%
Total cost of revenues	108,911,308	103,726,130	5.0%

COST OF REVENUES AS A % OF TOTAL REVENUES



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Direct Personnel Costs

In 2020, direct personnel costs amounted to RMB8,300 million, representing a decrease of 8.9% from RMB9,111 million in 2019. Direct personnel costs accounted for 6.8% of our total revenues, representing a decrease of 1.0 percentage point from 2019. In order to help enterprises overcome the impact of the pandemic, the government launched certain relief policies, which resulted in a decrease in the Group's direct personnel costs during the reporting period. Meanwhile, the Group kept a reasonable control over its total headcount, continued to optimize the employee structure and flexibly utilized the subcontracting model to strictly control staff costs.

Depreciation and Amortisation

In 2020, depreciation and amortisation amounted to RMB827 million, representing an increase of 9.3% from RMB757 million in 2019. Depreciation and amortisation cost accounted for 0.6% of our total revenues.

Materials Costs

In 2020, materials costs amounted to RMB15,057 million, representing an increase of 17.3% as compared to RMB12,838 million in 2019. Materials costs accounted for 12.3% of our total revenues, representing an increase of 1.4 percentage points from 2019. The main reason for the increase was the rapid growth of our construction and system integration businesses which took a relatively high proportion in our materials costs.

Direct Costs of Products Distribution

In 2020, the direct costs of products distribution amounted to RMB4,068 million, representing a decrease of 2.4% as compared to RMB4,168 million in 2019. Direct costs of products distribution accounted for 3.3% of our total revenues, representing a decrease of 0.2 percentage point over 2019. 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 2020, subcontracting charges were RMB67,166 million, representing an increase of 4.2% as compared to RMB64,462 million in 2019. Subcontracting charges accounted for 54.8% of our total revenues, representing a decrease of 0.1 percentage point over 2019. As compared to 2019, the growth of subcontracting charges in 2020 was basically in line with the growth of total revenues. The Group continued to transform to technology-intensive operation model and focus on high-end businesses, and promoted subcontracting of low-end businesses. The Group will continue to strengthen and regulate the management over subcontracting, with a view to maintaining the growth of subcontracting charges at a relatively reasonable level.

Lease Charges and Others

In 2020, lease charges and others were RMB13,493 million, representing an increase of 8.9% over RMB12,390 million in 2019. Lease charges and others accounted for 11.0% of our total revenues, representing an increase of 0.4 percentage point over 2019.

GROSS PROFIT

In 2020, the Group recorded gross profit of RMB13,738 million, representing an increase of 0.4% over RMB13,687 million in 2019. The Group's gross profit margin in 2020 was 11.2%, representing a decrease of 0.5 percentage point from 11.7% in 2019. In 2020, the Group saw a decrease in gross profit margin under the influence of the pandemic which hampered our business development and due to a combination of factors including the increased anti-pandemic expenses and sustained rigid costs, as well as the decrease in unit prices of businesses from domestic telecommunications operators. During the year, the Group strove to improve its gross profit margin through strengthening project management and enhancing the value of its services. In addition, the domestic non-operator market is still in an introductory phase, which would impair its gross profit margin to some extent. However, with the Group's deployment in digital economy, smart society and new infrastructure areas phasing in, the Group expects that the proportion of high-value businesses will gradually increase and the gross profit margin of the domestic non-operator market could stabilize and even improve in the future, thereby driving the Group's overall gross profit margin in the long run eventually. In fact, the domestic non-operator market has already become the largest contributor to the increase in gross profit of the Group.

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SELLING, GENERAL AND ADMINISTRATIVE EXPENSES

In 2020, the selling, general and administrative expenses of the Group were RMB11,826 million, representing an increase of 2.9% as compared to RMB11,494 million in 2019. The selling, general and administrative expenses accounted for 9.6% of our total revenues, representing a decrease of 0.2 percentage point from 2019. Of which, the research and development costs were RMB3,782 million, representing an increase of 15.4% as compared to RMB3,276 million in 2019, and accounted for 3.1% of our total revenues, representing an increase of 0.3 percentage point from 2019. The main reasons for the slowdown of increase in selling, general and administrative expenses in 2020 as compared with that of 2019 (a year-on-year increase of 8.3% was recorded in 2019) were mainly due to the pandemic which hampered our business development and the effective management measures undertaken by the Group to overcome the impact of the pandemic by controlling costs and enhancing efficiency.

FINANCE COSTS

In 2020, the finance costs of the Group were RMB63 million, representing a decrease of 7.8% as compared to RMB69 million in 2019.

INCOME TAX

In 2020, the income tax of the Group was RMB398 million and its effective tax rate was 11.4%, representing a decrease of 1.9 percentage points from 13.3% in 2019. The decrease in the Group's effective tax rate and the difference between such effective tax rate and the statutory tax rate was mainly due to the increased investment in research and development by the Group. In accordance with the relevant national policies, the Group enjoyed more preferential income tax rate treatments as a new and high-technology enterprise and the preferential policy of tax deduction before income tax for research and development expenses. In 2020, 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

In 2020, profit attributable to equity shareholders of the Company was RMB3,081 million, representing an increase of 1.1% over RMB3,049 million in 2019. Profit attributable to equity shareholders of the Company accounted for 2.5% of our total revenues, which slightly decreased as compared to 2019. Basic earnings per share of the Company were RMB0.445 (2019: RMB0.440).

CAPITAL EXPENDITURE

The Group implemented stringent budget management over capital expenditure, and made adjustments according to changes in market condition. In 2020, capital expenditure amounted to RMB3,962 million, representing a considerable increase of 318.6% over RMB946 million in 2019. The capital expenditure in 2020 accounted for 3.2% of the total revenues, representing an increase of 2.4 percentage points over 2019. The considerable increase in capital expenditure was mainly due to the acquisition of a property during the reporting period for the Group's bases for the smart production, operation as well as research and development. Other than the above, 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 RMB1,856 million in 2020, representing a decrease of RMB1,259 million from RMB3,115 million in 2019. Such change was mainly due to the increase of cash used in investing activities during the reporting period. As at the end of 2020, the balance of cash and cash equivalents of the Group amounted to RMB21,008 million, of which 96.1% was denominated in Renminbi.

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The following table sets out our cash flow positions in 2019 and 2020, respectively:

	2020 RMB'000	2019 RMB'000
Net cash generated from operating activities	5,453,485	4,811,651
Net cash used in investing activities	(2,243,695)	(311,316)
Net cash used in financing activities	(1,353,860)	(1,385,133)
Net increase in cash and cash equivalents	1,855,930	3,115,202

In 2020, net cash generated from operating activities of the Group was RMB5,453 million, representing an increase of RMB642 million from RMB4,811 million in 2019. The increase in operating cash flow was mainly due to the fact that the Group persisted in value-driven principle with effective clearing and settlement of accounts receivable while expanding business, and put more efforts on management of accounts payable in the meantime.

In 2020, net cash used in investing activities of the Group was RMB2,243 million, representing an increase of RMB1,932 million from RMB311 million in 2019. The increase was mainly attributable to the acquisition of a property for the Group's bases for the smart production, operation as well as research and development during the reporting period.

In 2020, net cash used in financing activities of the Group was RMB1,354 million, representing a decrease of RMB31 million from RMB1,385 million in 2019.

WORKING CAPITAL

As at the end of 2020, the Group's working capital (i.e. current assets net of current liabilities) was RMB21,034 million, representing a decrease of RMB1,535 million from RMB22,569 million at the end of 2019. The decrease in working capital was mainly due to the acquisition of a property for the Group's bases for the smart production, operation as well as research and development during the reporting period.

ASSETS AND LIABILITIES

The Group continued to maintain its solid financial position. As at the end of 2020, the Group's total assets was RMB94,489 million, representing an increase of RMB6,948 million from RMB87,541 million in 2019. Total liabilities was RMB57,302 million, representing an increase of RMB4,799 million from RMB52,503 million in 2019. The liabilities-to-assets ratio was 60.6%, which was slightly higher than 60.0% at the end of 2019.

INDEBTEDNESS

As at the end of 2020, total indebtedness of the Group was RMB704 million, representing an increase of RMB193 million from RMB511 million as at the end of 2019. Indebtedness of the Group was mainly denominated in US dollar, of which Renminbi loan accounted for 3.3% and US dollar loan accounted for 77.6%; and of which 22.4% was the loans with a fixed interest rate and 77.6% was those with a floating interest rate.

As at the end of 2020, our gearing ratio⁵ was 1.9%, which was slightly higher than 1.5% as at the end of 2019.

⁵ Gearing ratio = total interest-bearing debts at the end of the financial year/(equity attributable to equity shareholders of the Company + interest-bearing debts)

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CONTRACTUAL OBLIGATIONS

The following table sets out our contractual commitments as at 31 December 2020:

	Total	2021	2022	2023	2024	2025 and after
	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000
Short-term debt	704,401	704,401	–	–	–	–
Long-term debt	–	–	–	–	–	–
Lease commitments	655,425	227,466	143,939	102,032	78,412	103,576
Contracted for but not provided capital commitments	41,270	41,270	–	–	–	–
Total of contractual obligations	1,401,096	973,137	143,939	102,032	78,412	103,576

EXCHANGE RATE

Most of the Group's revenues and expenses are denominated in Renminbi. As at the end of 2020, the balance of the Group's cash and cash equivalents in foreign currencies accounted for 3.9% of the balance of its total cash and cash equivalents, of which 2.1% and 0.4% were denominated in US dollars and Hong Kong dollars, respectively.