

# CHAIRMAN'S STATEMENT

Dear Shareholders,

In the first half of 2018, the Group successfully transformed its growth momentum and achieved favourable operating results by adhering to the overall roadmap of “value-driven, seeking steady yet progressive growth and high-quality development”, adapting to the development trend and expanding cooperation in ecosystems. The Group successfully overcame the adverse impacts of the declining investment in telecommunications industry for consecutive years through leveraging both domestic non-telecom operator market and domestic telecommunications operator market as the dual growth drivers, and total revenues of the Group realized double-digit growth, which hit 6-year high. The Group's net profit achieved high single-digit growth, and its free cash flow<sup>1</sup> sustained at a healthy level. Meanwhile, the further control on the products distribution business of lower efficiency and effective market expansion enabled the Group to further optimize its business and customer structures, in which the proportion of the Core Businesses<sup>2</sup> continuously increased and the mix of customer revenue became more balanced, further reduced reliance on a single customer. Focused on seizing development opportunities in China such as Digital Economy, Smart Society and 5G construction, the Group has clearly pinpointed “Smart” services as the main track of development. The Group will accelerate its transformation towards digital services, endeavour to enhance development quality and reinforce new growth momentum, with a view to laying a solid foundation for sustainable, healthy and high-quality development in the long run.

## Operating Performance

During the first half of 2018, the Group endeavoured to expand the domestic non-telecom operator market, solidified the fundamental of the domestic telecommunications operator market and proactively controlled the development of the products distribution business. As a result, the Group realized total revenues of RMB50,792 million, representing a growth of 13.2% year-on-year, in which the Core Businesses revenue increased by 17.1% year-on-year. Cost of revenues amounted to RMB44,616 million, up by 13.9% year-on-year. Gross profit was RMB6,176 million, representing a year-on-year increase of 8.2%. Due to the decreased service prices and increased costs in relation to labour, gross profit margin was 12.2%, representing a 0.5 percentage point decrease year-on-year. With the Group's continued effort on controlling the selling, general and administrative expenses, such expenses amounted to RMB4,661 million and its percentage over the total revenues further decreased by 0.5 percentage point year-on-year to 9.2%. Profit attributable to equity shareholders of the Company grew by 8.6% year-on-year to RMB1,595 million, and the growth rate increased by 2.7 percentage points year-on-year. Net profit margin was 3.1%, decreased by 0.2 percentage point year-on-year. Basic earnings per share amounted to RMB0.230, representing a year-on-year growth of 8.6%. Due to the significant increase in free cash flow last year, free cash flow for the current period dropped from the same period of last year to RMB877 million, but still accounted for over 50% of the profit attributable to equity shareholders, which continued to stand at a healthy level.

<sup>1</sup> Free cash flow = Profit for the year + Depreciation and amortisation – Changes in working capital – Capital expenditure

<sup>2</sup> Core Businesses include telecommunications infrastructure (“TIS”) services, business process outsourcing (“BPO”) services (excluding products distribution), as well as applications, content and other (“ACO”) services.

## Market Expansion

During the first half of 2018, the Group reaped fruitful results in market development by seizing the crucial opportunities in the domestic non-telecom operator market, the domestic telecommunications operator market and the overseas market, and all the three markets showed a stronger development impetus compared to the same period of last year, among which the domestic non-telecom operator market and the domestic telecommunications operator market both realized a double-digit revenue growth, while the revenue from the overseas market stabilized and recovered. During the period, the Group's customer revenue mix continued to optimize. Among that, revenues contribution from both the domestic non-telecom operator market and the domestic telecommunications operators other than China Telecom continued to increase, and the proportion of Core Businesses revenues from these two markets over total Core Businesses revenue reached 30% for the first time, respectively.

The Group's revenue from the domestic non-telecom operator market increased by 19.3% year-on-year to RMB16,396 million, indicating a remarkable acceleration as compared to the same period of last year<sup>3</sup> and accounting for 32.3% of the total revenues. In the meantime, the Group continued to optimize its business structure. Excluding the products distribution business, revenue from the Core Businesses reported a rapid year-on-year increase of 29.0% to RMB14,448 million, accounting for over 88% of the revenue from such market. Internally, the Group carried out synergistic operation in research and development and launched more smart society products. Leveraging the "Capabilities Accumulation, Capabilities Enabling" initiative, the Group enriched integrated service capabilities for industry penetration through strengthening the collaboration among products, markets and businesses. Externally, the Group focused on key sectors such as government, electricity and transportation, endeavoured to broaden the cooperation for a continued "Capabilities Expansion", and strengthen the "Smart Service Industrial Ecosystem Alliance". By promoting its "Consultant + Staff" business model and demonstrating its integrated service capabilities, the Group leveraged its top-level design and high-end consultation to drive project development and achieved favourable results. The series of smart products, including the Smart City, Smart Town, Smart Park, Smart Security and Smart Highway, were successively launched in different regions across the nation, and the Group's branding and competitiveness in the industry have been effectively enhanced.

In the first half of 2018, the Group insisted on the "CAPEX and OPEX-driven"<sup>4</sup> businesses as the dual growth drivers to further penetrate and expand into the domestic telecommunications operator market, and consistently increased market share. Revenue from such market increased by 10.7% year-on-year to RMB32,950 million and accounted for 64.9% of the total revenues. Among that, revenue from China Telecom amounted to RMB18,368 million, representing a year-on-year growth of 0.5%, and accounting for 36.2% of the total revenues. Driven by the rapid revenue growth from domestic telecommunications operator customers other than China Telecom, aggregate revenue from those customers grew by 27.0% year-on-year to RMB14,582 million, with its percentage of the total revenues increased to 28.7%<sup>5</sup>.

In the first half of 2018, the Group further optimized its overseas management structure by promoting the synergistic allocation of resources and enhancing service capabilities as well as risk prevention capabilities. With these efforts, the overseas market stabilized and revenue from such market resumed growth and increased by 4.6% year-on-year to RMB1,446 million, accounting for 2.8% of the total revenues. In tandem with developing traditional overseas telecommunications operator customers, the Group further expanded the overseas market of industrial customers by replicating its successful experience in China, in which key projects made a breakthrough and several large-scale projects in electricity, education and telecommunications, etc. in regions such as the Middle East and Southeast Asia made further progress.

<sup>3</sup> In the first half of 2017, the revenue from domestic non-telecom operator customers increased by 7.5% year-on-year.

<sup>4</sup> CAPEX and OPEX refer to the capital expenditure and operating expenditure of domestic telecommunications operators, respectively.

<sup>5</sup> Based on the revenue from the Core Businesses (excluding the products distribution business), revenue from domestic telecommunications operator customers other than China Telecom accounted for 30.0%.

### Business Development

In the first half of 2018, all three businesses of the Group showed a stronger development impetus compared to the same period of last year. Revenue from TIS services amounted to RMB28,330 million, representing an expedited growth<sup>6</sup> of 17.7% year-on-year, and accounting for 55.8% of the total revenues. For TIS services, the Group continuously improved its delivery quality and service capabilities, and captured the opportunities arising from the optimization of 4G network and the construction of broadband transmission infrastructures by domestic telecommunications operators, supporting them to build intelligent supreme networks with its high-quality integrated services. At the same time, focusing on the flourishing domestic demand for informatization construction, the Group stepped up its efforts in developing the TIS business of domestic non-telecom operator customers through cross-sector operation and penetration among businesses. Of the revenue from TIS services, the revenue from China Telecom recorded a year-on-year decline of 6.9%; the revenue from domestic telecommunications operator customers other than China Telecom had a rapid year-on-year growth of 31.6%; and the revenue from domestic non-telecom operator market grew sharply by 44.2% year-on-year, indicating a remarkable acceleration as compared to the same period of last year<sup>7</sup>. The rapid growth in revenue from TIS services for domestic non-telecom operator customers strongly bolsters the positive development of the business and has become a new impetus for future business growth.

In the first half of 2018, the Group's revenue from BPO services amounted to RMB16,608 million, representing a year-on-year increase of 4.7% and accounting for 32.7% of the total revenues. In pursuit of high-quality development, the Group continued to proactively control the products distribution business, and as a result, revenue from products distribution business decreased by 28.9% year-on-year and its proportion to the total revenues decreased to 5.3%. Excluding the impact of such factor, the Core BPO services<sup>8</sup> grew healthily and realized a revenue of RMB13,894 million, up by 15.3% year-on-year. The Group achieved breakthroughs in the areas of synergistic operation for logistic business, building integrated capabilities for distribution channels, constructing unified platform for property management and uplifting standard of its integrated maintenance capabilities continuously. All the above measures have accelerated the development of the Core BPO services.

In the first half of 2018, the Group's revenue from ACO services amounted to RMB5,854 million, indicating a rapid growth of 18.2% year-on-year and its proportion to the total revenues increased to 11.5%. During the period, the Group increased R&D investment, strengthened the competitiveness of its products including the software and industrial applications, launched a series of smart society products and focused on establishing industrial ecosystems. Leading by its design and consultation businesses as well as capitalizing on its core software products, the Group further promoted the development of other businesses by providing its customers with integrated solutions. The synergistic effect and mutual interaction created between businesses and cross-region operation have become increasingly prominent, allowing the ACO services to effectively drive sound development of both TIS services and BPO services.

<sup>6</sup> In the first half of 2017, the revenue from TIS services increased by 11.0% year-on-year.

<sup>7</sup> In the first half of 2017, the revenue from TIS services for domestic non-telecom operator market increased by 20.3% year-on-year.

<sup>8</sup> Core BPO services include management of infrastructure for information technology (network maintenance), general facilities management and supply chain services.

### Innovation and Transformation

The Group has been persistent in deepened reform in order to speed up its innovation and transformation towards smart and digital services. During the first half of 2018, the Group adopted a science-prioritized and technology-driven approach to promote business integration and consolidate its product capabilities, thus cultivating a series of products for smart society, building the “Big” Smart City IT structure, promoting product-oriented services such as Smart Safety and Smart Town, and initially establishing our cloud services (CCSYUN) and Internet of Things (“IoT”) platforms. In May 2018, the Group formally introduced China Comservice Smart Society Products successfully in the “7th China International Big Data Industry Expo”, which has been well recognized by the community and customers. In June 2018, China Information Technology Industry Federation ranked the Group 6th among “China’s Top 100 Software Enterprises 2018”, showcasing its entry to the software ecosystem and enhanced influence in the industry. Meanwhile, the Group is committed to the main development track of “Building Smart Society, Boosting Digital Economy, Serving a Good Life” for the domestic non-telecom operator market. The Group initiated the “Smart Service Industrial Ecosystem Alliance” through cooperation with the top scientific research institution in China, industrial partners and related technology and innovative enterprises, to consolidate resources along industry chain, accelerate the deployment of its financial segment, explore the integration of finance with industrial development, and jointly build a value-sharing ecosystem with its partners in an open, collaborative and win-win way, with a goal to boost development into a new phase.

### Corporate Governance

The Company’s standardized and effective corporate governance has always been highly recognized by the capital market. In the “8th Asian Excellence Recognition Awards” organized by *Corporate Governance Asia*, a renowned corporate governance journal in Asia, Mr. Si Furong, the Executive Director, President of the Company, and Ms. Hou Rui, the Executive Director, Chief Financial Officer and an Executive Vice President of the Company, were awarded the “Best CEO” and “Best CFO”, respectively. Meanwhile, the Group also won the “Best Investor Relations” Award. In the “Tao Zhu Gong Awards” organized by *EuroFinance* and supported by the Association of International Certified Professional Accountants, the Company was awarded 2018 “Tao Zhu Gong Awards — Best Working Capital Management”. In the “Asia’s Best Managed Companies Poll 2018” organized by *FinanceAsia*, an authoritative financial magazine in Asia-Pacific, the Company was one of the companies in the top 10 list in various award categories for China, including the “Best Managed Company” and the “Most Committed to Corporate Governance”. In 2018, the Company was ranked 81st on the “2018 FORTUNE China 500” released by *FORTUNE China*.

### Social Responsibilities

The Group has always committed to the fulfillment of its corporate social responsibilities and rewarding its customers and the society through practical actions. In poverty alleviation, in order to actively implement the requirements of national policies, the Group carried out poverty alleviation programmes in different locations of Sichuan and Xinjiang. Such initiatives effectively improved the living standard of local people and was well recognized by the society. In combating natural disasters, the Group has always played an active role on the frontline. In 2018, Tropical Storm Ewiniar and Typhoon Maria made landfall over the regions in Guangdong, Jiangsu, Fujian and other places, and continuous and heavy rainfalls occurred in Sichuan, Guizhou and the neighbouring places, which triggered a number of flood disasters. The Group initiated contingency plans at once, organized manpower to commence repair works and more than 5,600 communications facilities were restored in total. In communications support, the Group acted as the communications support unit in the “Boao Forum for Asia Annual Conference 2018”, deploying more than 100 person-time for construction, maintenance and support to conduct testing and optimization on the communications network near the conference venue. A total of 494 kilometres of communications lines were checked and more than 100 potential issues were eliminated. Stable network operation and normal communication signal coverage in key areas were thus ensured, and the Group’s work was highly recognized by the organizer of the conference. Besides, the Group also proactively participated in the communications support work in events such as international marathons held in different regions of China.

### Future Outlook

2018 is a crucial year for the Group's reform and development. New technologies such as IoT and Artificial Intelligence are integrating with traditional economy, and Digital Economy, Smart Society as well as 5G are going to create a vast market space. However, in the wake of situation such as the China-US trade dispute, the international economic environment has been getting more complicated and presented uncertainties to the economic development of China. Besides, under the above new situation, there will be dramatic changes in customer demand, market environment and business model. Facing opportunities and challenges, the Group will plan ahead and remain vigilant. By adhering to its overall roadmap of "value-driven, seeking steady yet progressive growth and high-quality development" and persisting in its "main tracks" of development, the Group will grasp the opportunities arising from the reform, explore new market space for its digital services and accelerate its high-quality development.

The domestic non-telecom operator market is the growth pole for the development of the Group's businesses. We will focus on the main track of "Building Smart Society, Boosting Digital Economy, Serving a Good Life". To achieve this, we will integrate internal and external resources and strengthen our collaboration with industrial partners. On top of continuously solidifying our product-oriented services, we will speed up our development of platform-oriented products, explore ways for constructing platforms and ecosystems and establish a new branding for Smart Comservice. We will continue to focus on key industries such as electricity, transportation and information security, enlarge the industry scale and deepen the industry penetration, so as to provide integrated service solutions to our customers.

The domestic telecommunications operator market remains a fundamental for the Group's business development, and we will focus on the main track of "Bolstering Cyberpower Strategy, Integrating into Ecosystem Construction, Serving Transformation and Upgrade". To achieve this, we will integrate ourselves into operators' ecosystem, keep abreast of the new technologies such as 5G and IoT and equip ourselves with accumulating technologies, resources and capabilities to enhance service quality, and further penetrate into CAPEX business and expand OPEX business. Meanwhile, we will seek to apply the new businesses and new models of the domestic non-telecom operator market to the development of the domestic telecommunications operator market, with a view to enhancing the capabilities to expand into the domestic telecommunications operator market and integrating ourselves into the new ecosystem for the domestic telecommunications operator market.

For the overseas market, we will focus on the main track of "Serving 'Belt and Road' Information Infrastructure Construction, Promoting Smart Society Construction Overseas". To achieve this, we will adapt to the political and environmental changes in domestic and international markets, strengthen the collaboration between our domestic product centres and external business partners, enhance cooperation with domestic operators and "Go Abroad" state-owned enterprises to jointly develop projects. We will leverage on different parties' resources, focus on large-scale projects, and extend our domestic smart products and capabilities overseas, striving to achieve transformation and upgrade of our overseas business.

Although the external macro-environmental changes will bring certain uncertainties to our operating environment, the development of Digital Economy and informatization as well as 5G construction in China are creating favourable opportunities for the future growth of the Group. Besides, in August 2018, the Company has been included by the State-owned Assets Supervision and Administration Commission of the State Council in the list of State-owned Enterprise Reform "Double-hundred Action" which provided good opportunities for further promoting deepened reform. The Group believes that the reform could further enhance its vibrancy and motivation, increase its operating efficiency and risk prevention capability, thereby promoting a healthier, sustainable and high-quality growth. Going forward, the Group will grasp the best window of opportunity for development, and overcome difficulties with its proactive attitude and unremitting efforts. The Group will persist in high-quality operation, foster high-quality features, realize high-quality management and establish high-quality team, with a view to laying solid foundation for the future and rewarding its shareholders and customers with better development and enhanced performance.



## CHAIRMAN'S STATEMENT (Continued)

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Finally, on behalf of the Board, I would like to express my sincere gratitude to our shareholders, customers and all sectors of society for their long-term attention and support. I would also like to deeply thank our employees for their continued dedication and hard work.

**Zhang Zhiyong**

*Chairman*

Beijing, PRC

30 August 2018