FINANCIAL REVIEW

Financial Review

In 2013, faced with changes in the complex and intense operating environment, the Group accelerated the strategic transformation, concentrated efforts on the three major drivers of its operations in existing business, data traffic and corporate customer services. Revenue achieved a stable growth. With a view to maintaining sustainable development, the Group implemented the mobile Internet strategy, rationally increased input of resources and focused efforts on building up its core competitiveness, such as network quality and customer services, in order to provide customers with better experience and quality services. The Group also greatly improved its management efficiency and compressed management costs in order to continuously create value for the shareholders.

- Operating revenue was RMB630.2 billion, up by 8.3% compared to the previous year
- Profit attributable to equity shareholders of RMB121.7 billion, down by 5.9% compared to the previous year. Margin of profit attributable to equity shareholders was 19.3%
- EBITDA[1] of RMB240.4 billion, down by 5.2% compared to the previous year. EBITDA margin was 38.2%
- Basic EPS of RMB6.05, down by 5.9% compared to the previous year

[1] *The Company defines EBITDA as profit for the year before taxation, share of loss of a joint venture, share of profit of associates, finance costs, interest income, non-operating net income, depreciation and amortization of other intangible assets.*

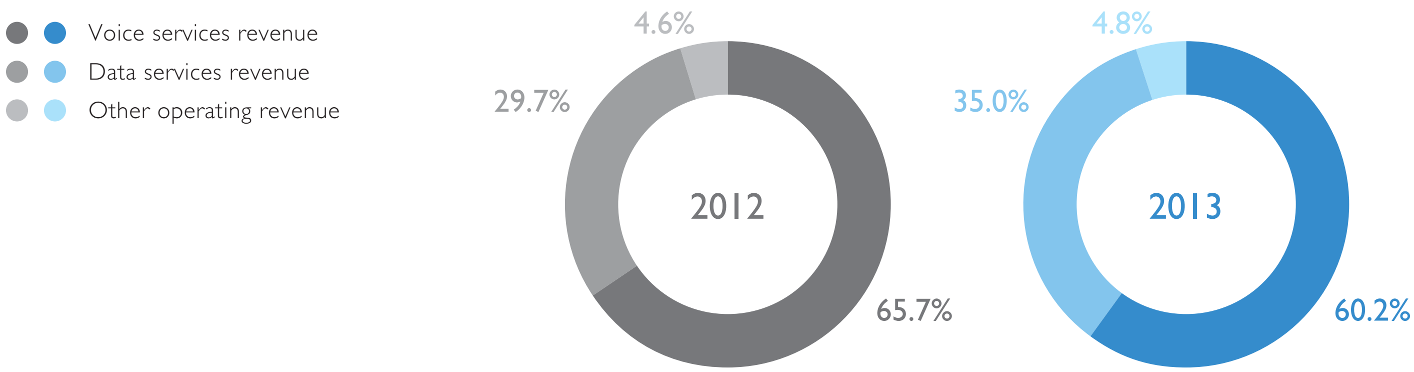
Financial Review

Operating Revenue

In 2013, amid the background of rapid mobile Internet development, the Group actively responded to the challenges arising from the telecommunications industry and other industries and focused its efforts on implementing strategic transformation, achieving favorable retention rates for middle-to-high-end customers, accomplishing important breakthroughs in the data traffic operation and expanding development in the corporate customer business. Apart from achieving a stable revenue growth, the revenue structure was further optimized. The operating revenue of the Group for the year reached RMB630.2 billion, representing an increase of 8.3% compared to the previous year, of which the revenue from telecommunications services was RMB590.8 billion, representing an increase of 5.4% compared to the previous year.

	2013 RMB million	2012 RMB million	Change %
Operating revenue	630,177	581,835	8.3
Revenue from telecommunications services	590,811	560,413	5.4
Voice services	355,686	368,025	(3.4)
Data services	206,886	166,348	24.4
Others	28,239	26,040	8.4
Revenue from sales of products and others	39,366	21,422	83.8

Revenue from Telecommunications Services Composition



Voice Services Revenue

The voice services revenue in 2013 was RMB355.7 billion, down by 3.4% compared to the previous year. Due to the impact of the substitution effect brought on by mobile Internet, the growth of voice usage experienced a further slowdown with a total voice usage of 4.32 trillion minutes, representing an increase of 3.0% compared to the previous year. In order to alleviate the downward trend of voice services, the Group segmented the customer market and provided more attractive tariff packages in order to effectively promote voice usage and actively maintain the value of voice services and thereby, won valuable time for the Company's transformation to the mobile Internet businesses operation.

Data Services Revenue

In 2013, the data services revenue was RMB206.9 billion, representing an increase of 24.4% compared to the previous year and accounting for 35.0% of the revenue from telecommunications services, which was an increase of 5.3 percentage points compared to the previous year. With a focus on network optimization and upgrading and sales of 3G smart devices, the Group actively promoted data traffic operation and achieved remarkable results. The revenue from wireless data traffic reached RMB108.2 billion, representing an increase of 58.6% compared to the previous year and accounting for 18.3% of the revenue from telecommunications services, and has become a strong driving force of revenue growth. Mobile data traffic was 526.8 billion megabytes, up by a significant 81.8% compared to the previous year. The rapid growth of data traffic effectively mitigated the impact brought by the slowdown of SMS, MMS and other traditional data services. SMS and MMS revenue was RMB41.3 billion, down by 6.5% compared to the previous year. With the accelerated substitution by OTT businesses, the SMS usage decreased for the first time with a decrease of 1.4% compared to the previous year. With the stable growth of the Group's applications and information services, revenue reached RMB57.3 billion, representing an increase of 6.4% compared to the previous year. The growth momentum of the revenue from contents-type services such as "Migu Music", "and-Mobile Reading", "and-Mobile Video", "and-Mobile Gaming" and "and-Mobile Animation" was favorable and the information services for corporate customers also achieved a relatively fast growth.

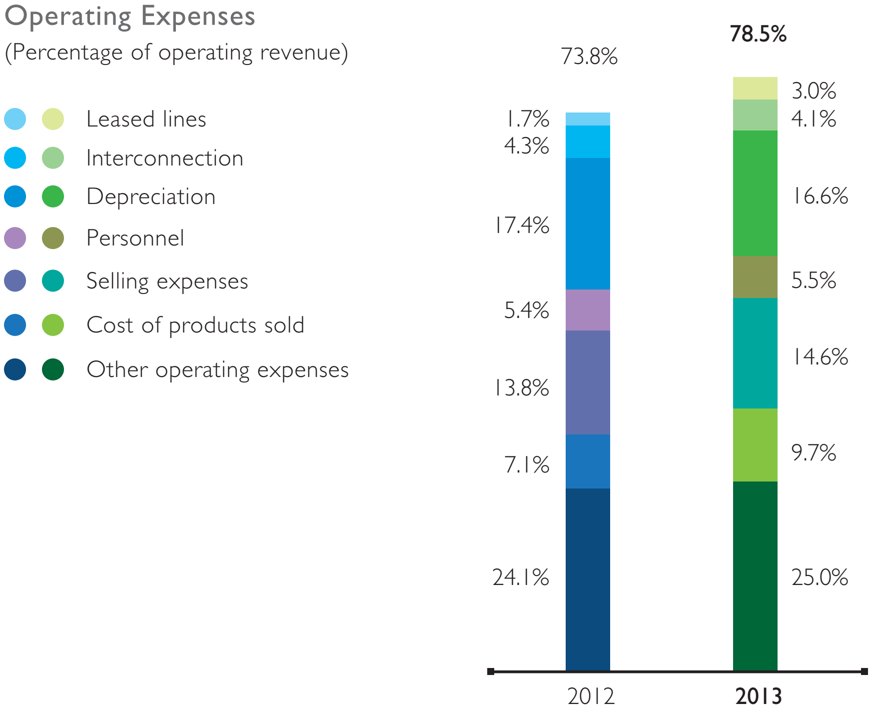
Financial Review

Operating Expenses

As the Group is at the critical stage of the strategic transformation, the demand for input of resources in order to enhance the network capabilities and support the business development is relatively high. In 2013, the Group rationally increased input of resources for network maintenance and optimization, customer services, social channels, research and development and other areas in order to constantly consolidate and improve its core competitiveness. At the same time, the Group made tremendous efforts to promote the diligent and thrifty mantra in its business operations, strived to improve the management efficiency, compressed administrative expenses and promote a low-cost, high efficient operation. The operating expenses increased by 15.2% compared to the previous year to RMB494.5 billion, representing 78.5% of the operating revenue.

	2013 RMB million	2012 RMB million	Change %
Operating Expenses	494,528	429,105	15.2
Leased lines	18,727	9,909	89.0
Interconnection	25,998	25,140	3.4
Depreciation	104,699	100,848	3.8
Personnel	34,376	31,256	10.0
Selling expenses	91,834	80,232	14.5
Cost of products sold	61,363	41,448	48.0
Other operating expenses	157,531	140,272	12.3

Operating Expenses
(Percentage of operating revenue)



Financial Review

Leased Lines

The expenses for leased lines in 2013 were RMB18.7 billion, up by 89.0% compared to the previous year and representing 3.0% of the operating revenue. The expenses for leased lines comprised mainly the leasing fees for TD network capacity, Internet ports and "Village Connect" assets[2] and others. The TD network capacity leasing fees increased as a result of the increase in the TD network utilization rate and the growth of the relevant assets scale, and the leasing fees for Internet ports also increased as a result of the rapid development of data traffic business.

Interconnection

Interconnection expenses in 2013 increased by 3.4% compared to the previous year to RMB26.0 billion, representing 4.1% of the operating revenue. The increase in interconnection expenses was mainly due to the increase in the volume of outbound voice usage to other operators.

Depreciation

Depreciation expenses in 2013 increased by 3.8% compared to the previous year to RMB104.7 billion, representing 16.6% of the operating revenue. As the Company is at a critical stage of network upgrading and business transformation, the relevant scale of capital input is fairly large and depreciation expenses increased correspondingly due to the expansion of the assets scale. The Group has always regarded network quality as its lifeline. Faced with the 4G era and mobile Internet development, the Group is committed to providing customers with quality network services and favorable experience.

Personnel

Personnel expenses for 2013 were RMB34.4 billion, increased by 10.0% compared to the previous year, representing 5.5% of the operating revenue. In order to support the network upgrading and business development and provide customers with better quality and safer information services, the Group recruited more employees. As at 31 December 2013, the Group had a total of 197,030 employees. Personnel expenses increased accordingly with the increase in the number of personnel and the fixed increase in the social insurance expenses.

Selling Expenses

Selling expenses in 2013 increased by 14.5% compared to the previous year to RMB91.8 billion, representing 14.6% of the operating revenue. In order to effectively respond to market competition, strengthen the relationship with existing customers and middle-to-high-end customers and continuously improve customer services and satisfaction, the Group increased the investment in sales channels, customer services and other areas which led to the corresponding increase in the selling expenses.

Cost of Products Sold

Cost of products sold for 2013 were RMB61.4 billion, increased by 48.0% compared to the previous year. The Group made tremendous efforts in increasing the sale of devices, especially the sales of TD smart phones. The long-term development of the TD device supply chain has considerable potential to drive data traffic growth. Cost of products sold increased accordingly with the increase in the sale of devices.

Other Operating Expenses

In 2013, other operating expenses (consisting primarily of network maintenance expenses, operating lease charges, labor service expenses, impairment loss of doubtful accounts, asset write-offs and others) were RMB157.5 billion, up by 12.3% compared to the previous year and representing 25.0% of the operating revenue. Network maintenance and other related expenses increased due to the expanded assets scale. The network maintenance expenses were RMB46.1 billion. The number of labor sourced by third parties reached 311,920 by the end of 2013 and the related labor service expenses were RMB27.6 billion. Endeavoring to reduce costs and improve returns, the Group made tremendous efforts to promote the diligent and thrifty mantra in its business operations and implement stringent control over administrative expenses, leading to a significant decrease in the conference and travelling expenses.

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2 *Since 2013, the Group paid the leasing fees to the parent company for the "Village Connect" assets already constructed before 2013 and undertook the investments on any new "Village Connect" assets after 2013.*

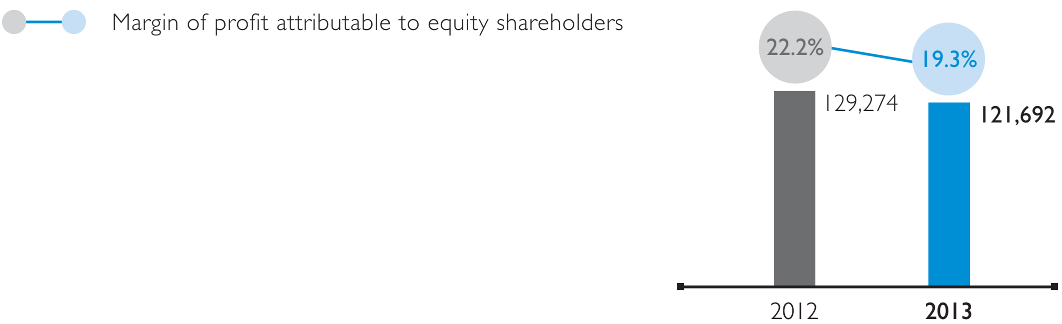
Financial Review

Profitability

The Group continued to lead the industry in terms of profitability. The profit from operations, EBITDA and profit attributable to equity shareholders in 2013 were RMB135.6 billion, RMB240.4 billion and RMB121.7 billion, respectively. The margin of profit attributable to equity shareholders and EBITDA margin were 19.3% and 38.2%, respectively. Basic EPS was RMB6.05. The Group is committed to promoting the strategic transformation and sustainable healthy development and continuously consolidating and improving its core competitiveness in order to provide its customers with quality services and its shareholders with a favorable return.

	2013 RMB million	2012 RMB million	Change %
Profit from operations	**135,649**	152,730	(11.2)
Profit attributable to equity shareholders	**121,692**	129,274	(5.9)
EBITDA	**240,426**	253,646	(5.2)
Basic EPS (RMB)	**6.05**	6.43	(5.9)

Profit Attributable to Equity Shareholders
(RMB million)



EBITDA
(RMB million)

Financial Review

Capital Structure, Fund Management, Cash Flow and Credit Ratings

Capital Structure

The Group's financial position continued to remain at a sound level. As at the end of 2013, the aggregate sum of the Group's long-term and short-term debts was RMB6.4 billion and its total debt to total book capitalization ratio (with total book capitalization representing the sum of total debt and total equity attributable to equity shareholders) was 0.8%. All the borrowings were denominated in RMB (consisting primarily of RMB bonds) and approximately 98.9% of the Group's borrowings were made at fixed interest rates. The Group firmly adhered to its prudent financial risk management policies and maintained sound repayment capabilities. The Group's effective average interest rate of the borrowings was 1.96% and the effective interest coverage multiple was about 434 times.

	As at 31 December 2013 RMB million	As at 31 December 2012 RMB million	Change %
Current assets	467,189	446,593	4.6
Non-current assets	700,203	605,516	15.6
Total assets	1,167,392	1,052,109	11.0
Current liabilities	370,913	297,796	24.6
Non-current liabilities	5,755	29,004	(80.2)
Total liabilities	376,668	326,800	15.3
Non-controlling interests	1,951	1,862	4.8
Total equity attributable to equity shareholders	788,773	723,447	9.0

Financial Review

Fund Management and Cash Flow

The Group consistently upheld prudent financial principles and strict fund management policies and ensured the safety and integrity of its funds through its highly centralized management of investments and financing and strict control over its investments. In order to further strengthen the safe custody of its cash, enhance efficiency of fund usage and reduce the costs of capital, the Group established its financial company, in order to continue to reinforce its centralized fund management function and make appropriate allocations of the overall funds, thereby enhancing the Group's ability to deploy internal funds effectively.

In 2013, the Group continued to maintain sustainable healthy cash flow. The Group's net cash generated from operating activities was RMB225.0 billion and its free cash flow was RMB40.1 billion. As at the end of 2013, the Group's total cash and bank balances were RMB426.7 billion, of which 99.2%, 0.2% and 0.6% were denominated in RMB, U.S. dollars and Hong Kong dollars, respectively. The steady fund management and healthy cash flow further provided a sound foundation for the long-term development of the Group.

	2013 RMB million	2012 RMB million	Change %
Net cash generated from operating activities	224,985	230,709	(2.5)
Free cash flow[3]	40,097	103,306	(61.2)

Credit Ratings

The Group currently has a corporate credit rating of Aa3/Outlook Stable from Moody's Investor Service and AA-/Outlook Stable from Standard & Poor's, which remain at levels equivalent to China's sovereign credit rating respectively. These ratings demonstrated that the Company's sound financial strength, favorable business opportunities and solid financial management have led to high market recognition.

Dividends

In view of the Group's operating results in 2013 and taking into consideration its long-term future development, the Board recommends payment of a final dividend of HK$1.615 per share for the financial year ended 31 December 2013. This is in accordance with the dividend payout ratio of 43% planned for the full financial year of 2013. This, together with the interim dividend of HK$1.696 per share that was paid in 2013, amounts to an aggregate dividend payment of HK$3.311 per share for the full financial year of 2013.

In 2014, taking into consideration various relevant factors, such as the Group's overall financial condition, cash flow generating capability and future sustainable development needs, the Company's planned dividend payout ratio for the full year of 2014 will be 43%.

The Board believes that the Company's industry-leading profitability and healthy cash flow generating capability will be able to provide sufficient support to its future development, while providing shareholders with a favorable return.

Conclusion

In this era of intensified mobile Internet competition, the Group will endeavor to accommodate both short-term market circumstances and long-term development, strengthen its refined management, uphold prudent financial principles, strictly monitor and control financial risks, rationally allocate resources, consolidate and enhance its core competitiveness in the network, services, management, personnel and other areas, maintain its industry-leading position in profitability, a solid capital structure and a healthy cash flow in order to achieve a sustainable healthy development and continuously create value for its shareholders.

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3 *The Company defines free cash flow as net cash generated from operating activities less investments incurred in capital expenditure during the year.*