

FINANCIAL REVIEW

SUMMARY OF THE FINANCIAL RESULTS – ESTABLISHED 4G COMPETITIVE ADVANTAGE

In 2014, the Group firmly seized its first-mover opportunity in 4G services, concentrated and devoted full efforts and breakthrough the routines in order to realize transcending 4G developments and establish the competitive advantage in the industry. Focusing on the three major drivers and based on the three growth curves of voice services, data traffic services and digital services, the Group was committed to promoting data traffic operation, proactively fostered digital services and endeavored to mitigate the significant impacts of various policy factors including the transformation from business tax to value-added tax and the adjustments of interconnection settlement standards on its operating performance. The Group directed resources to areas affecting its core competitiveness, including accelerating 4G development, forging network capacity and optimizing customer services. The Group also proactively promoted the transformation of sales and marketing activities, endeavored to improve its management efficiency, significantly compressed its administrative expenses, comprehensively promoted operations with low cost and high efficiency in order to continuously create value for the shareholders.

- Operating revenue reached RMB641.4 billion, up by 1.8% compared to the previous year
- Profit attributable to equity shareholders was RMB109.3 billion, down by 10.2% compared to the previous year and margin of profit attributable to equity shareholders reached 17.0%
- EBITDA was RMB235.3 billion, down by 2.1% compared to the previous year and EBITDA margin reached 36.7%. EBITDA was 40.4% of revenue from telecommunications services
- Basic EPS was RMB5.38, down by 11.1% compared to the previous year

OPERATING REVENUE – REVENUE FROM DATA TRAFFIC SHOWED ENCOURAGING INCREASE

In 2014, the Group actively leveraged on the trends of rapid development of mobile Internet, focused its efforts on implementing strategic transformation and accelerated 4G development. The operating revenue of the Group for the year reached RMB641.4 billion, representing an increase of 1.8% compared to the previous year, of which the revenue from telecommunications services was RMB581.8 billion, representing a decrease of 1.5% compared to the previous year. Revenue from data traffic services became the primary driver of revenue growth, and the revenue structure was optimized remarkably. The Group proactively deployed the development of new services. With the driving force of digital services as the third growth curve became more apparent, the sustainable development capacity of the Group continued to become stronger as well.

	2014 RMB million	2013 RMB million	Change %
Operating revenue	641,448	630,177	1.8
Revenue from telecommunications services	581,817	590,811	-1.5
Voice services	308,959	355,686	-13.1
Data services	253,088	206,886	22.3
Others	19,770	28,239	-30.0
Revenue from sales of products and others	59,631	39,366	51.5

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Voice Services Revenue

The voice services revenue was RMB309.0 billion, down by 13.1% compared to the previous year. Due to the substitution effect of OTT mobile Internet, voice usage decreased for the first time with a total voice usage of 4.29 trillion minutes, representing a decrease of 0.5% compared to the previous year. The voice services revenue accounted for 53.1% of the revenue from telecommunications services, which represented a decrease of 7.1 percentage points compared to the previous year. The Group consolidated its operations in both traditional services and data traffic services, and maintained the stability of total customer ARPU through reasonable tariff packages and sales and marketing activities.

Data Services Revenue

The data services revenue was RMB253.1 billion, representing an increase of 22.3% compared to the previous year and accounting for 43.5% of the revenue from telecommunications services, which represented an increase of 8.5 percentage points compared to the previous year. Through quickly building up 4G network capacity and proactively promoting sales of 4G terminals, the Group made remarkable achievements in its data traffic operation and the development pace of its 4G services was phenomenal. The revenue from wireless data traffic reached RMB153.9 billion, representing an increase of 42.2% compared to the previous year and accounting for up to 26.4% of the revenue from telecommunications services, and has become a strong driving force of revenue growth. The mobile data traffic reached 1.1329 trillion megabytes, up by a significant 115.1% from the previous year, the growth rate of which increased by 33 percentage points compared to the previous year. The rapid growth of data traffic services effectively mitigated the impact brought by the slowdown of SMS, MMS and other traditional data services. Due to the impacts of substitution by OTT businesses, SMS and MMS revenue was RMB34.8 billion, down by 15.8% compared to the previous year. The SMS usage decreased by 16.7% compared to the previous year. Applications and information services experienced a faster growth, achieving a revenue of RMB64.4 billion, up by 12.3% compared to the previous year and accounting for up to 11.1% of the revenue from telecommunications services. The growth momentum of the revenue from digital services such as “and-Reading”, “and-Video”, “and-Game” and “and-Animation” was favorable and the Group’s informationalization services for corporate customers also achieved a relatively fast growth.

OPERATING EXPENSES – MARKETING AND SALES TRANSFORMATION ACHIEVED SIGNIFICANT RESULTS

In 2014, the Group proactively optimized its allocation of resources, enforced a precise management of costs and directed its resources to areas that are favorable to improve its core competitiveness and to stimulate a long-term sustainable development by strengthening benchmarking management and promoting best practices according to experience. The Group focused on mobilizing existing assets and strictly controlled construction costs and thereby, increased its efficiency of asset costs. The Group continuously optimized its marketing and sales model by appropriately reducing its selling expenses and proactively promoting transformation in sales and marketing, and promoted operation with low costs and high efficiency by continuing to carry out the diligent and thrifty mantra in its business operations and significantly reducing administrative expenses. The operating expenses increased by 6.0% compared to the previous year to RMB524.1 billion, representing 81.7% of the operating revenue.

	2014 RMB million	2013 RMB million	Change %
Operating Expenses	524,114	494,528	6.0
Leased lines	21,083	18,727	12.6
Interconnection	23,389	25,998	-10.0
Depreciation	116,225	104,699	11.0
Personnel	36,830	34,376	7.1
Selling expenses	75,781	91,834	-17.5
Costs of products sold	74,464	61,363	21.3
Other operating expenses	176,342	157,531	11.9

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Leased lines

The expenses for leased lines were RMB21.1 billion, up by 12.6% compared to the previous year and representing 3.3% of the operating revenue. The expenses for leased lines mainly comprised the leasing fees for TD-SCDMA network capacity, Internet ports and “Village Connect” assets. The TD-SCDMA network capacity leasing fees increased as a result of the increase in the TD-SCDMA 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 services.

Interconnection

Interconnection expenses decreased by 10.0% compared to the previous year to RMB23.4 billion, representing 3.7% of the operating revenue. This was mainly due to the decrease in SMS and MMS settlement expenses to other operators as a result of the adjustments of interconnection settlement standards.

Depreciation

Depreciation expenses increased by 11.0% compared to the previous year to RMB116.2 billion, representing 18.1% of the operating revenue. The Group is at a critical stage of building up its 4G network as well as transformation of its development. As the scale of capital expenditure is fairly large in recent years, depreciation expenses increased correspondingly with the expansion of the assets scale. The Group has always regarded network quality as its lifeline. Facing the 4G era and mobile Internet development, the Group is committed to providing customers with quality network services and favorable experience.

Personnel

Personnel expenses were RMB36.8 billion, increased by 7.1% compared to the previous year, representing 5.7% of the operating revenue. Due to the support of 4G network construction, transformation of its development, and adjustment of employment structure with the requirement of relevant laws and regulations, the total number of the Group's personnel increased. As at 31 December 2014, the Group had a total of 241,550 employees. Personnel expenses increased accordingly with the increase in the number of personnel and the rigid increase in social insurance expenses.

Selling Expenses

Selling expenses decreased by 17.5% compared to the previous year to RMB75.8 billion, representing 11.8% of the operating revenue. The Group actively promoted the transformation of marketing and sales model and appropriately reduced the selling expenses, achieving a significant improvement in marketing and sales efficiency. The Group also adjusted and optimized the investment structure of selling expenses and strengthened the retention of existing customers and maintenance of the relationship with middle-to-high-end customers.

Costs of Products Sold

Costs of products sold were RMB74.5 billion, increased by 21.3% compared to the previous year. The Group devoted itself to promote the long-term development of the TD-LTE terminal supply chain and focused on the sales of 4G terminal, which strongly drove the data traffic growth and led to the increase in costs of products sold accordingly.

Other Operating Expenses

Other operating expenses (consisting primarily of network maintenance expenses, operating lease charges, labor service expenses, impairment loss of doubtful accounts and asset written-off) were RMB176.3 billion, up by 11.9% compared to the previous year and representing 27.5% of the operating revenue. Network maintenance and other related expenses increased due to the expanded assets scale. The network maintenance expenses were RMB52.5 billion. The number of labor sourced by third parties reached 237,808 by the end of 2014 and the related labor services expenses were RMB28.3 billion. Endeavoring to reduce cost and improve returns, the Group stringently controlled its administrative expenses, which led to a significant decrease in the conference and travelling expenses continuously.

PROFITABILITY – CONTINUED TO MAINTAIN FAVORABLE PROFITABILITY

The Group was devoted to maintain profitability at a sound level. The EBITDA and profit attributable to equity shareholders in 2014 were RMB235.3 billion and RMB109.3 billion, respectively. The EBITDA margin and the margin of profit attributable to equity shareholders reached 36.7% and 17.0%, respectively. Basic EPS was RMB5.38. 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 to continuously create value for its shareholders.

	2014 RMB million	2013 RMB million	Change %
Profit from operation	117,334	135,649	-13.5
Profit attributable to equity shareholders	109,279	121,692	-10.2
EBITDA	235,259	240,426	-2.1
Basic EPS (RMB)	5.38	6.05	-11.1

CAPITAL STRUCTURE, FUND MANAGEMENT, CASH FLOW AND CREDIT RATINGS – CAPITAL STRUCTURE CONTINUED TO REMAIN AT A SOUND LEVEL

Underpinned by its perennially stable capital structure, prominent financial strength and sustainable healthy cash flow generating capability, the Group has laid a sound foundation for withstanding risk and the achievement of a sustainable healthy development.

Capital Structure

As at the end of 2014, the aggregate sum of the Group's long-term and short-term debt was RMB5.1 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 0.6%. All the borrowings were denominated in RMB (consisting primarily of RMB bonds) and 98.7% 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 4.51% and the effective interest coverage multiple was about 556 times.

	2014 RMB million	2013 RMB million	Change %
Current assets	477,583	467,189	2.2
Non-current assets	818,866	700,203	16.9
Total assets	1,296,449	1,167,392	11.1
Current liabilities	431,876	370,913	16.4
Non-current liabilities	5,930	5,755	3.0
Total liabilities	437,806	376,668	16.2
Non-controlling interests	2,067	1,951	5.9
Total equity attributable to equity shareholders	856,576	788,773	8.6

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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 investing and financing activities and strict control over its investments. Meanwhile, the Group continued to reinforce its centralized fund management function and make appropriate allocations of the overall funds through China Mobile Finance, thereby enhancing the Group's ability to deploy internal funds effectively.

In 2014, the Group continued to have healthy cash generated from operating activities. However, as the Group was in a critical phase of 4G development, the scale of capital expenditure was relatively large and a negative free cash flow was observed. The Group's net cash generated from operating activities was RMB211.0 billion and its free cash flow was RMB-2.5 billion. As at the end of 2014, the Group's total cash and bank balances were RMB428.3 billion, of which 98.6%, 0.2% and 1.2% were denominated in RMB, U.S. dollars and Hong Kong dollars, respectively. The steady fund management and healthy cash flow provided a solid foundation for the long-term development of the Group.

	2014 RMB million	2013 RMB million
Net cash generated from operating activities	211,022	224,985
Free cash flow ¹	(2,486)	40,097

Credit Ratings

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

DIVIDENDS

Based on the Group's operating performance in 2014 and taking into consideration its long-term future development, in accordance with the dividend payout ratio of 43% planned for the full financial year of 2014, the Board recommends payment of a final dividend of HK\$1.380 per share for the financial year ended 31 December 2014. This, together with the interim dividend of HK\$1.540 per share that was paid, amounts to an aggregate dividend payment of HK\$2.920 per share for the full financial year of 2014.

In 2015, taking into consideration various relevant factors, including 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 2015 will be 43%.

The Board believes that the Company's favorable 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 balance short-term performance 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 others, endeavored to maintain its profitability at a sound level and a healthy cash flow in order to achieve a sustainable healthy development and continuously create value for its shareholders.

¹ The Company defines free cash flow as net cash generated from operating activities less capital expenditure incurred during the year.