

Dear Shareholders,

During the first half of 2016, the Group upheld the management philosophy of “innovation and transformation, seeking steady yet progressive growth and efficient development”. Against the backdrop of the macro-economic downturn and the decrease in service charges, the Group endured the unfavourable impact and captured opportunities in the domestic telecommunications operator market whilst persisting in the development of the “Two New Markets”¹, resulting in an accelerated growth in revenue and net profit. The quality of our business development continued to improve as reflected in the continuous optimization in revenue structure of business and customer, decrease in accounts receivable turnover days and remarkable increase in free cash flow. Meanwhile, the Group enhanced corporate vitality through steady promotion of deepened reforms and active innovation of its system and mechanism, thus creating favourable conditions for future development.

OVERALL PERFORMANCE

During the first half of 2016, the Group sustained sound growth momentum in the domestic telecommunications operator market, achieved breakthroughs in the domestic non-operator market and resumed growth in the overseas market. As a result, the Group achieved total revenues of RMB42,176 million, representing a year-on-year growth of 12.3%. The cost of revenues was RMB36,784 million, up by 13.6% compared to that of last year. As a result of the decrease in service charges and increase in labour-related cost, the gross profit was RMB5,392 million, representing a year-on-year increase of 4.2%, while the gross profit margin was 12.8%, representing a year-on-year decrease of 1 percentage point. The Group's continuous control in selling, general and administrative expenses was effective and such expenses were RMB4,137 million, accounting for 9.8% of the total revenues and representing a year-on-year decrease of 0.7 percentage point. Profit attributable to the equity shareholders of the Company was RMB1,386 million, representing a year-on-year growth of 9.1%, with a noticeable increase in the growth rate as compared with the same period last year². The net profit margin was 3.3%, remained at a similar level as compared to the corresponding period last year, and the basic earnings per share amounted to RMB0.200. The Group adhered to the “value-driven” appraisal principle and delivered remarkable results in the management of working capital. As a result, turnover days of accounts receivable were 124 days, achieving a year-on-year decrease of 16 days. Free cash flow³ amounted to RMB2,385 million, representing a significant growth as compared to the corresponding period last year⁴.

1 Two New Markets refer to domestic non-operator market and overseas market.

2 In the first half of 2015, profit attributable to the equity shareholders of the Company recorded a year-on-year growth of 2.7%.

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

4 In the first half of 2015, the Group's free cash flow was RMB151 million.



CHAIRMAN'S STATEMENT (CONTINUED)

DEVELOPMENT QUALITY

During the first half of 2016, the Group's telecommunications infrastructure ("TIS") services was the main driver to the growth of our operating results. Coupled with the healthy growth of both the "core businesses"⁵ of business process outsourcing ("BPO") services and the applications, content and other ("ACO") services, as well as the effective management of the products distribution business⁶, the Group continued to optimize its overall revenue structure.

While capturing the opportunities arising from the 4G construction and capacity expansion of fiber optic broadband of domestic telecommunications operators and the enlarged construction scale of the Tower Company⁷, we also vigorously explored the demand for construction of informatization projects from domestic non-operator customers and overseas customers. Revenue from TIS services amounted to RMB21,687 million, representing a year-on-year growth of 20.3% and accounting for 51.4% of the total revenues. Among that, the revenue of TIS services from domestic telecommunications operators and overseas customers recorded a year-on-year growth of 13.9% and 21.0%, respectively, whereas the revenue of TIS services from domestic non-operator customers achieved a significant growth of 53.2% compared to the previous year.

Revenue from BPO services amounted to RMB16,144 million, representing a year-on-year growth of 0.6% and accounting for 38.3% of the total revenues. Among that, revenue from management of infrastructure for information technology ("Network Maintenance") secured a rapid year-on-year growth of 14.2%. After integration and cultivation, the Group's supply chain business⁸ grew favourably and recorded a year-on-year revenue growth of 23.9%, whereas revenue from products distribution business decreased significantly by 20.2% under the proactive control of the Group.

The Group grasped the demand for informatization construction of our customers, and revenue from ACO services amounted to RMB4,345 million, representing a year-on-year growth of 24.5%, representing a significant increase in the growth rate as compared with the same period last year⁹ and accounting for 10.3% of the total revenues.

CUSTOMER DEVELOPMENT

During the first half of 2016, the Group leveraged on both "CAPEX and OPEX-driven" businesses⁹ as the dual growth drivers to accelerate the development of domestic telecommunications operator market, and recorded a steady increase in our overall market share. Revenue from such market amounted to RMB27,240 million, representing a year-on-year growth of 14.4% and accounting for 64.6% of the total revenues. Among that, revenue from China Telecom was RMB16,435 million, representing a year-on-year growth of 3.7% and accounting for 39.0% of the total revenues. Besides, the Group thoroughly expanded the domestic telecommunications operator market other than China Telecom by strengthening high-end marketing, capturing good opportunities arising from the strategic cooperation between China Telecom and China Unicom and capitalizing on the preferential treatment and non-competition arrangements with the Tower Company. As a result, revenue from domestic telecommunications operator customers other than China Telecom amounted to RMB10,805 million, representing a significant increase of 35.9% as compared with the same period last year, and accounting for 25.6% of the total revenues, an increase of 4.4 percentage points compared to that of last year. Among that, revenue from the Tower Company achieved the fastest year-on-year growth and was the biggest contributor to incremental revenue among the domestic telecommunications operators. Revenue from China Unicom also recorded a significant growth over the same period last year.

5 Core businesses of BPO services include management of infrastructure for information technology, general facilities management and supply chain.

6 Since 2016, the Group sub-divided the former distribution 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.

7 The full name of the Tower Company is China Tower Corporation Limited.

8 In the first half of 2015, revenue from ACO services recorded a year-on-year growth of 3.3%.

9 CAPEX and OPEX refer to the capital expenditure and operating expenditure of domestic telecommunications operators, respectively.

During the first half of 2016, the Group's revenue from the domestic non-operator market was RMB12,784 million, representing a year-on-year increase of 5.0% and accounting for 30.3% of the total revenues. In particular, revenue from TIS services and ACO services recorded a year-on-year increase of 53.2% and 22.6%, respectively, constituting the main revenue growth drivers for the domestic non-operator market. With a focus on key sectors including government, energy, transportation and internet, the Group continued to achieve breakthroughs in construction for data centre, low voltage communication projects and urban communication pipelines relocation, and the internal synergistic development and promotion of the six major group-level products¹⁰ also achieved substantial progress. The Group adhered to its "value-driven" development philosophy and enhanced its risk awareness amid the current economic conditions, and exercised more stringent selection and control on the expansion of products distribution business during the first half of this year. Revenue from such business in the domestic non-operator market recorded a year-on-year decrease of 31.8%.

During the first half of 2016, the overseas business of the Group resumed steady development and realized a revenue of RMB2,152 million, representing a year-on-year increase of 35.9% and accounting for 5.1% of the total revenues, which reversed the downward trend of revenue in the last two years. We closely followed the national "Belt and Road" Initiative and the "10 Major Plans of Sino-African Cooperation", and proactively promoted our "China-Africa Partnership Program in Trans Africa Information Superhighway" Project, which has been identified as a key project of the relevant ministry of the PRC government in 2016. In addition, the Group has entered into a letter of intent for multilateral cooperation with domestic financial institutions, equipment vendors and the governments and operators of African countries for such project. During the first half of this year, the Group has been steadily pushing forward the implementation of turnkey projects such as national fiber cable backbone network project (Phase III) in Tanzania and proactively utilizing financial instruments such as accounts receivable factoring to facilitate the settlement of overseas projects and avoid operational risks.

INNOVATION IN MECHANISM

During the first half of 2016, the Group continued to promote deepened reforms to adjust and optimize the management mechanism for its overseas operations and set up a new operating entity for overseas business. We actively promoted the synergistic operation of supply chain business, officially commenced the operation of China Comservice Supply Chain Management Company Ltd. and created a unified brand of "中通福" for its distribution chain stores. The Group further expanded into the northern China market by commencing the formal operation of Inner Mongolia Autonomous Region Communications Services Company Limited and studying the feasibility of establishing new branches for our northern China business, with a view to strengthening our business development in the northern China market.

¹⁰ Six major group-level products include smart city, smart security, smart industrial park, intelligent building, cloud computing services and e-certification.



CHAIRMAN'S STATEMENT (CONTINUED)

CORPORATE GOVERNANCE

The Group has always maintained high standards of corporate governance practices. During the first half of 2016, I was honored the “Best CEO” Award in the 6th Asian Excellence Recognition Awards 2016 organized by *Corporate Governance Asia*, a famous corporate governance journal in Asia. Ms. Hou Rui, the Chief Financial Officer of the Company, was once again honored the “Best CFO” Award in the same election. According to the “2016 FORTUNE China 500” released by *FORTUNE China*, the Group ranked 71st, moving up seven places as compared to the corresponding period last year.

SOCIAL RESPONSIBILITIES

During the first half of 2016, many places in southern China suffered catastrophic floods resulting from severe convective weather. The Group promptly initiated contingency plans and proactively participated in flood prevention and disaster relief, repairing and restoring more than 10,000 communications facilities as well as fiber optic cables and electric cables of nearly 22,000 km in total. Through research and development efforts, the Group has effectively mastered the key energy saving technology for large-scale data centres in severely cold regions, and successfully applied such technology in information parks operated by domestic telecommunications operators. This not only addressed the technological difficulties of anti-freeze, energy saving and safety in severely cold regions, but also made new contribution to the establishment of a green, energy-saving and environmental-friendly society.

PROSPECTS

Although the Group achieved encouraging operating results during the first half of 2016, we are clearly aware that the Company is still confronted with challenges amid the bumpy recovery in global economy and the “New Normal” of China’s economy. Under such circumstances, the Company must stay vigilant and make innovative breakthroughs for long-term and sustainable development.

By capturing the opportunities arising from various national strategies such as “Cyberpower”, “Broadband China” and “Internet+”, we will focus on the development of both “CAPEX and OPEX-driven” businesses in the domestic telecommunications operator market and pursue revenue growth from businesses driven by OPEX spending of operators. Leveraging on the opportunities arising from strategic cooperation between China Telecom and China Unicom as well as the preferential treatment and non-competition arrangements between the Group and the Tower Company, we will strive to further enlarge our market share and maintain our leading position in the domestic telecommunications operator market. Benefited from the favourable opportunities arising from the vigorous promotion of the national policies of “Supply-side Structural Reform”, “SOE Reform”, “Made in China 2025” and development of information economics, we will focus on the informatization demand from customers in sectors including government, energy, transportation and information security, and continue to expand the Group’s business scale in the domestic non-operator market. We will also continue to promote group-level products such as “Smart City”, “Smart Security”, “Smart Industrial Park” and “Intelligent Building”, and accelerate the development of new products to further enhance our business value. Meanwhile, we will closely monitor the implementation of the “Belt and Road” Initiative and the overseas informatization demand. By leveraging the opportunities arising from our “China-Africa Partnership Program in Trans Africa Information Superhighway” Project, the favourable conditions in our overseas synergistic operation and aiming at breakthrough in “EPC+” projects, we will focus on project implementation, with a view to expanding our business scale in overseas market.

Meanwhile, the Group will vigorously develop cross-sector business according to different characteristics of the three key business segments and the changes in market demand. We will also strengthen business innovation and actively promote innovations in service, product and management, so as to enhance our core competence and provide better support for integrated intelligent information service in the future as well as creating higher returns for shareholders through better quality of development.

Finally, on behalf of the Board, I would like to express my sincere gratitude to Mr. Wang Jun, who resigned as an independent non-executive director of the Company in June 2016, for his outstanding contributions to the Group and express my sincere welcome to Mr. Liu Linfei for joining the Board. I would also like to take this opportunity to express my sincere gratitude to the shareholders and customers of the Group and all sectors of society for their long-standing care and support to the Group.



Sun Kangmin

Chairman

Beijing, PRC
25 August 2016