

# BUSINESS REVIEW





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In 2009, the Group proactively responded to challenges arising from the macro-economic conditions, increased mobile penetration rate and intensified market competition. The Group continued to maintain a solid customer base and achieved stable growth in voice usage volume. Value-added business has prominently boosted revenue. Meanwhile, the rural market remained a key growth driver, corporate business continued to expand, and 3G business made impressive achievements at the current stage. The Group has maintained stable growth in its operating results, strengthened its overall capabilities, enhanced its competitive advantages, and continued with its innovation endeavors.

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As at the end of 2009, the Group's customer base grew 14.2% to 522.283 million. Total voice usage volume grew 19.6% to 2,918.712 billion minutes. The number of value-added business customers grew to 463.386 million, representing an annual growth rate of 10.4%. SMS usage volume reached 681.225 billion messages, representing an annual growth rate of 12.2%. Revenue from value-added business reached RMB131.434 billion, which represented an annual growth rate of 16.0% and accounted for 29.1% of the operating revenue of the Group, an increase of 1.6 percentage point from the previous year.

## Key Operating Data of the Group

	2009	2008
Customer Base (million) *	522.3	457.3
Net Additional Customers (million)	65.0	87.9
Total Voice Usage Volume (billion minutes)	2,918.7	2,441.3
Average Minutes of Usage per User per Month (MOU) (minutes/user/month)	494	492
Average Revenue per User per Month (ARPU) (RMB/user/month) **	77	83
SMS Usage Volume (billion messages)	681.2	607.1
"Color Ring" Subscription Volume (million times)	1,684	1,350
Handset Internet Access Traffic Volume (billion megabytes)	35.0	13.3
MMS Usage Volume (billion messages)	45.4	33.1

\* The number of 3G customers who used our 3G network services in December 2009 was 3.408 million.

\*\* All monetary figures shown in this Business Review are expressed in Renminbi.

## Customer Growth

In 2009, the Group's customer base continued to be solid. As at the end of 2009, the Group's total customer base reached 522.283 million, and the number of net additional customers for the year was 65.033 million, translating into an average increase in net additional customers of 5.42 million per month. The rural market, which continues to serve as a key growth driver, contributed to nearly half of the customer growth in the year.

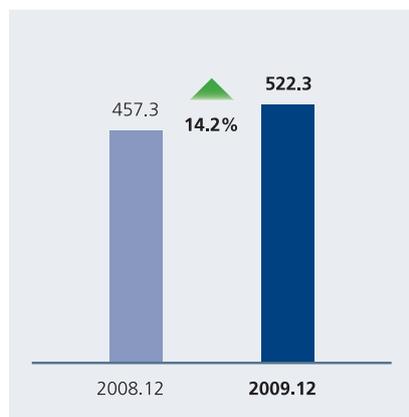
As at the end of 2009, mobile penetration rate in Mainland China reached 56.3%. While there were significant regional differences in their development, some large cities began to show signs of market maturity. The restructuring of the telecommunications industry and the issuance of 3G licenses have changed the competitive landscape and competition has intensified. The global financial crisis has adversely affected the country's economy. As a result, the Group's customer growth decreased in 2009. However, the Group still maintained 60.5% of market share for net customer additions. As at the end of 2009, the Group's total customer market share was approximately 70.6%.

In 2009, the Group continued to pursue the rural market development strategy of "Lower ARPU, Lower MOU, Lower cost". Cost savings were achieved through enhanced efficiency and co-ordinated sales and marketing efforts. The Group has taken full advantage of the State policies of building the new countryside. Through participating in the Home Appliances to the Countryside Scheme, the Group promoted sales of mobile handsets in rural areas, thereby reducing development costs for the rural market and enhancing the Company's influence. The Group further developed and promoted data business products to cater for the personalized needs of the rural customers, so as to increase their loyalty and enhance customer value. The Group continued to develop low-cost distribution channels in rural areas and to promote over-the-air recharging and small denomination recharging services. The Group has first-mover advantage in rural markets. Whilst urbanization in rural areas progresses, the rural telecommunications market presents significant potential and the rural market will continue to be the key growth driver for the Group.

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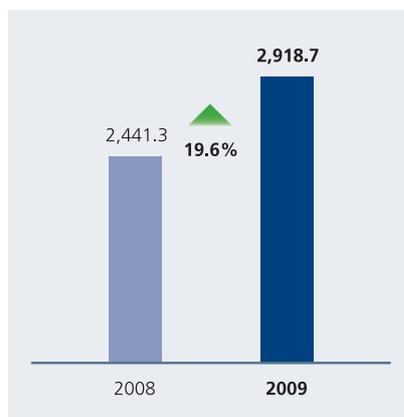
## Customer Base

(million)



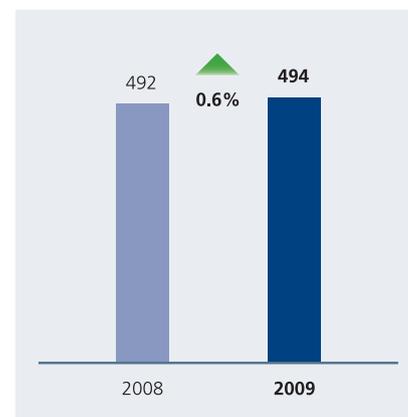
## Total Voice Usage Volume

(billion minutes)



## MOU

(minutes)



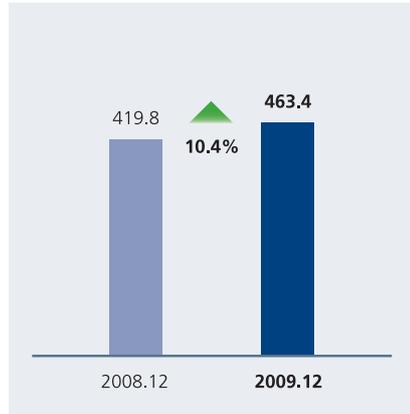
In 2009, the Group saw steady growth in its corporate customer base, which has become an increasingly important contributor to the overall growth of the Group. The Group made significant efforts in retaining and developing corporate customers. The Group has also been promoting broadband connection and content integration, informatization of small-to-medium sized enterprises and urban and rural areas. Sales, product planning, business integration and operation support were enhanced. The Group endeavored to achieve breakthroughs in the application of machine-to-machine (M2M) and Mobile e-Commerce business in the corporate arena. Leveraging on products with market advantages such as M2M, Mobile Mailbox and "All-In-One Card", the Group not only provided new mobile informatization solutions to customers, but also stimulated new market demands. B2B e-Commerce business targeting corporate customers has been officially launched. As at the end of 2009, corporate customer base reached 2.78 million accounts and the number of individual customers served under corporate accounts reached 35.4% of the total customer base. Revenue from corporate informatization exceeded RMB10 billion.

The Group believes that the country's economy is gradually recovering. While the Government continues to undertake effective measures to boost domestic economic growth, income of both urban and rural residents is increasing, urbanization is taking place rapidly and domestic demand is also expanding. All these factors will further stimulate demand for telecommunications and information services. Despite a higher mobile penetration rate compared to that of the past few years, there remains considerable growth potential in Mainland China's mobile telecommunications market. Demand for corporate and industry informatization remains robust. In rural areas, the Group will shift its focus to market penetration and promoting informatization. The rural areas will continue to be a key market for the development of the telecommunications sector and we see significant growth potential in this market. The campus market and migrant population present new development opportunities for the Group. Furthermore, new businesses and new applications continue to emerge, and the penetration of mobile Internet brought new growth opportunities. The accelerated initiation of the "Internet of Things" further enhances opportunities for business growth. These factors provided advantages for the growth of the telecommunications industry and the Group's customer base.

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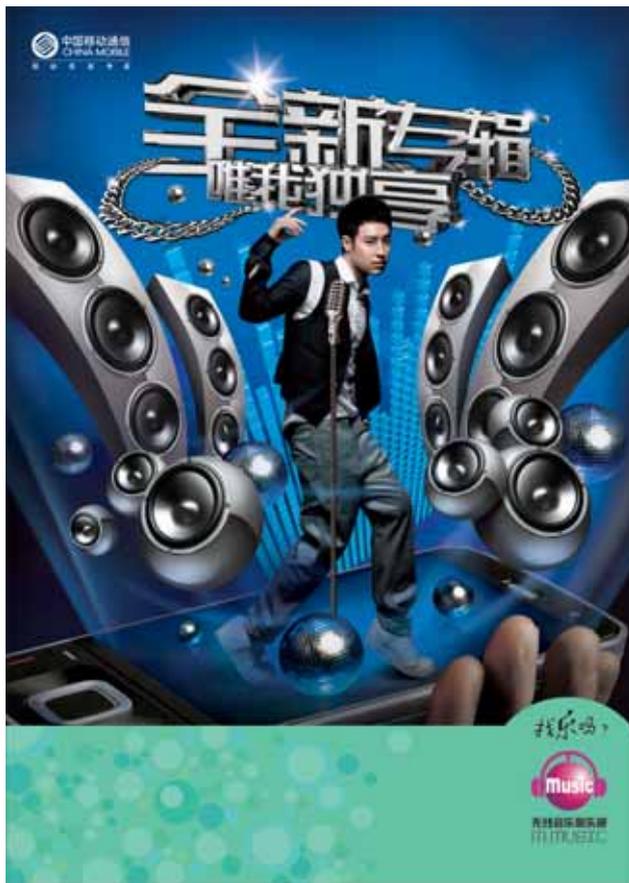
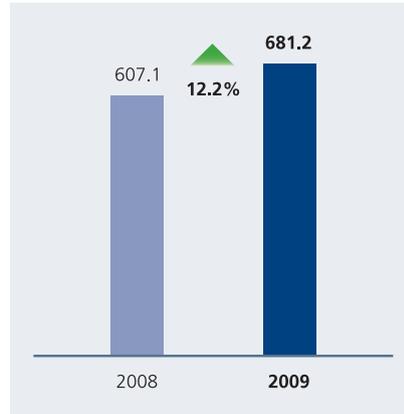
Value-Added Business Users

(million)



SMS Usage Volume

(billion messages)



Business Development

In 2009, despite the negative impact of the external environment, the Group further refined its sales for the voice business and product bundles by taking on differentiated sales strategies and a steady approach to tariff adjustment. These measures have stimulated usage volume. In 2009, the total voice usage volume reached 2,918.712 billion minutes, representing an annual growth rate of 19.6%. Average minutes of usage per user per month (MOU) was 494 minutes, which remained relatively stable compared to 2008. Average revenue per user per month (ARPU) dropped to RMB77.

Value-added business enjoyed favorable growth and has prominently boosted Group revenue, taking up an increasing proportion of the Group's operating revenue. In 2009, revenue from value-added business amounted to RMB131.434 billion, representing an increase of 16.0% from 2008, reaching 29.1% of operating revenue, which is an increase from that of 2008. Mature businesses, such as SMS continued to grow from their current scale. In 2009, revenue from SMS business reached RMB53.557 billion and SMS usage volume was 681.225 billion messages, averaging 1.866 billion messages a day. Non-SMS data business continued to grow rapidly and revenue from Handset

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Internet Access and MMS businesses in 2009 reached RMB18.338 billion and RMB3.306 billion, respectively. Other businesses such as Wireless Music, Mobile Paper, "Fetion", 12580 Integrated Information Service Line and "139 Mailbox" have also grown rapidly. Subscription of "Color Ring" service exceeded 1.684 billion times. The number of senior members of the Wireless Music Club reached 94.80 million and the Group recorded 82 million times of music download. The number of paying customers of Mobile Paper, active customers of "Fetion" and active customers of "139 Mailbox" reached 49.12 million, 62.56 million and 23.75 million, respectively. The number of searches through 12580 Integrated Information Service Line reached 273 million. The Group will continue to tap the growth potential of SMS, Handset Internet Access, "Color Ring" and MMS and increase the revenue contribution of these mature businesses. The Group will further expand the business scale of Wireless Music, Mobile Paper, "Fetion" and 12580 Integrated Information Service Line, as well as refine functions and optimize the products of Mobile Gaming and music download. The Group will realize the nationwide offering of new businesses such as Mobile Wallet, Mobile Reading and Mobile Video. It will push forward the operation of Mobile Market, "139 Community" and Internet Data Center (IDC), and promote the use of corporate email box. The Group will push forward the application and development of the "Internet of Things", using Machine-to-Machine (M2M) business as a key development area in that arena.

In 2009, the Group focused on innovation and expanding the telecommunications sector. It actively explored areas where the mobile telecommunications industry might integrate with other industries, with an aim to creating new demands. The Group also launched Mobile Market, providing customers with an open platform which enables convenient downloads of rich mobile software and applications. The Group launched its proprietary OMS platform, an intelligent mobile terminal software platform. Jointly working with handset vendors, the Group has launched OPhone handsets, and provided an end-to-end mobile Internet user experience. The Group's independently developed Mobile e-Commerce system was already in pre-commercial use.



In 2009, our parent company's wholly owned subsidiary, China TieTong Telecommunications Corporation provided assistance to the Group in areas including joint sales and marketing and corporate market development, achieving favorable progress.

### 3G Development

In 2009, the Group commenced operations of 3G network by leasing wireless network capacity from its parent company and actively pushed forward the development of 3G business. In December 2009, the number of customers who used our 3G network service was 3.408 million. The Group took innovative measures to enable customers to enjoy 3G

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services without changing their mobile numbers, SIM cards or re-registration. It also enhanced the 2G/3G network handover quality by using new mechanism, new standards and new measurements, and facilitated integration of networks, businesses and applications. The Group coordinated with its parent company to complete Phases Two and Three of 3G network construction, with 66,000 new and operational base stations constructed in the year. The total number of 3G base stations in operation exceeded 80,000, covering 238 cities across the country (representing more than 70% of prefecture-level cities nationwide). The Group was committed to enhancing network quality and resolving major technical problems. The 3G network quality was comparable to that of the Group's 2G network, which was of world leading quality. The Group has made impressive achievement in the construction and operation of 3G networks at the current stage.

In 2009, the parent company proactively promoted the development of the industry chain and established a RMB650 million R&D incentive fund to be used for joint research and development of TD-SCDMA terminals and chipsets with manufacturers. This initiative has boosted confidence in the industry chain and encouraged more capable manufacturers to participate. As at the end of 2009, there were 266 models of TD-SCDMA terminals, and the TD-SCDMA terminal industry chain gradually matures.

In 2009, the Group fully leveraged on the new 3G business and products, to target individuals, families, corporations and industry informatization markets. It actively promoted G3 applications through voice, broadband data and value-added businesses. It launched applications such as video calling, video messaging, video conferencing and video-on-demand IVVR services. The Group has also introduced G3 wireless desktop phone and pilot-launched Push To Talk and video surveillance products.



As a home-grown telecommunications technology, the TD-SCDMA business received strong support from the Government. TD-SCDMA networks were included in the Government's procurement program, and the TD-SCDMA technology was applied in the Government and the industry informatization arena. The Group signed strategic cooperation agreements with the local government of 31 provinces, autonomous regions and directly administered municipalities, and received full support from those local governments that prioritize the development of TD-SCDMA on land use, frequency resources and construction of wireless cities. More importantly, in addition to the existing 35 MHz frequency spectrum, TD-SCDMA has received an additional 50 MHz frequency spectrum for indoor coverage, thus further strengthening the competitive advantage of TD-SCDMA in frequency spectrum.

In 2009, the Group continued to partner with organizations within and outside the country on the development of TD-LTE and was committed to creating a harmonious industry with win-win outcome. The TD-LTE technology has been recognized by the International Organization for Standardization (ISO), equipment manufacturers and operators, and was confirmed by the International Telecommunication Union (ITU) as a candidate technology scheme for 4G. Currently, TD-LTE has completed indoor and

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outdoor tests on a small-to-medium scale, and the test performance met the design objectives of the Next Generation Broadband wireless system. Meanwhile, research and development of system and terminal chipsets have entered joint debugging stage and will be launched in stages during 2010. Up till now, a relatively complete industry chain with more than 30 reputable foreign and domestic enterprises was formed for TD-LTE. Global operators in Europe, America and the Asia Pacific region are actively planning for TD-LTE tests and considering the possibility of introducing TD-LTE to their markets. Based on the requirements and planning of the Shanghai 2010 Expo, the Group is fully committed to completing the final phase of construction of the TD-LTE demonstration network for the event. The objective is to serve the Expo with the most advanced technologies, impressive demonstrations and meticulous services.

### Overall Capabilities

As a market leader, the Group enjoys competitive advantage in scale, networks, support systems, branding, channels and services. Its solid financial strength helps weather various risks. Quality of management has been significantly enhanced. Its high quality workforce provides strong execution and innovation capabilities. These strengths form a solid foundation for sustainable growth in the future competitive environment.

The Group has an enormous customer base and networks with more than 460,000 2G base stations. Base station fiber optic access rate reached 96%. Significant economies of scale allow the Group to control marginal costs, explore the rural market, and maintain influence in the value chain. The Group has distinct network advantages, which are demonstrated in its leading 2G network quality, population coverage of 98%, wireless connection rate of 99.22%, voice call drop rate of 0.56% and SMS delivery rate of 99.47%.

Equipped with an advanced and flexible support network, the Group was able to establish differentiated competitive advantages in areas including network management system, business operation support system, customer relationship management system, operation analysis system, innovation management support system and management information system. Through continued brand building, the Group's corporate brand value ranked first amongst the world's telecommunications operators for the fourth consecutive year. Its clear brand structure is generally recognized. Overall customer satisfaction is leading in the market.

As at the end of 2009, the Group had 53,000 proprietary sales outlets. The Group continued to expand its sales and marketing channels and strengthen control. It has increased its efforts in building sales and marketing channels for G3 business and established a marketing and servicing system covering all major channels. The Group also worked on the refined management and operation of its proprietary channels and at the same time, strengthened its management of community sales and marketing channels. It further promoted the application of electronic channels and implemented co-operation amongst all the chained community channels within the network, with an aim of creating a diversified, open, concerted and controlled system of sales and marketing channels and sustaining competitive advantage.

The Group reinforced its centralized management and exercised effective control over investment scale and schedule. Network resource utilization was maintained at a relatively high level. B2B e-Commerce business was officially launched and the scale of centralized procurement was further expanded, resulting in substantial reduction in procurement costs. A higher degree of centralization in financial management has been achieved, enhancing management transparency. Measures for controlling costs, including reduction in non-production related expenditures, were beginning to show effect.

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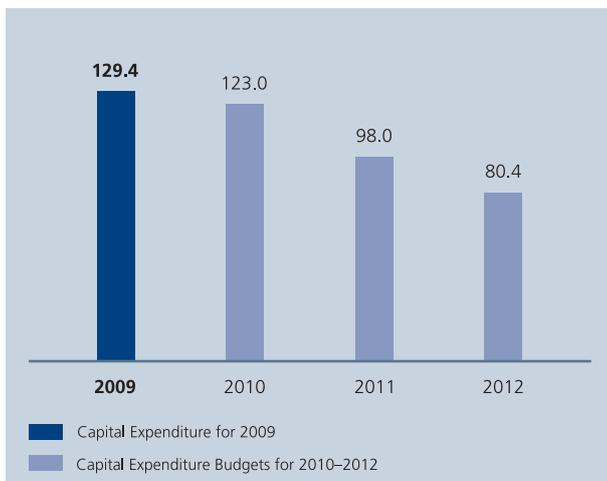
Capital Expenditure

The Group’s capital expenditure for 2009 was approximately RMB129.4 billion, primarily on the construction of mobile communications networks, support systems and transmission facilities and the development of new technologies and new businesses. Such expenditure has allowed the Group to meet the demands of stable growth in customer base and voice usage volume. The capital expenditure has ensured 2G/3G network integration and concerted development, strengthened the Group’s competitiveness in its full service business, supported the rapid development of value-added business and laid a strong foundation for the continued growth of revenue and profits.

Facing a new operating environment, the Group continued to enhance its management over investment returns. The Group endeavors to meet the steadily growing market demand, facilitate the continued development of value-added business, maintain leadership in networks, further promote 2G/3G network integration, and respond to full service competition. Meanwhile, centralization, standardization and informatization continue to drive down investment cost per traffic unit. The capital expenditure budgets of the Group for the years 2010, 2011 and 2012 are set at RMB123.0 billion, RMB98.0 billion and RMB80.4 billion respectively, representing an appropriate decrease from the amounts originally proposed.

Capital Expenditure

(RMB billion)



“Green Action Plan”

The Group continued implementing the “Green Action Plan” on various aspects of its operations and has achieved favorable results in areas including conservation of electricity, land resources, raw materials and cost control. The electricity usage per traffic unit in 2009 dropped by 14% as compared to that in 2008 and 1.8 billion kWh of electricity was conserved. As at the end of 2009, through the implementation of standardized facilities, the Group saved a total floor area of approximately 140,000m<sup>2</sup> on its premises. Approximately 40,000 tones of steel was saved as a result of the adoption of standardized tower design, and more than 6,000 green energy base stations were in our network. The Group’s efforts in promoting environmentally friendly packaging were further strengthened and resulted in the use of green packaging of approximately 46,000 times and conservation of 2,375m<sup>3</sup> of timber. Through the “Green Boxes Environmental Protection Campaign”, more than 5.31 million pieces of disposed mobile handsets and accessories were recycled.

The Group has further strengthened its cooperation with environmentally friendly supply chains and has reduced unnecessary resource consumption in the areas of product design, production technology, parts and components selection and raw material supply. As at the end of 2009, the Group entered into Strategic Cooperation Memorandum of Understanding on “Green Action Plan” with 53 major suppliers around the world, driving the industry in energy conservation and emission reduction. To further improve the energy efficiency of communications equipment, the Group has established an energy conservation grading system for the main communications equipment and auxiliary equipment such as power switches. Through this system, equipment vendors are encouraged to strengthen technology research and development to enhance overall equipment performance.

Energy conservation and emission reduction achieved through the “Green Action Plan” is not only a realization of the social responsibility borne by the Group, it also resulted in substantial cost savings, thereby further enhancing competitiveness of the Group.

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### Outlook

Looking to the future, the Group will proactively respond to difficulties and challenges, further the construction and operation of TD-SCDMA on a larger scale, and seize every opportunity brought about by the rapid development of mobile Internet, the “Internet of Things” and the integration of the three networks. The Group will also continue to strengthen and make full use of its strengths and enhance its competitive edge in the new operating environment. It will promote the centralization, standardization and informatization processes, thereby refining the low-cost, high-efficiency operating model. It will reinforce its development strategy of new customers, new voice usage and new business, actively explore “blue ocean” markets, and cope with the cross convergence and changes in the industry through continuous innovation of technology, products and business model. The Group will accelerate its development of TD-LTE technology to maintain sustainable business development. The Company aims to become an innovative enterprise and secure market leadership on the international stage.