

BUSINESS REVIEW



Business Review

In 2013, facing pressure from rising penetration and intensifying competition as well as challenges on the traditional telecommunications industry posed by Internet businesses, the Group overcame various difficulties. It leveraged the development strategies encompassing Four-Network Coordination, Mobile Internet and full service. Gravitating to the three key drivers, namely operations of existing business, data traffic and corporate customers, the Group endeavored to promote quality, services and innovation. It maintained its market leading position with further enhancement in operational management.

As at the end of 2013, the Group's total customer base reached 767 million, representing a growth of 8.0% from the prior year. Total voice usage was 4.32 trillion minutes in 2013, up 3.0% from the previous year. Data services revenue was RMB206.9 billion, up 24.4% from the previous year, and accounted for 35.0% of revenue from telecommunications services, which represented an increase of 5.3 percentage points from the prior year. Out of data services revenue, wireless data traffic revenue reached RMB108.2 billion, representing an increase of 58.6% from the prior year. 150 million TD-SCDMA handsets were sold, up 180% from the previous year.

Key Operating Data of the Group

	2013	2012
Customer Base (million)	767.2	710.3
Net Additional Customers (million)	56.9	60.7
3G Customer Base (million)	191.6	87.9
Net Additional 3G Customers (million)	103.7	36.7
Total Voice Usage (billion minutes)	4,316.0	4,192.3
Average Minutes of Usage per User per Month (MOU) (minutes/user/month)	486	512
SMS Usage (billion messages)	734.1	744.5
Wireless Data Traffic (billion megabytes)	2,011.8	1,039.2
Average Handset Data Traffic per User per Month (megabytes/user/month)	72	36
Average Revenue per User per Month (ARPU) (RMB/user/month)	67	68
TD-SCDMA handsets sold (million)	150	50

Business Review

Operating Results

Gravitating to the three key drivers of operations – existing business, data traffic and corporate customers, the Group continued to pursue its strategic transformation and achieved positive results.

As at the end of 2013, the Group's total customer base reached 767 million and net additional customers accounted for 56.91 million, continuously maintaining its scale advantage. Overall market share declined as a result of rising penetration and intensifying market competition. 3G customer base increased to 190 million reaching 45.8% of 3G market share. TD-SCDMA handsets sold reached 150 million, of which over 95% were smartphones. Benefiting from the management of existing customers, middle-to-high end customers remained stable in general. Management of corporate customers has improved, with corporate customer base reaching 3.23 million. Individual customers served under corporate accounts took up 30% of the total customer base and the cumulative number of corporate IP-VPN lines reached 1.34 million. Revenue from communications and informationalization services for corporate customers increased by 31%.

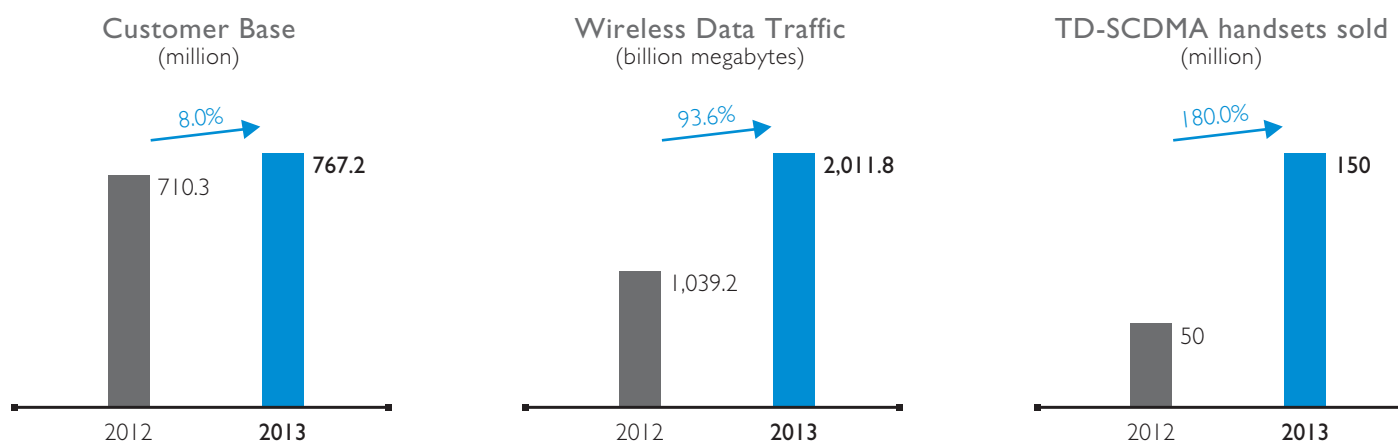
In 2013, voice services revenue declined due to substitution by Internet businesses. The Group actively adopted measures to stabilize the scale of its voice business. Total voice usage was 4.32 trillion minutes, up 3.0% from the prior year. Average minutes of usage per user per month (MOU) was 486 minutes. Voice services revenue was RMB355.7 billion, down 3.4% from the previous year.

The Group's data business maintained rapid development in 2013. Data services revenue was RMB206.9 billion, representing a growth of 24.4% from the previous year and accounting for 35.0% of the revenue from telecommunications services.

Among the data businesses, wireless data traffic continued to enjoy rapid growth. Wireless data traffic hiked 2.01 trillion megabytes, up 93.6% from the previous year. Revenue reached RMB108.2 billion, up 58.6% from the previous year, and uplifted to 18.3% of revenue from telecommunications services. Average handset data traffic per user per month reached 72 megabytes. Data traffic has become the major impetus of revenue growth.

Applications and information services enjoyed steady development. In addition to the rapid growth of corporate customer related services, a number of content businesses including "Migu Music", "and-Reading", "and-Video", "and-Gaming" and "and-Animation" experienced rapid growth.

Due to substitution by Internet businesses, SMS and MMS revenue for 2013 amounted to RMB41.3 billion, down 6.5% compared to the previous year.



Business Review

Quality Enhancement and Service Improvement

The Group has always adhered to its mantra of “Quality is the lifeline of a telecommunications company” and “Customers are our priority, quality service is our principle” and emphasized quality enhancements of its network, business and services.

Regarding networks, the Group continued to strengthen its overall competitive advantage through the development of Four-Network Coordination. 2G network utilization maintained at a reasonable level, while coverage and voice quality continued to secure a leading position in the industry. The number of 3G base stations of the parent company was 450,000 with steady enhancement in network coverage and quality, which continued to strengthen the capability to divert data traffic. WLAN access points reached 4.29 million in number, utilization rate further improved. The structure of traffic carriage continued to optimize, with evident migration from 2G to 3G and WLAN. The Group has officially launched 4G services, and is expecting to complete over 500,000 base stations by the end of 2014, accomplishing contiguous coverage in cities, urban counties and key villages and towns nationwide. In 2013, the Group entered into a long-term cooperation agreement with Apple Inc. to launch the iPhone which supports TD-LTE and TD-SCDMA. The Group published the White Paper on VoLTE, started trials and achieved inter-province/international VoLTE high definition voice connection and commercial handover with the 2G network. The Group endeavors full commercial launch of VoLTE by year end.

To compete in full service, the Group focused on strengthening the planning and deployment of basic network resources. Capabilities spanning optical transmission, coverage of metropolitan pipeline and access of IP-VPN for key corporate customers have been enhanced. The ability to introduce and allocate Internet content and resources was significantly strengthened. On-net traffic uplifted to 91%.

Regarding businesses and services, the Group furthered its quality enhancement initiatives. The bill-processing time for GPRS international roaming was significantly reduced. An across-the-board service assurance system which supports pan-network single-point-of-response has been established. The Group has been re-branded and launched the master commercial brand “and!”. The Group optimized its tariffs and introduced “voice+traffic+data” mix-and-match plans, realizing self-customization by users. “RMB1/2/3 international roaming zone tariffs” were extended to 242 countries and regions while promoting “RMB3/6/9 international roaming data packages”, which significantly enhanced customer perceptions. Regarding 4G business processing, the Group strived to realize “no new number, no re-registration and speedy SIM swap”. The Group adopted integrated sales and marketing, and introduced integrated tariff plans which were built around data traffic and supported multi-device sharing. While promoting mobile marketplace and the establishment of handset sales and service platform, the Group proactively developed third-party electronic channels. The Group also promoted key issue management, realizing centralized handling of Internet complaints, and centralized processing of spam SMS and MMS, indecent information and nuisance calls. The Group achieved the lowest rate of escalated complaints per million customers for four consecutive years in the industry.



Business Review

Redeploy Resources and Enhance Business Innovation

Regarding new business and service areas, the Group endeavored to explore and innovate, and to accelerate the development of centralized management, specialized operations, market-oriented mechanisms, lean organizational structure and process standardization.

Centralized management was furthered, achieving steady development of centralized infrastructure including data centers, call centers and research and development centers. The Group also organized and established service centers for shared procurement which enhanced the extent of centralized procurement and further drove procurement costs down. Phase I of International Information Port started service. The function of Southern Base (Center of Excellence) was further realized. Five regional logistics centers commenced operations. The Group unleashed its scale advantage while reducing costs and enhancing efficiency.

The Group gradually built up capabilities in professional operations. It consolidated partners in the supply chain and achieved breakthrough in the scale of device sales. 150 million TD-SCDMA handsets were sold. Industrialization and commercialization of TD-LTE devices enjoyed smooth development. Handset models continued to enrich with RMB1,000 handsets growing in variety and popularity. 100% of the Group's self-owned outlets sold devices, and sales capability continued to improve. Penetration of nationwide sales franchises was enhanced. Sales capability of social channels was enhanced. Per unit subsidy was further reduced by decoupling contract plans and device subsidies from handset models. Through promoting cooperation of non-custom built devices, the proportion of handset-only sales leapfrogged. International network saw enhanced capability. IDD network directly connected to over 100 operators. Total bandwidth surpassed 1,300 gigabytes, representing a 15-fold increase compared with that of 2010. Adjusting and optimizing tariffs further improved customer perception of international business.

The Group accelerated the development of Mobile Internet and Internet of Things (IOT). It launched NFC based Mobile Wallet. Businesses such as "Migu Music" and "and-Reading" continued to maintain leading positions. The user experience of Fetion, Lingxi and "and-Map", etc. was further enhanced. The Group accelerated the construction of IOT designated network platforms, and launched self-branded IOT devices and various communication modules. The Group explored new business models for Wireless City. It strived to accomplish unified communications featuring New Call, New Messaging and New Contact.

Capital Expenditure

The Group is at a critical juncture of maintaining value of traditional business operations while expediting the transformation of its development. It strives to promote changes, namely "from voice-centric to data-centric operations", "from developing communications business to Mobile Internet business and information consumption" and "from managing mobile communications to managing innovative full service".

To enhance its core capabilities and to adapt to the development pattern under the new industry landscape, the Group scientifically manages its investments, anchoring at assuring the development of Four-Network Coordination, maintaining voice advantage and fulfilling demand for the exponential growth of data traffic. The Group supports the innovation and business development of technologies such as Mobile Internet, IOT and cloud computing. It will strengthen accumulation of infrastructure resources to enhance full service competitiveness. The Group endeavors development for the long-term, and upkeeps a reasonable and necessary scale of investment to enhance its overall competitiveness while safeguarding efficiency and return on investment.

The Group's capital expenditure for 2013 was RMB184.9 billion, mainly expended on the construction of mobile communications networks (40%, of which TD-LTE wireless network accounted for RMB30.3 billion), transmission (37%), business networks (5%), support systems (5%), buildings and infrastructure (9%) and others (4%). Capital expenditure of the Group for 2014 is budgeted at RMB225.2 billion, among which 44% will be expended on the construction of mobile communications networks (of which TD-LTE wireless network will amount to RMB74.9 billion), transmission (28%), business networks (5%), support systems (5%), buildings and infrastructure (12%) and others (6%).

Sustainable and Healthy Development

Mobile Internet has penetrated the various aspects of people's lives. It is in the midst of shaping up a new form of society. Smart devices, wireless broadband and cloud computing have seen rapid and diversified development. The commercialization of 4G, in particular, has started off the new Mobile Internet era. Facing the future, the Group will seize opportunities, adapt to market trends and focus on quality and service. The Group will actively drive operations of existing business, data traffic, corporate customers and new business development. It will actively transform its strategies and align structure, promote entrepreneurship and innovation, striving to create a new future for the enterprise, and achieve sustainable and healthy development.