

CHAIRMAN'S STATEMENT

Dear Shareholders,

During the first half of 2014, in light of the government's initiatives in comprehensively deepening reforms, the Group's development was affected by various impacts brought by the changes in the internal and external operating environments. Among others, the introduction of industrial policies, including the 4G license issuance, was the critical factor affecting the Group's operating performance. During this period, leveraging on its experience, capabilities and resources accumulated throughout the years in the communications industry, the Group proactively responded to uncertainties by continuously implementing its "Customer-Focused and Service-Innovative Strategy" and strongly promoting its second round of innovation and transformation. As a result, the Group maintained its leading position in the domestic telecommunications operator market, drove its business development through the continuing expansion into the domestic non-operator market and overseas market, and achieved overall steady operating performance.

RESULTS PERFORMANCE

During the first half of 2014, the Group strived to overcome the impacts from the slow growth of overall capital expenditure of the domestic telecommunications operators¹ by actively implementing various strategies, including the "Strategy of Maintaining a Leading Position in the Domestic Telecommunications Operator Market", "Strategy of Differentiation and Cooperation in the Domestic Non-operator Market" and "Strategy of Overseas Market-Focused and Four-Step Approach"², and achieved steady operating results. Total revenues amounted to RMB33,743 million, up by 4.3% over the same period last year. Cost of revenues amounted to RMB28,920 million, representing an increase of 5.6% over the same period last year. Due to the slowdown of total revenues growth, the pressure from industry competition and relatively rapid increase in certain costs, gross profit decreased by 3.0% over the same period last year to RMB4,823 million. Gross profit margin was 14.3%, down by 1.1 percentage points over the same period last year. As the Group continued to strengthen its internal management, selling, general and administrative expenses amounted to RMB3,730 million, accounting for 11.1% of total revenues, decreased by 0.6 percentage points over the same period last year. Profit attributable to equity shareholders of the Company was RMB1,238 million, down by 0.4% over the same period last year, while net profit margin was 3.7%. Basic earnings per share amounted to RMB0.179. Due to the cyclical fluctuations of the Group's cash flow, the free cash flow³ for the first half of 2014 amounted to RMB-1,077 million, representing an improvement of RMB928 million over the same period last year, which is attributable to the Group's strengthened working capital management.

BUSINESS DEVELOPMENT

Revenue from the Group's telecommunications infrastructure ("TIS") services for the first half of 2014 amounted to RMB15,453 million, representing an increase of 0.7% over the same period last year and accounting for 45.8% of total revenues. Due to the impact of the slowdown in progress of overall network investment by the domestic telecommunications operators, revenue from TIS services attributable to the three telecommunications operators decreased by 4.1% over the same period last year. Meanwhile, the Group actively expanded into the domestic non-operator market and overseas market, and aggregate revenues from TIS services in these two markets recorded a relatively rapid growth, up by 16.6% over the same period last year.

¹ Telecommunications fixed assets investment for the first half of 2014 was RMB136.11 billion, increased by 5.0% over the same period last year. (Source: Ministry of Industry and Information Technology of the PRC)

² The "Strategy of Overseas Market-Focused and Four-Step Approach" involves sub-contracting projects, turnkey projects, operation outsourcing and equity acquisition.

³ Free cash flow = Profit for the year + Depreciation and amortization – Changes in working capital – Capital expenditure

CHAIRMAN'S STATEMENT (CONTINUED)

The Group endeavored to expand its maintenance business with a view to capture the opportunities arising from the continuously increasing operating expenditure of the domestic telecommunications operators and their demands for outsourcing. Meanwhile, the Group also provided differentiated products and services to domestic non-operator customers in response to the trend of “New Four Modernizations”⁴, and thus the businesses of “business process outsourcing (“BPO”) services” and “applications, content and other (“ACO”) services” became the major growth drivers of the Group’s development. Revenue from BPO services for the first half of 2014 amounted to RMB14,911 million, representing an increase of 6.2% over the same period last year and accounting for 44.2% of total revenues. Among which, the revenue from network maintenance services increased by 20.6%. The revenue from ACO services amounted to RMB3,379 million, increased by 13.1% over the same period last year and accounting for 10.0% of total revenues. Among which, revenue from the core ACO services⁵ amounted to RMB2,635 million, increased by 14.3% over the same period last year, and such growth showed encouraging results from the Group’s efforts to promote innovation and transformation and expand into high-value businesses.

During the first half of 2014, by leveraging on its integrated services advantages, the Group made dedicated efforts to achieve steady development notwithstanding the inconsistent progresses of network investment among the domestic telecommunications operators. Revenue from the domestic telecommunications operator market amounted to RMB20,539 million, representing a growth of 0.6% over the same period last year and accounting for 60.8% of total revenues. Among which, the revenue from China Telecom amounted to RMB12,637 million, representing a decrease of 5.0% over the same period last year and accounting for 37.4% of total revenues. The Group made sufficient preparation for 4G technology and changes of customer demands in advance and continued to enhance the service quality and responsiveness. Aggregate revenues from China Mobile and China Unicom totaled RMB7,902 million, representing a growth of 11.1% and an increase of 1.4 percentage points to 23.4% of total revenues over the same period last year.

During the first half of 2014, aggregate revenues from the Group’s two “New Engines”, namely the domestic non-operator market and overseas market, amounted to RMB13,204 million, representing a growth of 10.5% over the same period last year and accounting for 39.2% of total revenues and more than 90% of total incremental revenues. Among which, revenue from domestic non-operator customers amounted to RMB11,460 million, representing an increase of 11.6% over the same period last year and accounting for 34.0% of total revenues. Focusing on the governmental “Smart City”, solutions and data centre construction for industrial customers, and the demand for informatization services from small and medium enterprises, the Group has achieved a breakthrough in the development of key businesses and large-scale turnkey projects and entered into strategic cooperation agreements with a number of well-known enterprises. The Group’s revenue from overseas market amounted to RMB1,744 million, representing a growth of 3.9% over the same period last year and accounting for 5.2% of total revenues. The Group persistently optimized its overseas business structure by effectively controlling the development of certain businesses with relatively low efficiency and vigorously developing turnkey projects, and the proportion of revenue from turnkey projects to the revenue from overseas market increased to approximately 50%. During this period, the Group adopted a multi-level and multi-dimension marketing strategy and approach, and continued to expand its backlog for overseas turnkey projects. A number of large-scale turnkey projects are expected to be delivered in the second half of the year. During this period, the Group also made good attempts for external cooperation.

CORPORATE GOVERNANCE AND MANAGEMENT

In 2014, the Group was awarded “Best CFO” and “Best Investor Relations” of the Asian Excellence Recognition Awards by *Corporate Governance Asia*, a renowned journal on Corporate Governance in Asia, fully demonstrating the recognition of the Group’s excellent performance in corporate governance and management by the capital market.

⁴ New Four Modernizations refer to new Industrialization, Informatization, Urbanization, and Agricultural Modernization with Chinese characteristics.

⁵ Core ACO services include system integration, software development and system support, and value added service.

CHAIRMAN'S STATEMENT (CONTINUED)

The Group has newly appointed two executive vice presidents who have extensive experience in the telecommunications industry, and has also optimized its internal organization structure so as to better adapt to market changes and future development needs.

CORPORATE SOCIAL RESPONSIBILITY

The Group has always attached great importance to corporate social responsibility. After typhoons in Hainan and certain regions of Guangxi and the earthquake in Ludian, Yunnan, the Group promptly took actions in relief work, such as organizing maintenance of telecommunications network and assisting the operators to ensure uninterrupted telecommunications network. Meanwhile, the Group adhered to its environmental protection philosophy and focused on energy conservation and emission reduction, providing its customers with energy-saving products and services.

PROSPECTS

The Group believes that the development of 4G licensing in China is getting more clarity, and capital expenditure will be further released following the increase in the number of pilot cities of 4G hybrid network in future. While focusing on the development of their core business, the domestic telecommunications operators will continue to outsource their maintenance business, which creates more opportunities for the Group to expand into the domestic telecommunications operator market. The Chinese government has been putting greater efforts to develop strategic emerging industries, strengthen the informatization of manufacturing industries and promote information consumption, which offers the Group with ample opportunities to expand into the markets of domestic non-operator customers and pan-operators⁶. The strong demand in overseas emerging countries for telecommunications construction and the Chinese government's policies of "go abroad" create huge business opportunities for the Group to expand into overseas markets. In addition, China Communications Facilities Services Corporation Limited (the "Tower Company") was established. The Tower Company has indicated to the Company the relevant arrangements of preferential treatment and non-competition, which will offer the Group with new business opportunities and market space.

Looking into the future, the Group will endeavor to overcome adverse influences, and leverage on its deepening reform measures to implement its second round of innovation and transformation, boost internal vitality and encourage innovation, so as to promote its sustainable development. The Group will actively promote the innovation of its business model and operational management model, utilize its financial leverage and operating leverage effectively and realize soft management through Internet-based operation with a view to cut cost and open up more income sources, and ultimately create more value for its customers and shareholders.

Finally, on behalf of the Board, I would also like to welcome Mr. Cheng Hongyan and Mr. Xu Chuguo in joining as new members of the Group's management in July this year. Furthermore, I would like to express my sincere gratitude to shareholders and customers of the Group and all sectors of society for their long-standing care and support to the Group.



Li Ping
Chairman

Beijing, PRC
28 August 2014

⁶ Pan-operators include without limitation to Internet companies and virtual operators.