



Our People – Chen Yu

Business Review

The following table sets out our key operating data in 2004, 2005 and 2006:

	Unit	2004	2005	2006	2006 over 2005 Rate of change
Local wireline access lines in service	Thousand	186,648	210,094	223,045	6.2%
Local voice usage	Million pulses	429,150	449,404	422,562	-6.0%
Domestic long distance usage	Million minutes	81,960	93,817	95,567	1.9%
International, Hong Kong, Macau and Taiwan long distance usage	Million minutes	1,654	1,711	1,601	-6.4%
Broadband subscribers	Thousand	13,839	21,024	28,324	34.7%
2M digital circuit leased	Thousand	169.45	197.42	228.19	15.6%
Volume of inbound local calls	Million minutes	94,747	102,670	124,452	21.2%
Caller ID service subscribers	Thousand	109,031	131,461	145,725	10.9%
SMS usage volume	Million messages	–	17,254	23,277	34.9%
Colour Ring Tone subscribers	Thousand	–	18,162	36,684	102.0%

In 2006, the Company witnessed a stable development of its business with an increased proportion of revenue from its non-voice services business¹, demonstrating the success of its business transformation and the further optimisation of its revenue structure.

In 2006, total operating revenues were RMB175,093 million, an increase of 3.4% from 2005. Excluding the amortisation of upfront connection fees, the Company's operating revenues were RMB170,122 million, representing a 4.7% annual growth. The increase in operating revenues was mainly attributable to the rapid development of broadband services and value-added services ("VAS"), driving up revenue growth by 3.7% and 2.6% respectively. The revenue from non-voice services accounted for 29.0% of operating revenues excluding amortisation of upfront connection fees, an increase of 4.8 percentage points from 2005.

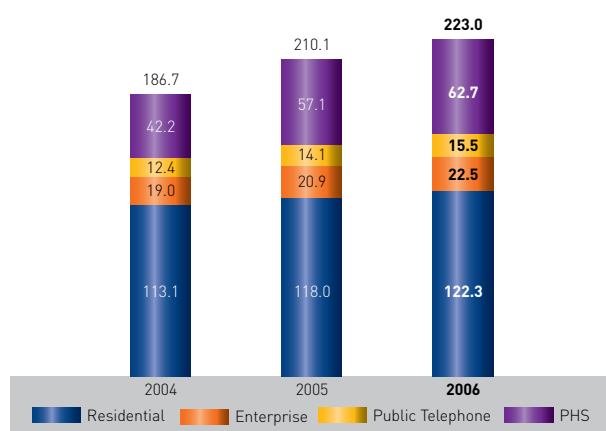
PRODUCTS ANALYSIS

Voice Services

In 2006, revenue from voice services² reached RMB120,826 million, a decrease of 1.9% from 2005, accounting for 71.0% of operating revenues (excluding amortisation of upfront connection fees). Of this, revenue from local telephone services was

Access Lines in Service

(millions)



¹ Revenues from non-voice services include revenues from Internet access services, value-added services, managed data services, leased line service and others.

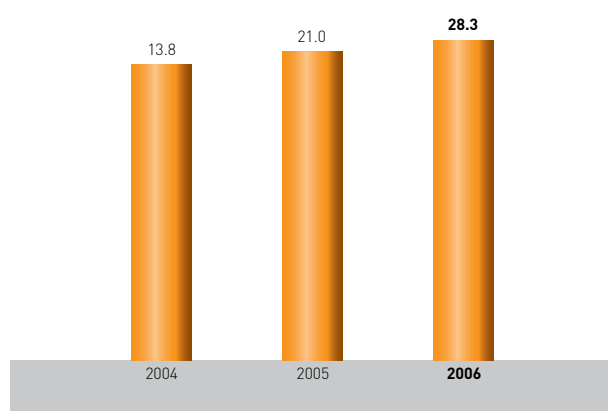
² Revenues from voice services include installation fees, monthly fees, local usage fees, domestic long distance fees, International, Hong Kong, Macau and Taiwan long distance fees, and interconnection service fees.

RMB78,074 million, a decrease of 3.5%. Revenue from domestic long distance services amounted to RMB25,517 million, a decrease of 1.8%. Revenue from international, Hong Kong, Macau and Taiwan long distance telephone services totalled RMB3,140 million, a decrease of 7.8% while revenue from interconnection was RMB14,095 million, an increase of 9.8%.

In 2006, the total number of wireline telephone subscribers reached 223.05 million, a net increase of 12.95 million, of which wireless local access services grew by a net increase of 5.64 million subscribers, a slight decline in net increase from 2005. The Company has focused on the economic value of voice services instead of boosting revenue growth solely by pursuing subscriber base expansion. The Company strictly restricted direct price competition, differentiated regions, customers and services, and launched product packages with precise positioning. In addition, the Company persisted in upholding the principle of effective coverage in order to optimise wireless local access networks, reduce subsidies for wireless local access terminals and enhance efficiency in the utilisation of the cost of sales and marketing.

Broadband Subscribers

(millions)



Best Tone — Voice Search Engine

In anticipation of increasing challenges posed by mobile communications and VOIP, the Company has adopted a number of measures to stabilise its revenue from voice services. Firstly, the Company has proactively utilised its competitive edge through the offering of multi-services and has strengthened the packaging of its voice services with broadband and value-added services. It has also consolidated the integration of ordinary wireline telephone services with its wireless local access services, promoted its cordless PHS services, and its super cordless services, which offer our customers the advantages of integrated terminals and unified numbers respectively. This has allowed the Company to effectively leverage the scale advantage of its ordinary wireline telephone services, telephone number resources and the mobility of its wireless local access services. Additionally, having firmly seized the opportunity arising from the information development of the affluent rural regions, the Company has further developed and profitably expanded its subscriber base in rural areas. In 2006, there was a net addition of 3.46 million subscribers to cordless PHS services and super cordless services³, and a net increase of 4.70 million rural subscribers.

³ Each subscriber of cordless PHS services or super cordless services includes both an ordinary wireline telephone account and a wireless local access account.

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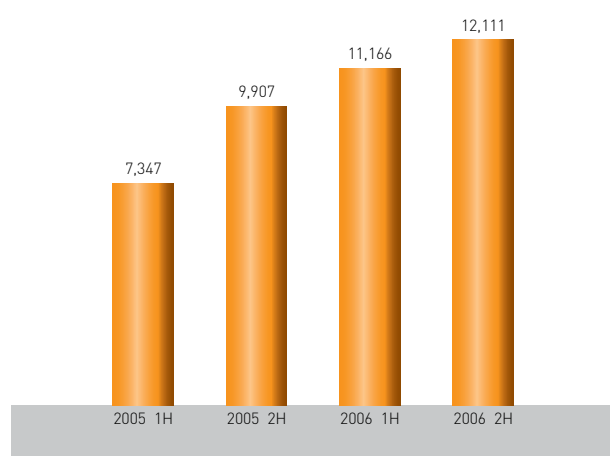
Non-Voice Services

In 2006, revenue from non-voice services totalled RMB49,296 million, an increase of 25.3% from 2005. Of this, the revenue from Internet access services grew 32.3% to RMB23,630 million, accounting for 13.9% of operating revenues (excluding the amortisation of upfront connection fees) and an increase of 2.9 percentage points from 2005. Revenue from VAS increased by 41.7% to RMB14,133 million, accounting for 8.3% of operating revenues (excluding the amortisation of upfront connection fees), a rise of 2.2 percentage points from 2005. The total revenues from managed data services and leased lines services grew 1.5% to RMB7,534 million.

In 2006, the Company continued to expand its broadband subscriber base. Total number of broadband subscribers grew by 7.30 million to 28.32 million, representing an annual growth rate of 34.7%. Meanwhile, the Company continued to promote the differentiation of its broadband products, and speed up network optimisation in order to provide high-end subscribers with broadband products that offer high reliability, richer applications, and better service. In addition, the Company, through further improving the interaction between broadband access, applications

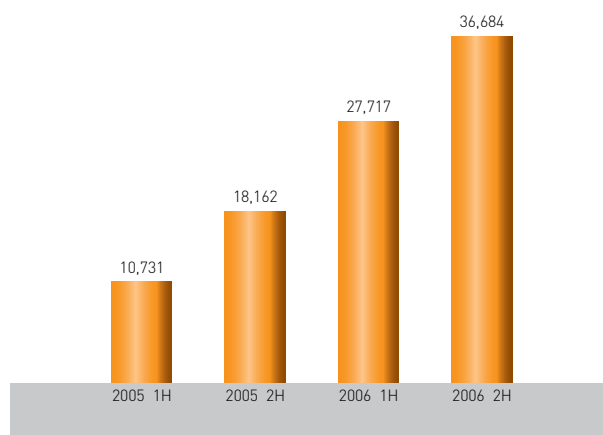
SMS Volume

(millions)



Color Ring Tone Subscribers

(thousands)



and contents, was able to establish a nationwide operation and sharing mechanism of its value-added services such as music, video, software and online game card recharging so as to reinforce the branding strength of "ChinaVNet" services. The Company also promoted the applications for key industries and various market segments, and improved the development, trial and promotion of its new products such as IPTV, Internet on TV, collaborative communication, and music gateway. In 2006, revenue from Internet VAS grew 59.1%.

In 2006, Caller ID, SMS and "Colour Ring Tone", our wireline VAS, maintained rapid growth rates of 19.5%, 29.0% and 150.5% respectively. The Company continued to expand its subscriber base for its wireline VAS businesses, cooperated with different service providers, introduced quality information sources, and promoted functional SMS application products such as "PHS Secretary" and "Account Enquiry". The Company also enabled easier subscription to and tone changes of the "Colour Ring Tone" services, and provided more personalised VAS to subscribers. In 2006, the total number of Caller ID service subscribers was 145.73 million. The number of "Colour Ring Tone" subscribers was 36.68 million, of which, 13.00 million were wireline "Color Ring Tone" subscribers. SMS usage volume reached 23,277 million messages with an annual growth rate of 34.9%.

The Company made great efforts in promoting integrated information services including “Best Tone” and corporate information applications. Through the collection of more daily life information, such as fashion, dining, shopping, accommodation, and transportation, and optimising the functioning of its “Best Tone” platform, the Company aimed to satisfy the demand from general customers for information enquiries and call forwarding. As a result, the Company has gradually established a leading position in voice-searching services. It also has gradually strengthened the value chain for its corporate information services through joint efforts with the providers of equipment, software and customer service so as to provide corporate customers with integrated solutions for information and applications. In 2006, VAS revenue from integrated information and application services⁴ grew 106.4%.

In 2006, revenue from managed data services was RMB3,031 million, an increase of 2.5%. This increase was mainly attributable to the development of the Company’s IT services and applications, the rapid growth of its IP-VPN business and a narrower decline in revenue from its DDN business. Revenue from leased line services grew 0.9% to RMB4,503 million.

BRAND MANAGEMENT

In 2006, the Company solidified its business transformation and implemented its customer brand management strategy. Based on the consumption patterns of the customers of wireline operators, the Company has classified customers into three categories, namely enterprises, households and individuals, hence progressively building up customer-oriented branding; and adopted branding as the pivot for sales plans, the improvement of quality distribution channels, the modification of network systems, the research and development of integrated terminals, as well as the re-allocation of cost and resources.

In 2006, the Company strongly promoted its corporate customer brand — “BizNavigator”. To satisfy the needs of large, medium and small-sized corporate customers for different information and IT solutions, the Company deployed three series of application solutions including a sector version, an information version and a communications version. All versions offered tailor-made industry specific solutions to meet the demands of corporate customers. In addition, our new products, such as “Enterprise Switchboard”, “Enterprise Colour Ring Tone”, and “Mega Eyes”, received wide recognition from various corporate customers, and has effectively stabilised the Company’s business services and invigorated VAS. In 2006, our “BizNavigator” subscribers reached 507,000, gradually creating our brand awareness on the market, helping improve the public image of the Company from a traditional wireline operator to an integrated information services provider.

In early December 2006, the Company launched its household brand — “One Home”. Leveraging on the Company’s unique competitive edge as a wireline operator on its household customers, “One Home” deployed an “e8” package with integrated fixed line telephony and broadband services, and an “e6”



BizNavigator — ICT for small & medium enterprises

⁴ The revenue from integrated information application service of VAS included the revenue from “Best Tone”, corporate information application, and IT service and application.

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One Home – Integrated information services for household customers

package with an integrated fixed line telephony and PHS services. It customised an integrated terminal to provide multi-Internet access for households supplemented with VAS such as Caller ID and “Colour Ring Tone”. Currently, the target market of “One Home” is the top 40% household customers with the most spending on fixed line telephony in different regions. Since its introduction, “One Home” has been well-received. This will help the future stabilisation of fundamental businesses as well as the expansion of integrated information services for households.

The Company will continue to launch the brand for individual consumers in due course.

Continued Network Optimisation, Strong Support for Business Transformation

The Company continued to uphold the principle of effective investment by fully exploring the resource potential of wireline network. Through further reduction of the Company’s capital expenditure and improvement of its control over budgeting, the total amount of capital expenditure has been strictly controlled. In 2006, our capital expenditure was RMB49,085 million or 28.9% of operating revenues (excluding the amortisation of upfront connection fees), indicating a decrease of RMB4,779 million or 4.2 percentage points from 2005. Meanwhile, as a

part of its business transformation, the Company continued to enhance its network construction, consolidation and modification, and sped up the construction of platforms for integrated information services. The Company has completed the upgrade of its wireline network to an intelligent network and has preliminarily formed its softswitch network structure. It has also proactively implemented an IPTV commercial trial, the technical preparation for mobile communication, and the research on the integration of both fixed line services and mobile communication. As a result, the capacity of wireline service innovation has been improved. Driven by the business transformation, the Company’s capital expenditure, except for the investment in maintenance, optimisation and expansion of existing networks, were focused on new businesses. This involved (1) more investment in broadband access layer and the broadband convergence layer to guarantee a rational redundant broadband capacity; (2) more investment in the platforms for VAS and transformation businesses; (3) continued upgrading of its wireline network to an intelligent network, and the improvement of the softswitch network structure. The Company applied dynamic management to the existing network assets in order to facilitate cross-regional asset re-allocation. For example, on the PHS network, where the Company has drastically reduced investment, 89,486 station re-allocations were carried out, accounting for 10.0% of the total number of base stations. As a result, utilisation rate of PHS assets and the quality of services were greatly enhanced.

In order to provide effective support for resolving the problems of illegal access to customers’ accounts and carrying out differentiated sales and service, in particular for laying a good foundation for the promotion of “One Home” in 2007, the Company continued to promote precise identification of its broadband customers and unique labels for them. Meanwhile, CN2 network construction has been completed and it started to carry softswitch relay traffic. The CN2 network has been fully interconnected with local transmission networks, Metropolitan Area Networks, IDC, and Metropolitan Area VPN networks.

By the end of 2006, the Company completed the intelligentisation of its wireline network within its service areas, and introduced new services, such as telephone number portability, "Super Cordless" (one call number for two phones), "Colour Ring Tone" and softswitch broadband services such as instant messages and video communication, etc. To date, there are more than 20 new services offered on the intelligentised wireline network platform. Moreover, the Company continued to replace copper cables with optic fibre cables gradually in order to support high bandwidth services such as IPTV. In 2006, the Company's investment in copper cables decreased by 21.5% from 2005.

Strong Promotion of the Development of IT Support System, Further Improvement of Sales and Marketing

In 2006, the Company continuously improved the development of its IT support systems. We preliminarily achieved the goals of precise customer profiles, and further improved targeted sales and marketing with the help of IT support systems. Of the corporate investment in IT development in 2006, 54.4% was spent on the Business Support System (BSS), 25.0% was on Operation Support System (OSS), 8.2% was on Management Support System (MSS) and 12.4% was on IT infrastructure and other systems. By the end of 2006, the Company completed the deployment of CRM system in 146 local branch companies, which accounted for 64.0% of the total number of local branch companies and covered 71.0% of subscribers in its service areas. Steady progress has been achieved in the development of new billing systems. Integration of billing systems was completed for 185, or 80.8% of local branch companies covering 80.5% of subscribers.

The further enhancement of the Company's IT systems has preliminarily supported customer brand management. Its IT system has been preliminarily transformed from a product-oriented system to a customer-oriented one. By standardising user identification through the establishment of a CRM system, the Company not only realised differentiated sales and services but also increased service efficiency and improved customer satisfaction. At the same time, CRM and the integrated billing systems have provided better support to the statistical work of "BizNavigator", as well as the subscription to, billing and accounting of "One Home".

The continuous improvement of the Company's IT systems has facilitated fundamentally the transformation of the Company from supporting a unitary product to accommodating combination marketing and integrated packages. This improvement basically enabled IT support for integrated services and preliminarily satisfied the demand for retaining existing customers while increasing the Company's customer base, and the demand for market management. The continuous uploading of its two core systems, CRM and the billing system, has facilitated the integration of IT systems, which are scattered over the local branch companies, including the sales and billing systems of individual products such as local telephone, PHS, and broadband service. The two systems effectively supported sales channels and customer service, and offered tremendous contribution to the healthy development of the Company's business.

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2007 BUSINESS OUTLOOK

In 2007, the Company will fully implement its customer brand management strategy to enhance the sales and marketing of its two major customer brands, "BizNavigator" and "One Home".

"BizNavigator" — Targeting at corporate customers, the Company will continue to promote business information applications with emphasis on hotels, commercial buildings, school campuses, conferences and exhibitions, and government administrations. The Company will commit itself to extending the deployment of such information services, increasing sales promotion for the communication and the information versions, whilst further expanding the influential power of its brand and stabilising the revenue from its voice services.

"One Home" — Targeting at household customers, the Company will accelerate the consolidation of its existing services and leverage on the competitive edge of multiple products. Through a customised terminal such as a broadband wireless terminal, the Company will improve customer experience with its integrated services, and will continuously enhance the products and supplementation of its VAS in order to satisfy the ever-increasing demand among household customers for integrated information services.

For the sake of brand management, the Company will optimise its channel services, reinforce the professional sales capability of its direct sales channels to the government and corporate customers, and develop standardised services for the electronic and physical channels between the Company and its public customers. Meanwhile, the Company will also enhance its IT systems so as to improve its overall ability to carry out brand management.

In 2007, the Company will continue to secure stable revenues from voice services, further deploy its integrated products and services, focus on the care of and retention of its existing customers and develop rural markets based on the principle of profitable development. Meanwhile, the Company will also continue to perfect its major businesses such as broadband, VAS and "Best Tone" in order to increase the revenue proportion of its non-voice services while optimising its revenue structure. In addition, the Company will continue to enhance the differentiation of its broadband products, as well as focusing on key industries and market segments in order to develop a broadband customer base on a large scale. Moreover, the Company will continue to promote the business development of Caller ID, SMS and "Colour Ring Tone", and develop "ChinaVNet" into an entertainment gateway for individuals and households. In the future, "Best Tone" will provide a comprehensive package of business travel services, progressively launching ticket booking and room reservations services.

In the face of intensifying market competition, the Company will be steadfast in adhering to its formulated strategy, fully implement its brand management strategy, and strive to maintain its traditional voice business. In addition, the Company will vigorously promote broadband and VAS services, and proactively develop integrated information application services in order to achieve healthy and stable development of the Company.



China Telecom – An Integrated Information Service Provider