

CHINA UNICOM (HONG KONG) Ltd

Form 20-F

April 21, 2016

Table of Contents

**SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

**FORM 20-F**

**.. REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR 12(g) OF THE SECURITIES EXCHANGE ACT OF 1934**

**OR**

**x ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the fiscal year ended December 31, 2015**

**OR**

**.. TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the transition period from \_\_\_\_\_ to \_\_\_\_\_**

**OR**

**.. SHELL COMPANY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**Date of event requiring this shell company report \_\_\_\_\_**

**Commission file number 1-15028**

**CHINA UNICOM (HONG KONG) LIMITED**

**(Exact Name of Registrant as Specified in Its Charter)**

N/A

**Hong Kong**

(Translation of Registrant's Name Into English) (Jurisdiction of Incorporation or Organization)  
75<sup>th</sup> Floor, The Center

**99 Queen's Road Central**

**Hong Kong**

**(Address of Principal Executive Offices)**

**Yung Shun Loy Jacky**

**Telephone: +852 2121 3220**

**Facsimile: +852 2121 3232**

**75<sup>th</sup> Floor, The Center**

**99 Queen s Road Central**

**Hong Kong**

**(Name, Telephone, E-mail and/or Facsimile Number and Address of Company Contact person)**

**Securities registered or to be registered pursuant to Section 12(b) of the Act:**

**Title of Each Class**  
**Ordinary shares**

**Name of Each Exchange On Which Registered**  
**The New York Stock Exchange, Inc.\***

\* Not for trading, but only in connection with the listing on The New York Stock Exchange, Inc. of American depositary shares, or ADSs, each representing 10 ordinary shares.

**Securities registered or to be registered pursuant to Section 12(g) of the Act:**

**None**

**(Title of class)**

**Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act:**

**None**

**(Title of Class)**

Indicate the number of outstanding shares of each of the issuer s classes of capital or common stock as of the close of the period covered by the annual report.

As of December 31, 2015, 23,947,081,083 ordinary shares were issued and outstanding.

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ☒ No ☐

If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934. Yes ☐ No ☒

Note Checking the box above will not relieve any registrant required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 from their obligations under those Sections.

Edgar Filing: CHINA UNICOM (HONG KONG) Ltd - Form 20-F

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ☐ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large Accelerated Filer ☒

Accelerated Filer ☐

Non-Accelerated Filer ☐

Indicate by check mark which basis of accounting the registrant has used to prepare the financial statements included in this filing.

U.S. GAAP ☐ International Financial Reporting Standards as issued ☐ Other ☐

by the International Accounting Standards Board ☒

If ☐ Other has been checked in response to the previous question, indicate by check mark which financial statement item the registrant has elected to follow.

Item 17 ☐ Item 18 ☐

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ☐ No ☒

**Table of Contents**

**TABLE OF CONTENTS**

<u>Note Regarding Forward-Looking Statements</u>	Page ii
<u>Certain Definitions</u>	iii
<b><u>PART I</u></b>	1
<u>Item 1. Identity of Directors, Senior Management and Advisers</u>	1
<u>Item 2. Offer Statistics and Expected Timetable</u>	1
<u>Item 3. Key Information</u>	1
<u>Item 4. Information on the Company</u>	18
<u>Item 4A. Unresolved Staff Comments</u>	47
<u>Item 5. Operating and Financial Review and Prospects</u>	47
<u>Item 6. Directors, Senior Management and Employees</u>	68
<u>Item 7. Major Shareholders and Related Party Transactions</u>	77
<u>Item 8. Financial Information</u>	83
<u>Item 9. The Offer and Listing</u>	83
<u>Item 10. Additional Information</u>	84
<u>Item 11. Quantitative and Qualitative Disclosures about Market Risks</u>	96
<u>Item 12. Description of Securities Other than Equity Securities</u>	99
<b><u>PART II</u></b>	100
<u>Item 13. Defaults, Dividend Arrearages and Delinquencies</u>	100
<u>Item 14. Material Modifications to the Rights of Security Holders and Use of Proceeds</u>	100
<u>Item 15. Controls and Procedures</u>	100
<u>Item 16A. Audit Committee Financial Expert</u>	101
<u>Item 16B. Code of Ethics</u>	101
<u>Item 16C. Principal Accountant Fees and Services</u>	101
<u>Item 16D. Exemptions from the Listing Standards for Audit Committees</u>	102
<u>Item 16E. Purchases of Equity Securities by the Issuer and Affiliated Purchasers</u>	102
<u>Item 16F. Change in Registrant's Certifying Accountant</u>	102
<u>Item 16G. Corporate Governance</u>	102
<u>Item 16H. Mine Safety Disclosure</u>	103
<b><u>PART III</u></b>	103

<u>Item 17. Financial Statements</u>	103
<u>Item 18. Financial Statements</u>	103
<u>Item 19. Exhibits</u>	103

- i -

**Table of Contents**

**Note Regarding Forward-Looking Statements**

This annual report contains certain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Such forward-looking statements may include, without limitation, statements relating to (i) our plans and strategies and our ability to successfully execute these plans and strategies, including those in connection with our mergers and acquisitions and capital expenditures; (ii) our plans for network expansion, including those in connection with the build-out of our mobile services and network infrastructure; (iii) our competitive position, including our ability to upgrade and expand existing networks and increase network efficiency, to improve existing services and offer new services, to develop new technological applications and to leverage our position as an integrated telecommunications operator and expand into new services and markets; (iv) our future business condition, including our future financial results, cash flows, financing plans and dividends; (v) the future growth of market demand of, and opportunities for, our new and existing products and services; and (vi) future regulatory and other developments in the PRC telecommunications industry.

The words anticipate, believe, could, estimate, intend, may, seek, will and similar expressions, as they are intended to identify certain of these forward-looking statements. We do not intend to update any of these forward-looking statements and are under no obligation to do so.

The forward-looking statements contained in this annual report are, by their nature, subject to significant risks and uncertainties. In addition, these forward-looking statements reflect our current views with respect to future events and are not a guarantee of our future performance. Actual results may differ materially from those expressed or implied in the forward-looking statements as a result of a number of factors, including, without limitation:

changes in the regulatory regime and policies for the PRC telecommunications industry, including without limitation, changes in the regulatory policies of the Ministry of Industry and Information Technology, or the MIIT (which has assumed the regulatory functions of the former Ministry of Information Industry), the State-owned Assets Supervision and Administration Commission, or the SASAC, and other relevant government authorities of the PRC;

changes in the PRC telecommunications industry resulting from the issuance of licenses for telecommunications services by the central government of the PRC;

changes in telecommunications and related technologies and applications based on such technologies;

the level of demand for telecommunications services, in particular, the fourth generation mobile telecommunications, or 4G, services;

competitive forces from more liberalized markets and our ability to retain market share in the face of competition from existing telecommunications companies and potential new market entrants;



effects of restructuring and integration (if any) in the PRC telecommunications industry and any cooperation among the PRC telecommunications operators;

the availability, terms and deployment of capital and the impact of regulatory and competitive developments on capital outlays;

changes in the assumptions upon which we have prepared our projected financial information and capital expenditure plans;

costs and benefits from our investment in and arrangements with the Tower Company;

effects of the imposition of and changes in value-added tax, or VAT, relating to the PRC telecommunications business;

- ii -

## **Table of Contents**

results and effects of any investigation by the relevant PRC regulatory authorities overseeing state-owned enterprises and their directors, officers and employees; and

changes in the political, economic, legal, tax and social conditions in China, including the PRC Government's policies and initiatives with respect to foreign exchange policies, foreign investment activities and policies, entry by foreign companies into the Chinese telecommunications market and structural changes in the PRC telecommunications industry.

Please also see D. Risk Factors under Item 3.

## **Certain Definitions**

As used in this annual report, references to we, us, our, the Company, our company and Unicom are to China (Hong Kong) Limited (formerly known as China Unicom Limited). Unless the context otherwise requires, these references include all of our subsidiaries. In respect of any time prior to our incorporation, references to we, us, our and Unicom are to the telecommunications businesses in which our predecessors were engaged and which were subsequently assumed by us. All references to Unicom Group are to China United Network Communications Group Company Limited (formerly known as China United Telecommunications Corporation), our indirect controlling shareholder. Unless the context otherwise requires, these references include all of Unicom Group's subsidiaries, including us and our subsidiaries.

All references to China Netcom are to China Netcom Group Corporation (Hong Kong) Limited, which merged with us in October 2008, and, as the context may require, its subsidiaries. References to Netcom Group mean China Network Communications Group Corporation, which merged with, and was absorbed by, Unicom Group in January 2009 and, as the context may require, its subsidiaries, other than us and our subsidiaries.

As used in this annual report:

references to China or PRC mean the People's Republic of China, excluding, for purposes of this annual report, Hong Kong, Macau and Taiwan, and references to the central government or the PRC Government mean the central government of the PRC;

references to our fixed-line northern service region mean the 10 municipalities, provinces and region where we operate fixed-line services in northern China, consisting of Beijing and Tianjin Municipalities, and Hebei, Henan, Shandong, Liaoning, Heilongjiang, Jilin, and Shanxi Provinces, and the Inner Mongolia Autonomous Region;

references to the 21 provinces in southern China mean Shanghai Municipality, Jiangsu Province, Zhejiang Province, Anhui Province, Fujian Province, Jiangxi Province, Hubei Province, Hunan Province, Guangdong Province, Guangxi Zhuang Autonomous Region, Hainan Province, Chongqing Municipality, Sichuan Province, Guizhou Province, Yunnan Province, Tibet Autonomous Region, Shaanxi Province, Gansu Province, Qinghai Province, Ningxia Hui Autonomous Region and Xinjiang Uygur Autonomous Region; we completed the acquisitions of certain telecommunications business and assets, including the fixed-line business in those 21 provinces in southern China, from Unicom

Group and Netcom Group and/or their respective subsidiaries and branches in January 2009; see A. History and Development of the Company Unicom Acquisitions and Sales Acquisitions of Fixed-Line Business in 21 Provinces in Southern China and Other Assets from Parent Companies and Lease of Telecommunications Networks in 21 Provinces in Southern China under Item 4;

references to Hong Kong Stock Exchange or HKSE mean The Stock Exchange of Hong Kong Limited, and references to NYSE or New York Stock Exchange mean The New York Stock Exchange, Inc; and

- iii -

**Table of Contents**

references to Renminbi or RMB are to the currency of the PRC, references to U.S. dollars or US\$ are to the currency of the United States of America, references to HK dollars or HK\$ are to the currency of the Hong Kong Special Administrative Region of the PRC and references to Euro are to the currency of the eurozone (19 of the 28 member states of the European Union).

- iv -

**Table of Contents**

**PART I**

**Item 1. Identity of Directors, Senior Management and Advisers**

Not Applicable.

**Item 2. Offer Statistics and Expected Timetable**

Not Applicable.

**Item 3. Key Information**

***A. Selected Financial Data***

The following tables present selected historical financial data of our company as of and for the years ended December 31, 2011, 2012, 2013, 2014 and 2015. Except for amounts presented in U.S. dollars, the selected historical consolidated income statement data for the years ended December 31, 2013, 2014 and 2015 and the consolidated statement of financial position data as of December 31, 2014 and 2015 set forth below are derived from, should be read in conjunction with, and are qualified in their entirety by reference to, our audited consolidated financial statements, including the related notes, included elsewhere in this annual report on Form 20-F. The selected historical consolidated income statement data for the years ended December 31, 2011 and 2012 and the consolidated statement of financial position data as of December 31, 2011, 2012 and 2013 set forth below are derived from our audited consolidated financial statements that are not included in this annual report on Form 20-F. Our consolidated financial statements as of and for the years ended December 31, 2011, 2012, 2013, 2014 and 2015 have been prepared and presented in accordance with IFRS. The statistical information set forth in this annual report on Form 20-F relating to China is taken or derived from various publicly available government publications that have not been prepared or independently verified by us. This statistical information may not be consistent with other statistical information from other sources within or outside China.

In October 2015, we, through our wholly own subsidiaries, China United Network Communications Corporation Limited, or CUCL, and Unicom New Horizon Telecommunications Company Limited, or Unicom New Horizon, completed the disposal of certain of our telecommunications towers and related assets to the Tower Company. See **B. Business Overview** The Tower Company under Item 4. As we own 28.1% of the share capital of the Tower Company, we recognized at the completion 71.9% of the gains on such disposal, with the remaining amount of such gain amortized over the remaining useful life of the transferred assets.

In December 2012, we completed the acquisition of the entire equity interest in Unicom New Horizon Telecommunications Company Limited, or Unicom New Horizon, through our wholly owned subsidiary, China United Network Communications Corporation Limited, or CUCL, from Unicom Group, or the 2012 Acquisition. See **A. History and Development of the Company** Unicom Acquisitions and Sales 2012 Acquisition under Item 4. As Unicom New Horizon did not meet the definition of a business under IFRS 3 (Revised) Business Combinations, we accounted for the 2012 Acquisition as an asset purchase transaction in accordance with IAS 16 Property, Plant and Equipment.



**Table of Contents**

	2011	As of or for the year ended December 31,				
	RMB	2012	2013	2014	2015	2015
		RMB	RMB	RMB	RMB	US\$( <sup>1</sup> )
		(in millions, except for per share data)				
Consolidated Income Statement Data:						
Revenue <sup>(2)</sup>						
Mobile services						
Service revenue	103,307	126,036	151,133	155,095	142,620	22,017
Sales of mobile telecommunications products	23,219	38,735	56,393	39,743	41,665	6,432
Total mobile telecommunications revenue	126,526	164,771	207,526	194,838	184,285	28,449
Fixed-line services						
Service revenue <sup>(2)</sup>	81,642	83,213	86,487	88,481	91,261	14,088
Sales of fixed-line telecommunications products	63	64	78	60	106	16
Total fixed-line telecommunications revenue	81,705	83,277	86,565	88,541	91,367	14,104
Unallocated amounts						
Service revenue <sup>(2)</sup>	936	878	947	1,302	1,397	216
Sales of other telecommunications products						
	936	878	947	1,302	1,397	216
Total revenue	209,167	248,926	295,038	284,681	277,049	42,769
Total costs, expenses and others	(203,569)	(239,405)	(281,324)	(268,750)	(263,014)	(40,602)
Income before income tax	5,598	9,521	13,714	15,931	14,035	2,167
Income tax expenses	(1,371)	(2,425)	(3,306)	(3,876)	(3,473)	(536)
Net income	4,227	7,096	10,408	12,055	10,562	1,631
Earnings per share for income attributable to equity shareholders during the year						
-Basic earnings per share <sup>(3)</sup>	0.18	0.30	0.44	0.51	0.44	0.07
-Diluted earnings per share <sup>(3)</sup>	0.18	0.30	0.43	0.49	0.44	0.07
-Basic earnings per ADS <sup>(4)</sup>	1.79	3.01	4.40	5.05	4.41	0.68
-Diluted earnings per ADS <sup>(4)</sup>	1.78	2.96	4.31	4.95	4.41	0.68
	23,564	23,565	23,658	23,852	23,947	23,947

-Number of shares outstanding for basic earnings per share <sup>(3)</sup>						
-Number of shares outstanding for diluted earnings per share <sup>(3)</sup>	23,785	24,664	24,656	24,795	23,947	23,947
-Number of ADS outstanding for basic earnings per ADS <sup>(4)</sup>	2,356	2,357	2,366	2,385	2,395	2,395
-Number of ADS outstanding for diluted earnings per ADS <sup>(4)</sup>	2,379	2,466	2,466	2,480	2,395	2,395

-2-



**Table of Contents**

	As of or for the year ended December 31,					
	2011	2012	2013	2014	2015	2015
	RMB	RMB	RMB	RMB	RMB	US\$( <sup>1</sup> )
	(in millions, except for per share data)					
Consolidated Statement of Financial Position Data:						
Assets						
Cash and cash equivalents and short-term bank deposits	15,410	18,282	21,560	25,364	21,957	3,390
Property, plant and equipment	381,859	430,997	431,625	438,321	454,631	70,183
Inventories and consumables	4,651	5,803	5,536	4,378	3,946	609
Prepayments and other current assets	6,127	9,580	9,664	10,029	10,864	1,677
Financial assets at fair value through other comprehensive income	6,951	5,567	6,497	5,902	4,852	749
Total assets	456,233	516,124	529,171	545,072	610,346	94,221
Liabilities						
Accounts payable and accrued liabilities	95,252	108,486	102,212	120,371	167,396	25,841
Short-term bank loans	32,322	69,175	94,422	91,503	83,852	12,945
Commercial papers	38,000	38,000	35,000	9,979	19,945	3,079
Current portion of long-term bank loans	50	850	48	45	84	13
Current portion of other obligations	2,586	2,642	2,672	2,698	2,797	432
Current portion of corporate bonds		5,000				
Current portion of promissory notes		15,000			2,499	386
Long-term bank loans	1,384	536	481	420	1,748	270
Promissory notes	15,000			21,460	36,928	5,701
Convertible bonds	11,118	11,215	11,002	11,167		
Corporate bonds	7,000	2,000	2,000	2,000	2,000	309
Tax payable	1,232	1,820	2,634	1,466	3,163	488
Total liabilities	250,335	306,619	310,272	317,531	379,130	58,527
Shareholders' equity	205,898	209,505	218,899	227,541	231,216	35,694
Share capital <sup>(5)</sup>	2,311	2,311	2,328	179,101	179,102	27,649

**Table of Contents**

	As of or for the year ended December 31,					
	2011	2012	2013	2014	2015	2015
	RMB	RMB	RMB	RMB	RMB	US\$( <sup>1</sup> )
	(in millions, except for per share data)					
Other Financial Data:						
Net cash inflow from operating activities of continuing operations	66,491	70,620	78,482	88,094	84,301	13,014
Net cash outflow from investing activities of continuing operations	(82,970)	(99,480)	(77,110)	(75,319)	(91,354)	(14,102)
Net cash inflow/(outflow) from financing activities of continuing operations	8,988	32,004	1,926	(8,973)	3,427	528
Net (decrease)/increase in cash and cash equivalents	(7,491)	3,144	3,298	3,802	(3,626)	(560)
Dividend declared per share	0.10	0.12	0.16	0.20	0.17	0.03

- (1) The translation of RMB into U.S. dollars has been made at the rate of RMB6.4778 to US\$1.00, representing the exchange rate as set forth in the H.10 statistical release of the Federal Reserve Board on December 31, 2015. The translations are solely for the convenience of the reader.
- (2) Revenue and service revenue figures for the year ended December 31, 2011 include fixed-line upfront connection fees for basic telephone access services that were eliminated by order of the former Ministry of Information Industry in July 2001. As of December 31, 2011, we made an accumulated appropriation of approximately RMB12,289 million to the statutory reserve in relation to fixed-line upfront connection fees, which were deferred and amortized over the expected customer service period of 10 years. No upfront connection fees will be recognized after December 31, 2011.
- (3) See Note 39 to our consolidated financial statements included elsewhere in this annual report on Form 20-F on how basic and diluted earnings per share are calculated under IFRS.
- (4) Earnings per ADS is calculated by multiplying earnings per share by 10, which is the number of shares represented by each ADS.
- (5) The significant increase in our share capital in 2014 is primarily caused by the conversion of the amounts standing to the credit of the share premium account and the capital redemption reserve into our share capital due to the implementation of the no-par value regime under the Hong Kong Companies Ordinance (Cap. 622), which became effective on March 3, 2014. See Note 19 to our consolidated financial statements included elsewhere in this annual report on Form 20-F.

**Exchange Rate Information**

We publish our consolidated financial statements in Renminbi. Solely for the convenience of the reader, this annual report on Form 20-F contains translations of certain Renminbi and Hong Kong dollar amounts into U.S. dollars at specific rates. The exchange rate refers to the exchange rate as set forth in the H.10 statistical release of the Federal Reserve Board, or the daily exchange rate. Unless otherwise indicated, conversions of Renminbi or Hong Kong dollars into U.S. dollars in this annual report are based on the exchange rate on December 31, 2015 (RMB6.4778 to US\$1.00 and HK\$7.7507 to US\$1.00). These translations should not be construed as representations that the Renminbi or Hong Kong dollar amounts could actually be converted into U.S. dollars at such rates or at all.

The daily exchange rates were RMB6.4810 = US\$1.00 and HK\$7.7562 = US\$1.00, respectively, on April 14, 2016. The following table sets forth the high and low daily exchange rates between Renminbi and U.S. dollars and between

Hong Kong dollars and U.S. dollars for each month during the previous six months:

**Exchange Rate**

	<b>RMB per US\$1.00</b>		<b>HK\$ per US\$1.00</b>	
	<b>High</b>	<b>Low</b>	<b>High</b>	<b>Low</b>
October 2015	6.3591	6.3180	7.7503	7.7495
November 2015	6.3945	6.3180	7.7526	7.7498
December 2015	6.4896	6.3883	7.7527	7.7496
January 2016	6.5932	6.5219	7.8270	7.7505
February 2016	6.5795	6.5154	7.7969	7.7700
March 2016	6.5500	6.4480	7.7745	7.7528
April 2016 (up to April 14, 2016)	6.4810	6.4580	7.7569	7.7537

**Table of Contents**

The following table sets forth the average exchange rates between Renminbi and U.S. dollars and between Hong Kong dollars and U.S. dollars for each of 2011, 2012, 2013, 2014 and 2015, calculated by averaging the daily exchange rate on the last day of each month during the relevant years.

**Average Exchange Rate**

	<b>RMB per US\$1.00</b>	<b>HK\$ per US\$1.00</b>
2011	6.4475	7.7793
2012	6.2990	7.7556
2013	6.1412	7.7565
2014	6.1704	7.7554
2015	6.2869	7.7519

**B. Capitalization and Indebtedness**

Not Applicable.

**C. Reasons for the Offer and Use of Proceeds**

Not Applicable.

**D. Risk Factors****Risks Relating to Our Business**

*We face intense competition from other telecommunications operators, including China Mobile and China Telecom, and other companies that provide telecommunications or related services, which may materially and adversely affect our financial condition, results of operations and growth prospects.*

The telecommunications industry in China has been rapidly evolving. We, along with China Mobile Communications Corporation, or China Mobile, and China Telecommunications Corporation, or China Telecom, are the three full-service telecommunications service providers that operate both fixed-line and mobile telecommunications networks in China. See A. History and Development of the Company Restructurings of the Telecommunications Industry under Item 4. We face intense competition in virtually all aspects of our services, including mobile services, fixed-line voice services, broadband services and data communications services, from China Mobile and China Telecom and expect that this competition will further intensify. In particular, we compete with China Mobile and China Telecom in mobile services. For fixed-line services, we are a leading fixed-line operator in northern China, while China Telecom has a dominant market position in southern China and the MIIT granted to China Mobile the approval for China Mobile to authorize China Mobile Limited to operate the fixed-line telecommunications business in December 2013. In addition, the PRC Government is in the process of introducing new policies that may intensify competition among the three telecommunications operators, such as the policies that would allow mobile subscribers to switch to the networks of another telecommunications operator with their existing numbers in certain areas in China and the removal by the State Council of the MIIT's approval requirement on the tariff standard of telecommunications services.



## **Table of Contents**

We also face increasing competition from other service providers, such as cable television companies and Internet service providers, which compete against our broadband access, voice and messaging services and other services by offering telecommunications or related services. Such competition may further intensify due to recent policies of the PRC Government. For example, the PRC Government is in the process of implementing policies regarding the convergence of television broadcast, telecommunications and Internet access networks, and has introduced a series of policies that encourage non-State-owned companies to enter the PRC telecommunications industry. In May 2013, the MIIT issued the pilot program for mobile telecommunications resale business that permit non-State-owned companies to purchase mobile services from telecommunications operators and provide mobile services to end-customers after repackaging and rebranding. The initial trial period of the pilot program ended on December 31, 2015, but the telecommunications resale business will continue to be governed by the rules of the pilot program before the MIIT issues any further rules. Since December 2013, the MIIT has approved 42 companies to operate such business.

We also face increasing competition from other telecommunications operators for key employees. Competition for these individuals could cause us to offer higher compensation and other benefits in order to attract and retain them, which could result in significant increase in our operating expenses, and we may be unable to attract or retain these personnel.

Intensive competition from China Mobile and China Telecom, as well as other companies that provide telecommunications or related services, could lead to slower subscriber growth, lower usage or traffic volume of our telecommunications services, continued price pressure, higher customer acquisition and retention costs and higher labor costs, which may materially and adversely affect our financial condition, results of operations and growth prospects.

***The successful development of our mobile services is subject to market demand, consumer acceptance, technological challenges, competition on service fees, terminal subsidies and other marketing expenses, and other uncertainties, and expected benefits from investments in our mobile networks.***

Our principal telecommunications services are mobile services, of which 4G services have become a critical part. We commercially launched our 4G services in March 2014 and we will continue to make investments in our 4G networks, expand our network coverage and improve our network quality in the future. We may experience various difficulties in the development of our 4G services and other mobile services, including software, network, handset and other technical issues. We cannot assure you that we will be able to do so in a timely fashion or that we will not encounter other difficulties. Moreover, with respect to our mobile business, in particular our 4G services, we cannot assure you that:

we will be able to gain access to sufficient resources at commercially reasonable terms and conditions for expansion of our mobile networks;

our mobile services will be more popular among potential subscribers than those of our competitors;  
and

our mobile services will generate an acceptable or commercially viable rate of return.

Any failure or delay in expanding and upgrading our mobile networks, any increase in the associated costs (including the costs and expenses that may be incurred as a result of the changes of our marketing and sales policies) could

hinder the recovery of our significant capital investment in mobile services, respectively, which could in turn have a material adverse effect on our financial condition, results of operations and growth prospects. For example, our depreciation and amortization expenses increased by 3.9% from RMB73.87 billion in 2014 to RMB76.74 billion in 2015, primarily due to our continuing expansion and upgrade of our 4G networks, mainly attributable to the expansion of our network coverage as well as our increased investment in network operation and enhanced network support and maintenance. The increase in depreciation and amortization expenses was partially offset by the decrease in the depreciation and amortization relating to the telecommunications towers and related assets we disposed of to the Tower Company in October 2015. Also, our network, operation and support expenses increased by 11.8% from RMB37.85 billion in 2014 to RMB42.31 billion in 2015, primarily due to the usage fees payable to the Tower Company with respect to certain telecommunications towers and related assets, the expansion of networks, facilities and base stations and the increases in other rental expenses and utilities charges. If such expenses continue to increase without corresponding increase in the relevant service revenue, our profitability would be adversely affected.

## **Table of Contents**

***The industry trends of mobile service substitution and mobile service migration from old generations to new generations may continue to have a material adverse effect on our fixed-line local telephone services and old generations mobile services, which may materially and adversely affect our financial condition, results of operations and growth prospects.***

We experienced a continuing decline in the number of fixed-line local telephone subscribers and usage of our fixed-line local telephone services during the past several years due to the trend of mobile service substitution for fixed-line services. Consistent with trends in global markets in recent years, significant traffic from our fixed-line networks has been diverted to mobile networks, including mobile networks of other mobile operators. This trend has resulted in a continuing decline in our revenue derived from our fixed-line local telephone services in recent years.

Similarly, as the technology of mobile services evolves, the trend of mobile services migration from old generations to new generations would generally have an adverse effect on our old generations services, including a growth slowdown or a decrease in the number of subscribers and usage. In particular, our Global System for Mobile Communications, or GSM mobile services, and third generation mobile telecommunications services, or 3G services, have been negatively affected by the trend of migration to 4G services, which resulted in a decrease in our subscribers and revenue from our non-4G mobile services in 2015. Although such trend of migration would increase our 4G services subscribers and revenue, it may not fully offset the adverse effect.

We have been taking various measures to retain our subscribers and their service usage of our fixed-line local telephone services, attract our old generations mobile services subscribers to migrate to our 4G networks, and attract mobile service subscribers from other telecommunications operators to our mobile services network, in particular, the 4G networks. Such measures include improvement of our products and services, acceleration of the construction and coverage of our 4G networks, and promotion of the integrated development of our mobile services and fixed-line services in order to mitigate the adverse impact caused by the above mentioned industry trends. If these efforts are not successful, our financial condition, results of operations and growth prospects could be materially and adversely affected.

***Competition from foreign-invested operators may further increase the competition for employees, exacerbate price competition and increase our operating expenses, thereby adversely affecting our financial condition, results of operations and growth prospects.***

As a result of China's accession to the World Trade Organization, or WTO, in December 2001 and the adoption of the Regulations on the Administration of Foreign-Invested Telecommunications Enterprises in January 2002, which implement China's commitments to the WTO, the PRC Government has agreed to gradually liberalize the various segments and regions of the telecommunications market in China to foreign investors. Currently, foreign investors are permitted to own up to 49% of joint ventures that offer basic telecommunications services without any geographic restrictions in China and up to 50% of joint ventures that offer value-added telecommunications services without any geographic restrictions in China. More foreign-invested operators may enter China's telecommunications market as a result of this liberalization. They may have greater financial, managerial and technical resources and more expertise in network management and sales and marketing than we do.

Increased competition from foreign-invested operators into the PRC telecommunications market may further increase the competition for skilled and experienced employees, exacerbate price competition and increase our customer acquisition costs and other operating expenses, and thereby adversely affect our financial condition, results of operations and growth prospects.





## **Table of Contents**

***Failure to respond to technological and industry developments in a timely and effective manner or failure to continually optimize, expand and upgrade our networks and infrastructure could materially and adversely affect our competitive position and hinder our growth.***

The telecommunications industry in China and elsewhere in the world has been experiencing rapid and significant changes in the diversity and sophistication of the technologies and services offered. Such changes may render our existing services or technologies inadequate or obsolete. We cannot assure you that we will be able to respond to technological and industry developments in a timely and cost-effective manner, or at all. Our inability to respond successfully to technological or industry developments may adversely affect our financial condition, results of operations and growth prospects. Furthermore, if the new technologies adopted by us do not perform as expected, or if we are unable to effectively deliver new services based on these technologies in a commercially viable manner, our revenue growth may decline and our competitive position may be adversely affected.

In addition, the growth of our business depends on whether we are able to continue to optimize the capacity, expand the coverage and improve the quality of, and upgrade our existing networks and infrastructure in a timely and effective manner. Our ability to expand and upgrade our networks and infrastructure is subject to a number of uncertainties, including our ability to achieve the following on a timely basis and on acceptable terms:

manage technology migration in an effective manner, including effectively responding to a shortage of available Internet Protocol version 4 addresses and timely developing mobile network long-term evolution;

obtain adequate financing;

obtain relevant government licenses, permits and approvals;

obtain adequate network equipment and software;

retain experienced management and technical personnel;

obtain sufficient spectrum frequencies, network numbers and other telecommunications resources controlled by the PRC Government;

gain access to the sites for network construction or upgrade; and

enter into interconnection and other arrangements with other operators.

If we are not able to timely and effectively overcome the uncertainties and difficulties we may encounter in expanding and upgrading our networks and infrastructure, our competitive position, financial condition, results of operations and growth prospects may be materially and adversely affected.

***Because we rely on arrangements with other telecommunications operators, changes to the terms or availability of these arrangements may result in disruptions to our services and operations and may result in customer dissatisfaction and materially and adversely affect our financial condition, results of operations and growth prospects.***

Our ability to provide telecommunications services depends upon arrangements with other telecommunications operators. In particular, interconnection is necessary to complete all calls between our subscribers and subscribers of other telecommunications operators. We, either through ourselves or through Unicom Group, have established interconnection and transmission line leasing arrangements with other telecommunications operators, including our parent company, as required to conduct our current business. Any disruption to our interconnection with the networks of those operators or other international telecommunications carriers with which we interconnect may affect our operations, service quality and customer satisfaction, thus adversely affecting our business. Furthermore, we are generally not entitled to collect indirect or consequential damages resulting from disruptions in the networks with which we are interconnected. Any disruption in existing interconnection arrangements and leased line arrangements or any significant change of their terms, as a result of natural events or accidents or for regulatory, technical, competitive or other reasons, may lead to temporary service interruptions and increased costs that can seriously jeopardize our operations and adversely affect our financial condition, results of operations and growth prospects. Difficulties in executing alternative arrangements with other operators on a timely basis and on acceptable terms, including the inability to promptly establish additional interconnection links or increase interconnection bandwidths as required, could also materially and adversely affect our financial condition, results of operations and growth prospects.

## **Table of Contents**

***Interruptions to our networks and operating systems or to those with which we interconnect, including those caused by natural disaster and service maintenance and upgrades, may disrupt our services and operations and may result in customer dissatisfaction and materially and adversely affect our financial condition, results of operations and growth prospects.***

Our network infrastructure and the networks with which we interconnect are vulnerable to potential damages or interruptions from floods, wind, storms, fires, power loss, severed cables, acts of terrorism and similar events. The occurrence of a natural disaster or other unanticipated problems at our facilities or any other failure of our networks or systems, or the networks to which we are interconnected, may result in consequential interruptions in services across our telecommunications infrastructure. In 2015, certain areas of China suffered from natural disasters including typhoons, floods, mountain torrents, mudslides and landslides, and these natural disasters caused extensive damage to our network equipment, including our base stations and optical fiber networks, in the affected areas. As a result, we experienced service stoppage and other disruptions in our operations in those areas and also sustained economic losses. Any future natural disasters may, among other things, significantly disrupt our ability to adequately staff our business, and may generally disrupt our services and operations. Moreover, our networks and systems and the networks with which we interconnect also require regular maintenance and upgrades. Such maintenance and upgrades may cause service disruptions. Network or system failures, as well as high traffic volumes, may also affect the quality of our services and cause temporary service interruptions. Any such future occurrence may result in customer dissatisfaction and materially and adversely affect our financial condition, results of operations and growth prospects.

***If we are unable to fund our capital expenditure and debt service requirements, our financial condition, results of operations and growth prospects will be materially and adversely affected.***

We continue to have a significant level of capital expenditure and debt service requirements necessary to implement our business strategies. We incurred capital expenditure of RMB133.88 billion in 2015. To the extent these capital expenditures exceed our cash resources, we will be required to seek additional debt or equity financing. We cannot assure you that we will be able to obtain future financing on a timely basis and/or on acceptable terms. Even if we obtain such financing, our financing cost may increase significantly as a result of additional financing or higher interest rate. See **Liquidity and Capital Resources** under Item 5. Our failure to do so may adversely affect our financial condition, results of operations and growth prospects. Our ability to obtain acceptable financing at any time may depend on a number of factors, including, among others:

our financial condition and results of operations;

our creditworthiness and relationship with lenders;

changes in credit policies, other government or banking policies that may affect credit markets in China;

conditions of the economy and the telecommunications industry in China;

conditions in relevant financial markets in China and elsewhere in the world; and

our ability to obtain any required government approvals for our financings.

***We may continue to experience declines in ARPU for our telecommunications services.***

In 2015, the overall ARPU for our mobile services decreased by 7.5% from 2014, primarily due to (i) the implementation of VAT to replace business tax relating to the telecommunications services in China; (ii) the implementation of the PRC Government's policy of increasing network speed and reducing tariffs in 2015 as well as our mobile data carry-over programs launched in October 2015, which allows subscribers of our data plans with pre-determined monthly data limit to carry over their unused data to the following month with no extra charge; (iii) our late entry into the 4G services market in the PRC compared to a major telecommunications operator and the intensifying competition with other telecommunications operators, both of which had a negative effect on our ability to attract or retain 4G subscribers or other subscribers with higher usage of telecommunications services and (iv) many of our new subscribers who are users with lower usage of telecommunications services. We may continue to experience declining ARPU in the foreseeable future, which could have a material adverse effect on our financial condition and results of operations. Although we have been making efforts to manage those effects by allocating more resources to diversify our service offerings, particularly the value-added services, promote our integrated mobile and fixed-lined services to encourage more usage of our services, and develop our high-end customers, we cannot assure you that these efforts will be able to achieve the anticipated results.

---

**Table of Contents**

***Adjustments in our tariff plans may have a material adverse effect on our financial condition and results of operations.***

From time to time, we adjust our tariff plans by taking into account various factors, including the market conditions and policies of the PRC Government, and such adjustments may have a material negative effect on our revenue and profitability. In May 2015, the PRC government introduced a policy of increasing network speed and reducing tariffs. Since May 2015, in order to expand our customer base as well as to comply with the relevant policies, we have, in addition to continuing increasing our network speed, offered discounts to our tariff plans. In addition, in October 2015, we launched an mobile data carry-over programs, which allow subscribers of our data plans with pre-determined monthly data limit to carry over their unused data to the following month with no extra charge. Furthermore, in light of the governmental policy of achieving coordinated development of Beijing Municipality, Tianjin Municipality and Hebei Province issued in April 2015 by the PRC Government, we cancelled the long-distance and roaming tariffs for voice services within the tariff zones of Beijing Municipality, Tianjin Municipality and Hebei Province so that our customers are only charged with local usage tariff for our voice services provided within the tariff zones. See B. Business Overview Regulatory and Related Matters Tariff Setting under Item 4. Such measures have resulted in reduced tariffs of our voice services in 2015, which in turn had a negative impact on our revenue and profitability. These policies have had an adverse impact on our results of operations. Any future governmental policies in China or market conditions that require us to further reduce our tariffs could materially and adversely affect our financial condition and results of operations.

***Our business relies on the usage arrangements with the Tower Company as to telecommunications towers, and we may not be able to achieve the expected benefits from the establishment of the Tower Company.***

In July 2014, we, China Mobile and China Telecom, the three major telecommunications operators in China, jointly established China Tower Company Limited, or the Tower Company (formerly known as China Communications Facilities Services Corporation Limited), which engages primarily in the construction, maintenance and operation of telecommunications towers in China and other ancillary facilities, including base station control rooms, power supplies, air conditioning and interior distribution systems, as well as the provision of maintenance services of base station equipment. In October 2015, the Tower Company completed the acquisition of telecommunications towers and related assets from us, China Mobile and China Telecom. As of April 14, 2016, we owned 28.1% equity interest in the Tower Company. We are in the process of negotiating the final arrangements with the Tower Company with respect to our use of telecommunications towers and related assets of the Tower Company. See B. Business Overview The Tower Company under Item 4.

The main purpose of establishing the Tower Company is to consolidate the telecommunications towers of the three major telecommunications operators in China so as to enhance the efficiency of their capital expenditure, to improve the network coverage and to reduce competition on sites of telecommunications towers. However, there is no assurance that these benefits will be achieved as expected, or at all. In addition, as we do not control the Tower Company, the Tower Company may not act in the best interest of us. As such, we cannot assure you that our investment in the Tower Company will achieve the anticipated results in the near future as expected, or at all.

Furthermore, since it is expected that none of us, China Mobile or China Telecom will construct any telecommunications towers in the future, our business will rely on the usage arrangements with the Tower Company as to telecommunications towers and related assets. There is no assurance that the usage arrangements will be on terms commercially favorable or reasonable to us. In particular, according to our preliminary negotiation results, certain factors affecting usage pricing to be set forth in the usage agreement are beyond our control, including inflation, real estate market and steel price fluctuation. In addition, the usage agreement may provide for a pricing adjustment mechanism which allows the Tower Company to adjust the fees charged to us if there is a material change

in the actual operations, operating data and forecast of the Tower Company. Therefore, the usage fees with respect to telecommunications towers and related assets of a certain financial year may exceed the depreciation expenses and the maintenance costs we would incur if we own and operate the telecommunications towers and related assets by ourselves in the same period.

-10-

## **Table of Contents**

### ***We face risks associated with our Internet-related services.***

We have been proactively exploring and developing certain innovative and Internet-related services, including mobile Internet, digital services and big data services. We face a number of risks in providing these services.

Our network may be vulnerable to unauthorized access, computer viruses and other disruptive problems. We cannot assure you that the security measures we have implemented will not be circumvented or otherwise can fully protect the integrity of our network, including our mobile network. Unauthorized access could jeopardize the security of confidential information stored in our customers' computer systems and mobile phone systems and may subject us to litigation, liabilities for information loss and/or reputational damage. Eliminating computer viruses and other security problems may also require interruptions, delays or suspension of our services, reduce our customer satisfaction and cause us to incur costs.

In addition, because we provide connections to the Internet and host websites for customers and develop Internet content and applications, we may be perceived as being associated with the content carried over our network or displayed on websites that we host. We cannot and do not screen all of such content and may face litigations due to a perceived association with such content. These types of litigations have been brought against other providers of online services in the past. Regardless of the merits of the litigations, they can be costly to defend, divert management resources and attention, and may damage our reputation.

### ***Our controlling shareholder, Unicom Group, can exert influence on us and cause us to make decisions that may not always be in the best interests of us or our other shareholders and may fail to provide services and facilities that we rely on to operate our business.***

Unicom Group indirectly controlled an aggregate of approximately 74.36% of our issued share capital as of April 14, 2016 and all of our executive directors also serve as directors or executive officers of Unicom Group. As our controlling shareholder, subject to our articles of association and applicable laws and regulations, Unicom Group is effectively able to control our management, policies and business by controlling the composition of our board of directors and, in turn, indirectly controlling the selection of our senior management, determining the timing and amount of our dividend payments, approving significant corporate transactions, including mergers and acquisitions, and approving our annual budgets. The interests of Unicom Group as our controlling shareholder may conflict with our interests or the interests of our other shareholders. As a result, Unicom Group may cause us to enter into transactions or take (or fail to take) other actions or make decisions that may not be in our or our other shareholders' best interests.

In addition, our operations depend on a number of services and facilities provided by Unicom Group. For example, Unicom Group provides us with international gateway services, interconnection services, sales agency and collection services and provision of premises. See B. Related Party Transactions under Item 7. The interests of Unicom Group as provider of these services and facilities may conflict with our interests. Failure by Unicom Group to fulfill its obligations under any of these arrangements may have a material adverse effect on our business operations. We currently have limited alternative sources of supply for these services and facilities and, as a result, may have limited ability to negotiate with Unicom Group regarding the terms for providing these services and facilities. Changes in the availability, pricing or quality of these services or facilities may have a material adverse effect on our business and profitability.



## **Table of Contents**

***The previous internal reorganization of Unicom Group for the A Share offering created a two-step voting mechanism that requires the approval of the minority shareholders of both our Company and China United Network Communications Limited (formerly known as China United Telecommunications Corporation Limited), or the A Share Company, for significant related party transactions between us and Unicom Group.***

In October 2002, Unicom Group completed an internal reorganization of its shareholding in our company and the initial public offering in China of its then newly established subsidiary, the A Share Company. As part of this restructuring, a portion of Unicom Group's indirect shareholding in our company was transferred to the A Share Company, whose business is limited to indirectly holding the equity interest of our company without any other direct business operations. A voting mechanism was established to allow public shareholders of the A Share Company to indirectly participate in our shareholders' meetings and a two-step voting mechanism was established for the approval of related party transactions. As a result, any significant related party transaction between us or our subsidiaries and Unicom Group or its other subsidiaries will require the separate approval of the independent minority shareholders of both our company and the A Share Company. Related party transactions approved by our independent minority shareholders nevertheless cannot proceed if they are not approved by the independent minority shareholders of the A Share Company. This adds another necessary step of approval process for those transactions. See A. History and Development of the Company Two-Step Voting Arrangements under Item 4.

***Investor confidence and the market prices of our shares and ADSs may be materially and adversely impacted if we are or our independent registered public accounting firm is unable to conclude that our internal control over financial reporting is effective in future years as required by Section 404 of the Sarbanes-Oxley Act of 2002.***

We are a public company in the United States that is subject to the Sarbanes-Oxley Act of 2002. Pursuant to the requirements of Section 404 of the Sarbanes-Oxley Act of 2002, we include in this annual report a report of management on our internal control over financial reporting and an attestation report of our independent registered public accounting firm on the effectiveness of our internal control over financial reporting.

Our management conducted an assessment of the effectiveness of our internal control over financial reporting and concluded that our internal control over financial reporting as of December 31, 2015 was effective. The effectiveness of our internal control over financial reporting as of December 31, 2015 has been audited by KPMG, an independent registered public accounting firm, as stated in their report appearing on page F-2. However, we cannot assure you that, in the future, our management will continue to conclude that our internal control over financial reporting is effective. Even if our management concludes that our internal control over financial reporting is effective for future periods, our independent registered public accounting firm may disagree. If our independent registered public accounting firm is not satisfied with our internal control over financial reporting or the level at which our controls are documented, designed, operated, reviewed or evaluated, or if the independent registered public accounting firm interprets the relevant requirements, rules or regulations differently from us, then it may issue an adverse opinion. Any of these possible outcomes in the future could result in an adverse reaction in the financial marketplace due to a loss of investor confidence in the reliability of our consolidated financial statements, which could materially and adversely affect the market prices of our shares and ADSs.

Moreover, internal control over financial reporting may not prevent or detect misstatements because of its inherent limitations, including the possibility of human error, the circumvention or overriding of controls, or fraud. Therefore, even effective internal control over financial reporting can provide only reasonable assurance with respect to the preparation and fair presentation of financial statements. If we fail to maintain the adequacy of our internal control over financial reporting, including through a failure to implement required new or improved controls, or if we experience difficulties in their implementation, our business and operating results could be harmed, we could fail to meet our reporting obligations and there could be a material adverse effect on the market prices of our shares and

ADSs.

-12-

---

**Table of Contents**

***Certain misconducts or alleged misconducts by our executive officers or employees may not be detected or prevented in a timely manner, and such misconduct may damage our reputation and cause the trading price of our ordinary shares and ADSs to decrease.***

As a state-owned enterprise of the PRC, we and our directors, officers and employees are subject to various periodic inspections, examinations, inquiries and audits by PRC regulatory authorities. In December 2015, the Central Commission for Discipline Inspection of the Communist Party of China and the Ministry of Supervision of the PRC initiated an investigation on our former chairman and chief executive officer, Chang Xiaobing for alleged violations of the disciplinary rules of the Communist Party of the PRC. As of April 14, 2016, the relevant investigating authorities had not notified us of the incidents underlying the investigation. See C. Board Practices under Item 6 for more details.

In addition, in the course of investigations conducted jointly by the Central Commission for Discipline Inspection of the Communist Party of China and the Ministry of Supervision of the PRC in November and December 2014, two officers of our Group, who are not directors or members of the senior management of our company, were alleged to have engaged in unlawful conduct and other misconduct. Such allegations of unlawful conduct include the acceptance of bribes. While these incidents have been transferred to the judicial authorities, we believe that they are isolated incidents.

In response to these investigations, we have taken and will continue to take various measures, including enhancing our employee's compliance awareness and strengthening our risk management and internal control procedures in this regard, to detect and prevent similar misconduct by our employees in the future. However, we cannot assure you that these measures will effectively detect or prevent all misconduct by our employees in a timely manner or at all. If these measures prove ineffective in detecting or preventing employee misconduct, our reputation may be severely harmed, our operations could be disrupted and the trading price of our ordinary shares and ADSs could decrease significantly.

***The implementation of VAT to replace business tax relating to the telecommunications services in China has had, and may continue to have, a negative impact on our results of operations.***

The PRC Government implemented VAT to replace business tax relating to the telecommunications services in China on June 1, 2014. As opposed to the business tax of 3% imposed on the revenue that was applicable to us prior to June 1, 2014, we are subject to the output VAT at the rate of 11% for our basic telecommunications services (including, among others, voice communication, and lease or sale of network resources) and 6% for our value-added telecommunications services (including, among others, Internet access services, short and multimedia messaging services, and transmission and application service of electronic data and information). Sales of our telecommunications terminals and equipment are subject to the output VAT at the rate of 17% before and after June 1, 2014. The Input VAT rate depends on the type of services received and the assets purchased as well as the VAT rate applicable to the vendors' specific industry, and ranges from 6% to 17%.

The revenue is presented in our financial statements after excluding any output VAT in accordance with IFRS. Therefore, the implementation of VAT has a negative impact on our revenue, although the implementation of VAT also reduces our costs and expenses to the extent we are entitled to input VAT credits. See B. Business Overview Regulatory and Related Matters VAT Applicable to the Telecommunications Industry under Item 4 for more details. To the extent that the decrease in revenue is larger than the decrease in our costs and expenses due to the implementation of VAT in the PRC telecommunications industry, the implementation of VAT would have a negative impact on our net income. See Operating Results under Item 5 for more details. We have taken certain initiatives to manage the adverse impact from the implementation of VAT, such as increasing the contribution of the non-voice services to our total revenue, optimizing the marketing models and operations, and enhancing tax planning capabilities. However, we cannot assure you that the measures we take to manage the adverse effect on our net income

due to the implementation of the VAT in the PRC telecommunications industry will achieve the anticipated results in the near future.

## **Table of Contents**

### **Risks Relating to the Telecommunications Industry in China**

***Government regulation of the telecommunications industry in China may affect our ability to respond to market conditions or competition, and may have a material adverse effect on our financial condition, results of operations and growth prospects.***

As a telecommunications operator in China, we are subject to regulation by, and under the supervision of, the MIIT, which is the primary regulator of the telecommunications industry in China. The MIIT is responsible for formulating policies and regulations for the telecommunications industry, granting telecommunications licenses, allocating frequency spectrum and numbers, formulating interconnection and settlement arrangements between telecommunications operators, and enforcing industry regulations. Other PRC Governmental authorities also regulate capital investment and foreign investment in the telecommunications industry. See B. Business Overview Regulatory and Related Matters under Item 4. The regulatory framework within which we operate may constrain our ability to implement our business strategies and limit our ability to respond to market conditions or to changes in our cost structure. Moreover, we operate our businesses pursuant to approvals granted by the State Council of the PRC, or the State Council, and under licenses granted by the MIIT. If these approvals or licenses were revoked or suspended, our business and operations would be materially and adversely affected. In addition, we are subject to various regulatory requirements as to a wide range of matters relating to our business operations, including service quality, pricing, real-name registration for telecommunications service subscribers and other actions, and failure to comply with such requirements may subject us to mandatory penalties or other punitive measures, any of which could have a material adverse effect on our financial condition, results of operations and growth prospects. Furthermore, we cannot assure you that we will not experience any adverse impact on our business during the course of our compliance with regulatory requirements in the PRC telecommunications industry. For instance, in 2016, we will continue to strictly comply with the PRC Government's policy relating to the real-name registration of telecommunications service subscribers by taking more stringent measures to manage the subscriber accounts that are not real-name registered or inactive. These measures are likely to cause a growth slowdown or a decrease in the number of our subscribers in 2016. Similarly, the PRC regulators may promulgate and implement new regulations, rules and policies on the telecommunications industry from time to time, and we cannot guarantee that any such new regulations, rules or policies will not have a material adverse effect on our financial condition, results of operations and growth prospects.

***Regulatory or policy changes relating to the PRC telecommunications industry or any future industry restructuring may materially and adversely affect our financial condition, results of operations and growth prospects.***

The PRC Government continues to regulate many aspects of the telecommunications industry in China. Potential changes in regulations and policies and their implementation could lead to significant changes in the overall industry environment and may have a material adverse effect on our financial condition, results of operations and growth prospects. As part of the comprehensive plan to restructure the telecommunications industry in China, the PRC Government has been adjusting and improving its regulatory oversight of the telecommunications industry, including further deregulating telecommunications tariffs.

The MIIT, under the direction of the State Council, is currently preparing a telecommunications law to provide a uniform regulatory framework for the telecommunications industry in China. As of the date of this annual report, the telecommunications law has not yet been officially promulgated by the PRC Government. The promulgation of the telecommunications law and other new telecommunications regulations or rules, or future changes thereto, such as enforcement of existing regulations and policies, may materially and adversely affect our financial condition, results of operations and growth prospects.

Issues may also arise regarding the interpretation and enforcement of China's WTO commitments regarding telecommunications services. Any future regulatory changes, such as those relating to the issuance of additional telecommunications licenses, interconnection and settlement arrangements, changes in technical and service standards, universal service obligations and spectrum and number allocations, may have a material adverse effect on our business and operations.

The PRC telecommunications industry has been extensively restructured in recent years and may be subject to further restructuring. Such further industry restructuring may materially affect the operations of all telecommunications operators in China, including us. Accordingly, we cannot predict the scope and effect of any further restructuring on our financial condition, results of operations and growth prospects.

## **Table of Contents**

***The PRC Government may require us, along with other telecommunications service providers in China, to provide universal services with specified obligations, and we may not be compensated adequately for providing such services.***

Under the Telecommunications Regulations promulgated by the State Council, telecommunications service providers in China are required to fulfill universal service obligations in accordance with relevant regulations to be promulgated by the PRC Government authorities, and the MIIT has the authority to delineate the scope of universal service obligations. The MIIT, together with the finance department and pricing authorities of the State Council, are also responsible for formulating administrative rules relating to the establishment of a universal service fund and compensation schemes for universal services. In December 2015, the Ministry of Finance and the MIIT jointly issued the rules regarding the pilot program for universal services to be implemented in 97 prefecture-level cities across the PRC. Since these rules were recently promulgated, we understand that the local authorities are in the process of formulating detailed plans and guidance to implement such rules.

Pursuant to rules promulgated by the Ministry of Finance and the MIIT in December 2015, telecommunications operators are urged to participate in the bidding process for being selected as providers to provide basic telecommunications services in less economically developed areas in China. In addition, as part of the transitional measures prior to the formalization of a universal service obligation framework, the MIIT has required major telecommunications service providers in China, including Unicom Group, to participate in a project to provide telephone and broadband access services in tens of thousands of remote villages in China. See B. Business Overview Regulatory and Related Matters Universal Services under Item 4.

We cannot predict whether the PRC Government will specifically require us to undertake universal service obligations in the future. To the extent we are required to do so, it is currently uncertain whether we will be adequately or timely compensated by the PRC Government or by the universal service fund. We cannot assure you that we will be able to realize an adequate return on investments for expanding networks to, and providing telecommunications services in, less economically developed areas due to potentially higher capital expenditure requirements, lower usage by customers and lack of flexibility in setting our tariffs. We also cannot predict whether we will be required to make a contribution to the universal service fund. Any of these events may adversely affect our financial condition and results of operations.

***Actual or perceived health risks associated with the use of mobile devices could impair our ability to retain and attract customers of our mobile services, reduce mobile service usage or result in litigation.***

Concerns have been expressed in some countries that the electromagnetic signals emitted by wireless telephone handsets and base stations may pose health risks at exposure levels below existing guideline levels, and interfere with the operation of electronic equipment. In addition, mobile operators have been subject to lawsuits alleging various health consequences as a result of mobile handset usage or proximity to base stations or seeking protective or remedial measures. While we are not aware that such health risks have been substantiated, there can be no assurance that the actual, or perceived, risks associated with the transmission of electromagnetic signals will not impair our ability to retain customers and attract new customers, reduce mobile service usage or result in litigation.

## **Risks Relating to Doing Business in China**

***Our operations may be materially and adversely affected by changes in or deterioration of China's economic, political and social conditions.***

Substantially all of our business operations are conducted in China and substantially all of our revenue is derived from our operations in China. Accordingly, our business, financial condition, results of operations and prospects are affected to a significant degree by economic, political and social conditions in China. The PRC economy differs from the economies of most developed countries in many respects, including with respect to the extent of government involvement, level of development, growth rate, and control of foreign exchange and allocation of resources. While the PRC economy has experienced significant growth in the past three decades, growth has been uneven across different regions and among various economic sectors. The PRC Government has implemented various measures to encourage economic development and guide the allocation of resources. Some of these measures benefit the overall PRC economy, but may also have a negative effect on us. For example, our financial condition and results of operations may be materially and adversely affected by government control over capital investments.



## **Table of Contents**

The PRC economy has experienced a slowdown for the past few years. The GDP growth rate of China decreased from 11.4% in 2007 to 6.9% in 2015. It is uncertain whether China's economic growth will return to the previous level of growth or it will encounter deterioration. In light of the slowdown of China's economic growth, our subscribers' usage of our services may decrease and we may experience increased difficulties in retaining existing subscribers or acquiring new subscribers, which could materially and adversely affect our business, as well as our financial condition and results of operations.

***If the PRC Government revises the current regulations that allow a foreign-invested enterprise to pay foreign exchange in current account transactions, our operating subsidiary's ability to satisfy its foreign exchange obligations and to pay dividends to us in foreign currencies may be restricted.***

The ability of our major operating subsidiary, CUCL, to satisfy its foreign exchange obligations and to pay dividends to us depends on existing and future foreign exchange regulations in China. The Renminbi is currently convertible by foreign-invested enterprises in China to settle transactions under the current account, which include trade- and service-related foreign exchange transactions and payments of dividends. The Renminbi currently cannot be freely converted without regulatory approval for transactions under the capital account, which includes outbound foreign investment and payments on foreign loans. CUCL, which holds substantially all of our assets and through which we conduct substantially all of our business, is a foreign-invested enterprise in China. However, there is no assurance that in the future the relevant PRC government authorities will not impose any limitation on the ability of foreign-invested enterprises to purchase foreign exchange to satisfy their foreign exchange obligations or to pay dividends. In that event, CUCL's ability to satisfy its foreign exchange obligations and to pay dividends to us in foreign currencies may be restricted and the interests of our shareholders may, in turn, be affected.

***Fluctuations in the value of the Renminbi could adversely affect the prices of our shares and ADSs as well as our profitability.***

Substantially all of our revenue and costs and expenses are denominated in Renminbi, while a portion of our borrowings, equipment purchases and other capital expenditures are denominated in foreign currencies. On July 21, 2005, the PRC Government changed its decade-old policy to permit Renminbi to fluctuate within a narrow and managed band against a basket of certain foreign currencies determined by the People's Bank of China, or the PBOC. On May 19, 2007, the PBOC announced a policy to further expand the maximum daily floating range of RMB trading prices against the U.S. dollar in the inter-bank spot foreign exchange market. With the increased floating range of the Renminbi's value against foreign currencies, the Renminbi may appreciate or depreciate significantly in value against the U.S. dollar or other foreign currencies in the long term, depending on the fluctuation of the basket of currencies against which it is currently valued, or it may be permitted to enter into a full float. Increased fluctuations of the Renminbi could adversely affect the value in foreign currency terms of cash flow generated from our operations or any dividends payable on our shares and ADSs, and therefore the price of our shares and ADSs. Any future Renminbi devaluations could also increase our equipment importation costs or lead to significant fluctuations in the exposure of our foreign-currency-denominated liabilities, thereby adversely affecting our profitability.

***Uncertainties in the PRC legal system could limit the legal protections available to us and to foreign investors and materially and adversely affect our financial condition, results of operations and growth prospects.***

Our wholly owned operating subsidiary, CUCL, is organized under the laws of PRC and is generally subject to laws and regulations applicable to foreign-invested enterprises in China. The Chinese legal system is a civil law system based on written statutes. Unlike common law systems, it is a system in which decided legal cases may be cited for reference but have limited precedential value. Since 1979, the PRC Government has promulgated laws and regulations dealing with economic matters such as foreign investment, corporate organization and governance, commerce,

property, taxation and trade. However, because these laws and regulations are relatively new, and because of the relatively limited volume of published cases and their non-binding nature, interpretation and/or enforcement of these laws and regulations involves uncertainties, which may limit the remedies available to you as an investor and to us in the event of any claims or disputes with third parties. In addition, any litigation in China may be protracted and result in costs and diversion of resources and management attention. Therefore, the protection provided by the PRC legal system may not be the same as the legal protection available to investors in the United States or elsewhere. Furthermore, various uncertainties involved in the rulemaking, interpretation and enforcement process of the laws, regulations and rules in China that are related to our business operations, in particular, those in respect of telecommunications and enterprise income tax, may also materially and adversely affect our financial condition, results of operations and growth prospects.

---

**Table of Contents**

***You may experience difficulties in effecting service of legal process and enforcing judgments against us and our management.***

Most of our current operations are conducted in China and most of our assets are located in China. In addition, four out of nine of our current directors and all of our current executive officers reside within China, and substantially all of the assets of these persons are located within China. As a result, it may not be possible to effect service of process within the United States or elsewhere outside China upon these directors or executive officers, including with respect to matters arising under U.S. federal securities laws or applicable state securities laws. Moreover, our PRC counsel has advised us that China does not have treaties with the United States or many other countries providing for the reciprocal recognition and enforcement of court judgments. Our Hong Kong counsel has also advised us that Hong Kong has no arrangement for the reciprocal enforcement of judgments with the United States. As a result, recognition and enforcement in China of judgments of a court of the United States or any other jurisdiction, including judgments against us or our directors, executive officers, underwriters or experts, may be difficult or impossible.

***Natural disasters and health hazards in China may severely disrupt our business and operations and may severely restrict the level of economic activities in affected areas which in turn may have a material adverse effect on our financial condition and results of operations.***

Natural disasters such as earthquakes, snowstorms and floods may result in significant and extensive damage to our base stations and network equipment. Moreover, certain countries and regions, including China, have encountered incidents of bird flu, or avian flu, as well as severe acute respiratory syndrome, or SARS, and the outbreak of influenza A (H1N1) in the past. In 2015, certain areas of China suffered from severe floods. We are unable to predict the effect, if any, that any other future natural disasters and health hazards may have on our business. Any future natural disasters and health hazards may, among other things, significantly disrupt our ability to adequately staff our business, and may generally disrupt our operations. Furthermore, natural disasters and health hazards may severely restrict the level of economic activities in affected areas, which may in turn materially and adversely affect our business and prospects. As a result, any natural disasters or health hazards in China may have a material adverse effect on our financial condition and results of operations.

***Our investors do not have the benefit to rely on the Public Company Accounting Oversight Board inspection of our independent registered public accounting firm.***

As a company registered with the U.S. Securities and Exchange Commission, or the SEC, and traded publicly in the United States, our independent registered public accounting firm is required by the laws of the United States to be registered with the Public Company Accounting Oversight Board, or the PCAOB, and undergo regular inspections by the PCAOB to assess its compliance with the laws of the United States and professional standards. The PCAOB, however, is currently unable to inspect a registered public accounting firm's audit work relating to a company's operations in China where the documentation of such audit work is located in China. Accordingly, our independent registered public accounting firm's audit of our operations in China is not subject to the PCAOB inspection. As a result, our investors do not have the benefit of the PCAOB inspection of our independent registered public accounting firm's audit works and quality control procedures.

## **Table of Contents**

***KPMG, our independent registered public accounting firm, relies on the Chinese member firm of the KPMG network for assistance in completing the audit work on us. If an order is imposed on the Chinese member firm of the KPMG network suspending its practice before the SEC, KPMG's audit work may be delayed and, as a result, we may be unable to timely file future financial statements in compliance with the requirements of the Exchange Act of 1934, as amended.***

On January 22, 2014, Judge Cameron Elliot, an SEC administrative law judge, issued an initial decision suspending the Chinese member firms of the Big Four accounting firms, including KPMG network, from, among other things, practicing before the SEC for six months. In February 2014, the initial decision was appealed. While under appeal and in February 2015, the Chinese member firms of Big Four accounting firms reached a settlement with the SEC. As part of the settlement, each of the Chinese member firms of Big Four accounting firms agreed to settlement terms that include a censure; undertakings to make a payment to the SEC; procedures and undertakings as to future requests for documents by the SEC; and possible additional proceedings and remedies should those undertakings not be adhered to.

Our independent registered public accounting firm currently relies on the Chinese member firm of the KPMG network for assistance in completing the audit work associated with our operations in China. If the settlement terms are not adhered to, Chinese member firms of Big Four accounting firms may be suspended from practicing before the SEC which could in turn delay the timely filing of our financial statements with the SEC. In addition, it could be difficult for us to timely identify and engage another qualified independent auditor to replace KPMG. A delinquency in our filings with the SEC may result in NYSE initiating delisting procedures, which could adversely harm our reputation and have other material adverse effects on our overall growth and prospect.

## **Risk Relating to our ADSs**

***Holders of our ADSs will not have the same voting rights as the holders of our shares and may not receive voting materials in time to be able to exercise their right to vote.***

Except as described in this annual report and in the deposit agreement, holders of our ADSs will not be able to exercise voting rights attaching to the shares represented by our ADSs on an individual basis. Holders of our ADSs will receive proxy materials with respect to matters to be voted on at a meeting of shareholders through the depositary and may only exercise voting rights by appointing the depositary or its nominee as their representative to exercise the voting rights attaching to the shares represented by the ADSs. Consequently, if the materials to be forwarded to holders of ADSs by the depositary are delayed or if the depositary sets deadlines by which holders of ADSs must give their instructions regarding how to vote that fall too soon after mailing of the proxy materials, the holders of our ADSs may not receive voting materials in time to instruct the depositary to vote. Thus, it is possible that such holders, or persons who hold their ADSs through brokers, dealers or other third parties, may not have the opportunity to exercise a right to vote.

## **Item 4. Information on the Company**

### ***A. History and Development of the Company***

We were incorporated under the laws of Hong Kong on February 8, 2000 under the predecessor of the Companies Ordinance as a company limited by shares under the name China Unicom Limited. In connection with the telecommunications industry restructuring initiated by the MIIT, the NDRC and the MOF in 2008 as discussed below,

we merged with China Netcom and changed our name to China Unicom (Hong Kong) Limited with effect from October 15, 2008. Following our merger with China Netcom, we became an operator providing a full range of telecommunications services, including mobile and fixed-line services, in China.

Our registered office and principal executive offices are located at 75th Floor, The Center, 99 Queen's Road Central, Hong Kong (telephone number: 852-2126-2018).

### **Restructurings of the Telecommunications Industry**

Since 1993, the PRC Government has implemented a number of measures to restructure and introduce competition in the telecommunications industry. Prior to July 1994, China Telecom was the sole provider of telecommunications services in China. In July 1994, Unicom Group was established in accordance with the State Council's approval to introduce orderly competition in the telecommunications industry. Since then, the PRC Government has approved Jitong Network Communications Company Limited, or Jitong, and China Netcom Corporation Ltd., or CNCL, to provide Internet protocol, or IP, telephony, Internet and data services. It has also approved China Tietong to provide most telecommunications services other than mobile services.

## **Table of Contents**

In 1999, the State Council approved a plan to restructure the former China Telecom along four business lines: fixed-line, mobile, paging and satellite communications. As a result of the restructuring, China Telecom retained the fixed-line, data and Internet businesses, while China Mobile assumed the mobile business previously operated by China Telecom. In 2002, the PRC Government further separated China Telecom into two companies, with the southern company retaining the name of China Telecom and assets and businesses in 21 provinces in southern China and the northern company retaining assets and businesses in 10 provinces in northern China and merging with CNCL and Jitong to form China Netcom. As a result of the PRC Government's efforts to introduce competition in the telecommunications industry, there are currently more than one service providers in most of the sectors within the telecommunications industry.

On May 24, 2008, the MIIT, the NDRC and the MOF issued a joint announcement relating to the further reform of the PRC telecommunications industry. According to the joint announcement, the principal objectives of such further reform included, among others: (i) supporting the formation of three telecommunications services providers of comparable scale and standing, each with nationwide network resources, full-service capabilities and competitive strength, in order to help optimize the allocation of telecommunications resources and foster market competition; (ii) promoting homegrown innovation by telecommunications services providers; and (iii) enhancing the service capabilities and quality of, and the regulatory framework governing, the telecommunications industry. To achieve these objectives, the three ministries encouraged the following restructuring transactions: (a) the acquisition by China Telecom of the CDMA network (including both assets and subscriber base) then owned by Unicom Group; (b) the merger between China Unicom and China Netcom; (c) the transfer of the basic telecommunications services business operated by China Satellite into China Telecom; and (d) the consolidation of China Tietong into China Mobile. The detailed implementation plans relating to these restructuring transactions were subsequently formulated by the relevant parties and, as a result, China Mobile, China Telecom and we became the current three major telecommunications operators in China, each providing a full range of telecommunications services nationwide.

## **Sale of CDMA Business, Merger with China Netcom and Related Transactions**

### ***Disposal of CDMA Business and Related Transactions***

Pursuant to the 2008 telecommunications industry restructuring announcement, on June 2, 2008, we, CUCL and China Telecom entered into a CDMA business disposal framework agreement, under which CUCL agreed to sell, and China Telecom agreed to purchase, the CDMA business of CUCL, including (i) the entire CDMA business, which is owned and operated by CUCL, together with the assets of CUCL that are relevant to the CDMA operations and the rights and liabilities of CUCL relating to its CDMA subscribers; (ii) the entire equity interest in China Unicom (Macau) Company Limited, our wholly owned subsidiary; and (iii) all of the 99.5% equity interest in Unicom Huasheng Telecommunications Technology Company Limited, a limited liability company incorporated under the laws of the PRC, held by CUCL.

On July 27, 2008, we, CUCL and China Telecom further entered into a CDMA business disposal agreement which set out the detailed terms and conditions of the CDMA business disposal. The consideration for the CDMA business disposal was RMB43.8 billion in cash, payable in three installments. While the consideration was subject to a price adjustment mechanism based on the CDMA service revenue generated by us for the six months ended June 30, 2007 and June 30, 2008, as agreed with China Telecom, there was no subsequent adjustment to the consideration as a result of the price adjustment mechanism.

On July 27, 2008, in connection with the CDMA business disposal, CUCL agreed (i) to waive its right to exercise its option to purchase the CDMA network from Unicom New Horizon, a wholly owned subsidiary of Unicom Group, and (ii) to terminate the CDMA lease pursuant to which CUCL leased capacity on the CDMA network from Unicom New

Horizon, in each case with effect upon the completion of the CDMA business disposal.

## **Table of Contents**

At our shareholders' meeting held on September 16, 2008, our shareholders approved the CDMA business disposal and our independent shareholders approved the waiver by CUCL of the option to purchase the CDMA network and the termination of the CDMA lease. As all of the conditions of the CDMA business disposal as specified in the CDMA business disposal agreement had been satisfied or deemed to have been satisfied, the CDMA business disposal was completed on October 1, 2008. On that date, China Telecom became the legal owner of the CDMA business and all the rights, interests, obligations and liabilities in relation to the CDMA business have been borne by China Telecom with effect from October 1, 2008. We recognized in our statements of income for the year ended December 31, 2008 a gain on disposal of the CDMA business of approximately RMB26.1 billion, net of corresponding income tax of approximately RMB9.0 billion.

In connection with the CDMA business disposal, we had been notified by Unicom Group that on June 2, 2008 and July 27, 2008, Unicom Group, Unicom New Horizon and China Telecom entered into a CDMA network framework agreement and a CDMA network disposal agreement, respectively, which set out the terms and conditions, under which Unicom Group and Unicom New Horizon agreed to sell, and China Telecom agreed to purchase, the CDMA network at a consideration of RMB66.2 billion. The disposal of the CDMA network was completed concurrently with our CDMA business disposal, on October 1, 2008.

## ***Merger with China Netcom and Related Transactions***

### ***Merger with China Netcom***

On October 15, 2008, following the approval of the merger by our shareholders and the shareholders of China Netcom at shareholders' meetings held on September 16, 2008 and September 17, 2008, respectively, and the satisfaction of all other conditions, the merger between China Unicom and China Netcom by way of a scheme of arrangement of China Netcom under Section 166 of the predecessor of the Companies Ordinance became effective. Upon the merger becoming effective, all ordinary shares of China Netcom outstanding at 5:00 p.m., Hong Kong time, on October 14, 2008 and all outstanding options to acquire China Netcom shares granted under the share option scheme of China Netcom were cancelled and new China Netcom shares were issued to us. As a result, China Netcom became our wholly owned subsidiary and the listings of China Netcom's ordinary shares and ADSs on the HKSE and the NYSE, respectively, were withdrawn.

In connection with our merger with China Netcom, each holder of China Netcom shares was entitled to receive 1.508 of our new ordinary shares for every cancelled China Netcom share and each holder of Netcom ADSs was entitled to receive 3.016 of our new ADSs for every cancelled China Netcom ADS. A total of 10,102,389,377 of our new ordinary shares (including ordinary shares underlying our newly issued ADSs) were issued to China Netcom's shareholders as consideration for the cancellation of the China Netcom shares held by China Netcom shareholders.

Furthermore, we adopted a special purpose share option scheme, pursuant to which we have granted new Unicom options to the holders of China Netcom options in consideration for the cancellation of their outstanding Netcom options (whether vested or not). The number of Unicom options granted and the exercise price of such options were determined in accordance with a formula which ensures that the value of the Unicom options received by a holder of Netcom options is equivalent to the value determined by deducting the exercise price of the relevant Netcom option from the value of HK\$27.87 per Netcom share. The special purpose share option scheme expired on February 14, 2015.

As a result of our merger with China Netcom, we have become an operator providing a full range of telecommunications services to our customers, including mobile voice and value-added, fixed-line voice and value-added, fixed-line broadband, data communications and other telecommunications services. Following the



merger, we have taken measures to combine the respective experience and technologies of Unicom and China Netcom and develop business strategies, taking into account current market developments, to promote business innovation and competitiveness and to improve operating and financial performance. By combining the resources and business strengths of Unicom and China Netcom in different areas, we seek to become a world-class provider of telecommunications services, in particular in fixed-line broadband communications and information services, establish competitive advantages in our technologies, products and services and provide professional and multi-tiered information services to satisfy the changing and diverse needs of the telecommunications market in China.

## **Table of Contents**

### *Change of Company Name*

Upon our merger with China Netcom becoming effective on October 15, 2008, our name changed from China Unicom Limited to China Unicom (Hong Kong) Limited. Our stock trading code on the HKSE and our ticker symbol on the NYSE remain unchanged.

### *Related Transactions*

As part of our integration with China Netcom, our wholly owned subsidiary, CUCL, merged with China Netcom (Group) Company Limited, or CNC China, a wholly owned subsidiary of China Netcom, in January 2009, and upon that merger becoming effective, CUCL assumed all the rights and obligations of CNC China, and all the assets, liabilities and business of CNC China were vested in CUCL. In addition, in January 2009, Unicom Group, our parent company, merged with and absorbed Netcom Group, the parent company of China Netcom. Upon completion of the merger between Unicom Group and Netcom Group, Unicom Group assumed all the rights and obligations of Netcom Group, and all the assets, liabilities and business of Netcom Group have vested in Unicom Group.

## **History and Corporate Development of China Netcom**

China Netcom was incorporated in Hong Kong on October 22, 1999, under the predecessor of the Companies Ordinance as a company limited by shares under the name Target Strong Limited. The company changed its name to China Netcom (Hong Kong) Corporation Limited on December 9, 1999, to China Netcom Corporation (Hong Kong) Limited on August 4, 2000, and to China Netcom Group Corporation (Hong Kong) Limited on July 23, 2004 (the last name change in anticipation of its IPO in 2004).

China Netcom's principal operating subsidiary, CNC China, which merged with, and was absorbed by, CUCL in January 2009, was incorporated as a PRC limited liability company in August 1999 by its four founders and shareholders, the Academy of Sciences, INC-SARFT, CRTC and Shanghai Alliance, as a facilities-based telecommunications operator in China. China Netcom was established in October 1999 to facilitate investments by foreign investors, including CNC Fund, L.P., in CNC China. Shortly thereafter, the four founders, using their respective equity interests in CNC China as capital contributions, established China Netcom (Holdings) Company Limited which in turn contributed its entire interests in CNC China through CNC BVI to China Netcom. China Netcom, through China Netcom Corporation International Limited, established Asia Netcom in 2002. Asia Netcom remained inactive until it acquired substantially all the assets, including cash, and most of the subsidiaries, of the former Asia Global Crossing Ltd. by the end of 2003.

China Netcom successfully completed its IPO in November 2004 with the listing of its ordinary shares on the HKSE and ADSs, each representing 20 of its ordinary shares, on the NYSE.

In October 2005, China Netcom acquired from CNC BVI the entire equity interests of China Netcom Group New Horizon Communications Corporation (BVI) Limited, or CNC New Horizon BVI, which merged into CNC China in November 2006. As a result of the merger, China Netcom acquired the fixed-line telecommunications assets and related liabilities in Heilongjiang Province, Jilin Province, the Inner Mongolia Autonomous Region and Shanxi Province. In August 2006, China Netcom sold the entire equity interest in Asia Netcom, which then provided international telecommunications services in the Asia-Pacific region, to Connect Holdings Limited. In February 2007, China Netcom sold its telecommunications assets, liabilities and business operations in Guangdong Province and Shanghai Municipality to Netcom Group. In December 2007, China Netcom's wholly owned subsidiary, China Netcom Group System Integration Limited Corporation, or China Netcom System Integration, acquired the entire equity interest in Design Institute from China Netcom Group Beijing Communications Corporation, a wholly owned

subsidiary of Netcom Group, in order to develop two of its key information and communication technologies, or ICT, services.

### **Our Parent Company and Our Initial Public Offering**

Our ultimate controlling shareholder is Unicom Group, a company incorporated under the laws of the PRC and majority-owned by the PRC Government. Unicom Group was established in accordance with the State Council's approval to introduce orderly competition in the telecommunications industry in 1994.

## **Table of Contents**

Unicom Group transferred certain of its telecommunications assets, rights and liabilities to CUCL (which became our wholly owned subsidiary in China) in April 2000 in preparation for our IPO. In June 2000, we successfully completed our IPO. Our ordinary shares are listed on the HKSE and our ADSs, each representing 10 of our ordinary shares, are listed on the NYSE.

## **Unicom Acquisitions and Sales**

In December 2002 and December 2003, respectively, we completed our acquisitions from Unicom Group of 100% of the equity interests in Unicom New Century and Unicom New World, both of which held mobile telecommunications operations (including GSM assets and business and CDMA business) in various provinces and autonomous regions in China. Subsequent to the completion of those acquisitions, Unicom New Century and Unicom New World merged into CUCL in July 2004 and September 2005, respectively.

In March 2003, we completed the sale to Unicom Group of the entire equity interest of Guoxin Paging Corporation Ltd., which at the time of transfer was engaged in paging business.

In September 2004, we acquired from Unicom Group of 100% of the equity interest in China Unicom International Limited, or Unicom International, a limited liability company established in Hong Kong and engaged in voice wholesale business, telephone cards business, line leasing services, managed bandwidth services and mobile virtual network services. In September 2009, the name of China Unicom International Limited was changed to China Unicom (Hong Kong) Operations Limited. Unicom International's wholly owned U.S. subsidiary, China Unicom USA Corporation, is engaged in the wholesale business of voice traffic between the United States and PRC. In August 2009, the name of China Unicom USA Corporation changed into China Unicom (Americas) Operations Limited upon the completion of its merger with China Netcom (USA) Operations Limited, a subsidiary of China Netcom.

In October 2004, we established China Unicom (Macau) Company Limited, or Unicom Macau, in Macau, which then provided CDMA mobile services to local CDMA users in Macau. In connection with the disposal of our CDMA business in October 2008, we sold the entire equity interest in Unicom Macau to China Telecom along with our other CDMA business and certain related assets.

In July 2005, CUCL and Unicom Xingye Science and Technology Trade Co., Ltd., or Unicom Xingye, a subsidiary of Unicom Group, incorporated Unicom Huasheng. Unicom Huasheng was principally engaged in the sales of CDMA handsets and telecommunications equipment and the provision of technical services for us. In connection with the disposal of our CDMA business in October 2008, CUCL sold all of the 99.5% equity interest it held in Unicom Huasheng to China Telecom.

In December 2007, we completed the acquisition from Unicom Group of the mobile telecommunications operations (including GSM assets and business and CDMA business) of its Guizhou Province branch. As a result of the acquisitions of Unicom New Century, Unicom New World and Unicom Guizhou, we extended our GSM and CDMA mobile businesses to all provinces, autonomous regions and municipalities across China.

On August 19, 2008, CUCL established a wholly owned subsidiary, Unicom Huakai Telecommunications Company Limited, or Unicom Huakai, as a limited liability company under the laws of the PRC. Unicom Huakai is principally engaged in the sales of handsets and telecommunications equipment and the provision of technical services. The paid-in capital of Unicom Huakai is RMB500 million. On December 26, 2008, the name of Unicom Huakai was changed to Unicom Vsens Telecommunications Company Limited.



**Table of Contents**

***Acquisitions of Fixed-Line Business in 21 Provinces in Southern China and Other Assets from Parent Companies and Lease of Telecommunications Networks in 21 Provinces in Southern China***

Following the approval by our independent shareholders and the shareholders of the A Share Company and upon the satisfaction of all other conditions, in January 2009, we completed our acquisitions, through CUCL, of certain telecommunications business and assets from Unicom Group and Netcom Group (which merged with, and was absorbed by, Unicom Group in January 2009), including:

the fixed-line business across 21 provinces in southern China operated by Unicom Group and Netcom Group and/or their respective subsidiaries and branches (but not the underlying fixed assets) and the local access telephone business in Tianjin Municipality operated by Unicom Group and related fixed assets (other than land and buildings) necessary for the operation of such local access telephone business and/or respective subsidiaries and branches;

the backbone transmission assets in 10 provinces in northern China owned by Netcom Group and/or its subsidiaries;

100% of the equity interest in Unicom Xingye, a limited liability company incorporated under the laws of the PRC and a wholly owned subsidiary of Unicom Group;

100% of the equity interest in China Information Technology Designing & Consulting Institute Company Limited, or CITC, a limited liability company incorporated under the laws of the PRC and a wholly owned subsidiary of Unicom Group; and

100% of the equity interest in New Guoxin Telecom Corporation of China Unicom, or New Guoxin, a limited liability company incorporated under the laws of the PRC and a wholly owned subsidiary of Unicom Group.

The total consideration for the above acquisitions is approximately RMB4.43 billion, payable in cash. Following the completion of these acquisitions, the coverage of our fixed-line services expanded to all 31 provinces, autonomous regions and municipalities across China. We believe that these acquisitions will help integrate and optimize our business and resources and enhance our overall competitive position.

In addition, in order to operate the fixed-line business in the 21 provinces in southern China, on December 16, 2008, CUCL entered into a network lease agreement, or the initial network lease agreement, with Unicom Group, Netcom Group and Unicom New Horizon, a wholly owned subsidiary of Unicom Group, to lease on an exclusive basis the telecommunications networks in those provinces, which are held by Unicom New Horizon and are necessary for the operation of the fixed-line business in southern China. The initial network lease agreement became effective in January 2009 upon the completion of our acquisitions of the fixed-line business in southern China and was for an initial term of two years effective from January 2009. On October 29, 2010, CUCL entered into a network leasing agreement, or the 2011-2012 network lease agreement, with Unicom New Horizon, which was for an initial term of two years effective from January 1, 2011 and was renewable at the option of CUCL with at least two months prior notice on the same terms and conditions, except for the future lease fee which will remain subject to further

negotiations between the parties. The annual lease fee paid by CUCL under the 2011-2012 network lease agreement for the years ending December 31, 2011 and 2012 was RMB2.4 billion and RMB2.6 billion, respectively. In December 2012, CUCL acquired the entire equity interest in Unicom New Horizon. See 2012 Acquisition .

***Mutual Investment with Telefónica, S.A.***

On September 6, 2009, we entered into a share subscription agreement with Telefónica, S.A., or Telefónica, one of our shareholders, to strengthen our cooperation. Pursuant to this agreement, we and Telefónica agreed to make a mutual investment in the amount of the equivalent of US\$1 billion in each other through acquisitions of shares in the other party. On October 21, 2009, we and Telefónica completed such mutual investments which were implemented by way of the subscription by Telefónica of 693,912,264 new ordinary shares in the capital of our company at a price of HK\$11.17 each and the contribution by Telefónica of 40,730,735 treasury shares in the capital of Telefónica at a price of Euro17.24 each to us. In addition, on September 6, 2009, we entered into a strategic alliance agreement with Telefónica, pursuant to which Telefónica and we agreed to establish a strategic alliance to strengthen the business of each party and achieve synergies by cooperation in various fields based on our respective networks, business model and experience.

## **Table of Contents**

On January 23, 2011, we entered into the Agreement to Enhance the Strategic Alliance with Telefónica. Pursuant to this agreement, we acquired from Telefónica 21,827,499 ordinary shares in the capital of Telefónica for aggregate purchase price of Euro374,559,882.84 on January 25, 2011, and Telefónica, through its wholly owned subsidiary, Telefónica International, acquired 282,063,000 ordinary shares in the capital of our company for aggregate consideration of approximately US\$500,000,000 in several transactions executed in the period between January 25, 2011 and September 7, 2011. In addition, Wang Xiaochu, our Chairman and Chief Executive Officer, as our designated representative, was appointed in September 2015 as a director on the board of directors of Telefónica.

On June 10, 2012, China Unicom Group Corporation (BVI) Limited, or Unicom Group BVI, a wholly owned subsidiary of Unicom Group, entered into the Share Purchase Agreement for the Sale and Purchase of Shares in China Unicom (Hong Kong) Limited, as amended, pursuant to which it acquired from Telefónica an aggregate of 1,073,777,121 ordinary shares in the capital of our company at a price of HK\$10.02 per share and for an aggregate consideration of HK\$10,759,246,752.42 in July 2012.

On November 13, 2014, Telefónica, through Telefónica International, completed the sale of 597,844,100 ordinary shares in the capital of our company for an aggregate consideration of HK\$6,660 million, and upon the completion of such transaction, Telefónica held less than 5% ordinary shares in the capital of our company.

### ***2011 Acquisition***

In December 2011, we completed our acquisitions through Broadband Online, a wholly owned subsidiary of CUCL, of the entire equity interest in Unicom NewSpace from Unicom Group for a total cash consideration of RMB158 million. Unicom NewSpace primarily engages in mobile value-added business in China.

### ***2012 Acquisition***

In December 2012, we completed our acquisition through CUCL of the entire equity interest in Unicom New Horizon from Unicom Group for a total cash consideration of RMB12,165,750,000. The assets of Unicom New Horizon consist of fixed-line telecommunications network assets located in 21 provinces in southern China and the rights and liabilities of Unicom New Horizon relating to its business operations.

### ***Our Relationship with Unicom Group***

Unicom Group holds the licenses required for our telecommunications businesses and we derive our rights to operate our businesses from our status as a subsidiary of Unicom Group. Unicom Group undertook to hold and maintain all licenses received from the MIIT in connection with our businesses solely for our benefit during the term of such licenses and at no cost to us. In addition, Unicom Group undertook to take all actions necessary to obtain and maintain for our benefit such governmental licenses or approvals as we shall require to continue to operate our businesses. Unicom Group also agreed not to engage in any business which competes with our businesses other than the then-existing competing businesses of Unicom Group and to grant us a right of first refusal in relation to any government authorization, license or permit, or other business opportunity to develop any new telecommunications technology, product or service. Finally, Unicom Group also gave us an undertaking not to seek an overseas listing for any of its businesses or the businesses of its subsidiaries in which we are engaged or may engage in the future, except through us.

In connection with the restructuring of Unicom Group and the acquisitions of Unicom New Century, Unicom New World and Unicom International, we entered into a number of agreements with Unicom Group pursuant to the two-step process described in A. Development and History of the Company Two-Step Voting Arrangements below.



These agreements expired on December 31, 2010. On October 29, 2010, CUCL and Unicom Group entered into a new comprehensive services agreement, or the 2010 comprehensive services agreement, to provide certain services and facilities to each other for a term of three years commencing on January 1, 2011. The 2010 comprehensive services agreement expired on December 31, 2013, and was renewed on October 24, 2013 through a new comprehensive services agreement, or the 2013 comprehensive services agreement, for a term of three years commencing on January 1, 2014 and expiring on December 31, 2016. See B. Related Party Transactions under Item 7 for a detailed description of our agreements with Unicom Group.

## **Table of Contents**

Set forth below is our shareholding structure as of April 14, 2016.

### **Two-Step Voting Arrangements**

As a result of a series of internal restructurings of Unicom Group's shareholding in us following our IPO, Unicom BVI became our direct controlling shareholder, which in turn is directly controlled by the A Share Company and indirectly controlled by the Unicom Group. The A Share Company's business is limited to indirectly holding the equity interest in Unicom without any other direct business operations. The A Share Company was listed on the Shanghai Stock Exchange in 2002. In order to allow public shareholders of the A Share Company to indirectly participate in our shareholders' meeting, a voting mechanism was designed in accordance with the articles of association of Unicom BVI and the A Share Company. Under this voting mechanism, before Unicom BVI votes on certain proposals at our shareholders' meeting, the A Share Company must first convene a shareholders' meeting to consider the same proposals in order to direct Unicom BVI to vote the shares in our company indirectly held by the A Share Company through Unicom BVI. Unicom Group can similarly direct the voting in respect of its direct equity interest in Unicom BVI.

The voting mechanism described above, however, will not apply to the approval process for any related party transaction between us or our subsidiaries and Unicom Group or its subsidiaries, on which Unicom BVI will not be permitted to vote under the Rules Governing the Listing of Securities on HKSE, or the HKSE Listing Rules. Those related party transactions would require the separate approvals of the public shareholders of each of our company and the A Share Company. We and the A Share Company therefore created the two-step voting arrangements, pursuant to which each related party transaction between us or our subsidiaries and Unicom Group or its subsidiaries will consist of an initial agreement and a further agreement. The initial agreement would be entered into by Unicom Group or its subsidiaries (excluding the A Share Company and its subsidiaries) on the one hand and the A Share Company or Unicom BVI on the other hand. The initial agreement would contain the following terms:

the closing of the initial agreement would be subject to (i) the successful transfer of all rights and obligations of the A Share Company or Unicom BVI under the initial agreement to us or our subsidiaries, and (ii) the approval of the further agreement by our independent shareholders; and

Unicom Group or its subsidiaries (excluding the A Share Company and its subsidiaries) would agree and acknowledge that all rights and obligations under the initial agreement can be transferred to us or our subsidiaries without any further consent requirements.

## **Table of Contents**

The initial agreement will constitute a related party transaction of the A Share Company and, if certain thresholds are met, will require the approval of the public or independent shareholders of the A Share Company under the rules of the Shanghai Stock Exchange. The further agreement would be entered into by the A Share Company or Unicom BVI, on the one hand, and us or our subsidiaries, on the other hand, and will provide for the transfer of all rights and obligations of the A Share Company or Unicom BVI under the initial agreement to us or our subsidiaries. The further agreement will constitute a related party transaction of our company and, if certain thresholds are met, will require the approval of our public or independent shareholders under the HKSE Listing Rules. We expect, to the extent the nature of a particular related party transaction allows, the two-step voting arrangements to apply as described above. However, when we or our subsidiaries are the providers, rather than recipients, of certain services, the two-step voting arrangements will need to be adjusted so that the process as described above is effectively reversed, such that the initial agreement is entered into by us or our subsidiaries rather than Unicom Group or its subsidiaries (excluding the A Share Company and its subsidiaries) with the A Share Company or Unicom BVI. Accordingly, Unicom Group or its subsidiaries (excluding the A Share Company and its subsidiaries), rather than us or our subsidiaries, will be a party to the further agreement. The arrangements (including the conditions) will apply correspondingly. This two-step structure will be applied in all related party transactions between us or our subsidiaries and Unicom Group or its subsidiaries and will effectively require the separate approvals of the public or independent shareholders of each of Unicom and the A Share Company for such related party transactions.

## **Capital Expenditures and Divestitures**

See **Liquidity and Capital Resources** **Capital Expenditures** under Item 5 for information concerning our principal capital expenditures for the previous two years and those planned for 2016. We currently do not have any significant divestiture in progress.

## ***B. Business Overview***

### **General**

We are an integrated telecommunications operator in China providing mobile voice and value-added, fixed-line voice and value-added, fixed-line broadband, data communications and other telecommunications services to our customers. We, China Mobile and China Telecom are the three major telecommunications operators in China. See **A. History and Development of the Company** **Restructurings of the Telecommunications Industry** .

In 2015, service revenue from mobile services continued to constitute a substantial portion of our total telecommunications service revenue. The service revenue from our mobile services was RMB142.62 billion, representing 60.6% of our total telecommunications service revenue. Our service revenue from mobile services in 2015 declined by 8.0% from RMB155.10 billion in 2014. The number of mobile services subscribers also declined by 4.16% from 299.10 million in 2014 to 286.66 million in 2015. Nevertheless, the total number of our 4G subscribers substantially increased from 2.11 million in 2014 to 44.16 million in December 2015. 4G subscribers are referred generally to subscribers who possess 4G handsets, use our 4G networks and have revenue contribution in the relevant month indicated.

In addition, our fixed-line broadband services continued to grow in 2015. Service revenue from fixed-line broadband services increased by 7.5% compared with 2014, accounting for 59.1% of total service revenue from the fixed-line services.



**Table of Contents****Mobile Services**

Our mobile services consist of GSM, 3G and 4G services. In 2015, we focused on 4G services. MIIT granted our parent company, Unicom Group, the licenses to operate 4G services adopting the two major variants of 4G LTE technologies, being the Time Division LTE technology, or TD-LTE, and the Frequency-Division LTE technology, or LTE FDD, in December 2013 and February 2015, respectively. Unicom Group authorized our wholly owned subsidiary, CUCL, to operate the 4G services. Our mobile services primarily consist of mobile voice services and mobile non-voice services. Our mobile voice services enable our subscribers to make and receive phone calls, including local calls, domestic long-distance calls, international long-distance calls, intra-provincial roaming, inter-provincial roaming and international roaming, with a mobile handset at any point within the coverage area of our mobile telecommunications networks. Our mobile non-voice services primarily include wireless Internet, mobile reading, mobile music, WO App Store, SMS, Cool Ringtone (a personalized ring-back tone service) and other wireless information services.

Although our 4G services grew significantly in 2015, our service revenue from mobile services and number of mobile services subscribers declined in 2015. This was primarily because we entered into the 4G services market later than a major competitor. In addition, the implementation of VAT in the PRC telecommunications industry, the PRC Government's policies of increasing the network speed and reducing tariffs and our mobile data carry-over programs launched on October 1, 2015 also had a negative effect on our mobile service revenue. Total revenue from our mobile services was RMB184.29 billion in 2015, of which service revenue from our mobile services decreased by 8.0% from RMB155.10 billion in 2014 to RMB142.62 billion in 2015. Such service revenue from mobile services accounted for 63.3% and 60.6% of our total service revenue in 2014 and 2015, respectively.

The following table sets forth selected historical information for our mobile operations and our subscriber base for the periods indicated.

	<b>As of or for the year ended December 31,</b>		
	<b>2013</b>	<b>2014</b>	<b>2015</b>
Number of subscribers (in thousands)	280,983	299,098	286,657
Number of mobile billing subscribers (in thousands) <sup>(1)</sup>	n.a.	266,579	252,317
Estimated market share for our mobile operations in our service areas <sup>(2)</sup>	22.8%	23.2%	21.9%
Estimated market share of mobile billing subscribers <sup>(1)(3)</sup>	n.a.	20.7%	19.8%
Average minutes of usage per subscriber per month (MOU) <sup>(4)</sup>	296.1	278.1	261.0
Mobile billing subscribers MOU <sup>(1)(5)</sup>	n.a.	299.8	293.4
Average revenue per subscriber per month (ARPU) (in RMB) <sup>(6)</sup>	48.2	44.1	40.8
Mobile billing subscribers ARPU <sup>(1)(7)</sup>	n.a.	47.8	46.3

- (1) Mobile billing subscribers are referred generally to subscribers who have revenue contribution in the relevant month indicated. The number of mobile billing subscribers as of December 31, 2014 and December 31, 2015 was the number of mobile billing subscribers who had revenue contribution in December 2014 and December 2015,

respectively. Since January 2016, we have been reviewing and analyzing our mobile billing subscribers data as we believe such data provides more meaningful information to measure our performance in accordance with our operating strategy. The number of mobile billing subscribers as of December 31, 2014 and December 31, 2015 has been generated for our management's review of the trend of performance.

- (2) Market share in a given area is determined by dividing the number of our mobile subscribers in the area by the total number of our mobile subscribers and mobile subscribers of our major competitors in the area. The number of mobile subscribers of our major competitors is publicly disclosed by the mobile operators.
- (3) Market share in a given area is determined by dividing the number of our mobile billing subscribers in the area by the total number of our mobile billing subscribers and mobile subscribers of our major competitors in the area. The number of mobile subscribers of our major competitors is publicly disclosed by the mobile operators.
- (4) We calculate the monthly MOU by dividing the total minutes of usage during a month by the number of our mobile services subscribers during such month. The MOU set forth in this table is the average monthly MOU in the relevant period.
- (5) We calculate the monthly MOU by dividing the total minutes of usage during a month by the number of our mobile services billing subscribers during such month. The MOU set forth in this table is the average monthly MOU in the relevant period.
- (6) We calculate the monthly ARPU by dividing the sum of revenue from mobile services during a month by the number of our mobile services subscribers during such month. The ARPU set forth in this table is the average monthly ARPU in the period.
- (7) We calculate the monthly ARPU by dividing the sum of revenue from mobile services during a month by the number of our mobile services billing subscribers during such month. The ARPU set forth in this table is the average monthly ARPU in the period.

**Table of Contents*****Subscribers of Mobile Services***

Our total number of mobile subscribers decreased by 4.2% from 299.10 million as of December 31, 2014 to 286.66 million as of December 31, 2015, and our total number of mobile billing subscribers decreased by 5.4% from 266.58 million as of December 31, 2014 to 252.32 million as of December 31, 2015. Mobile billing subscribers are referred generally to subscribers who have revenue contribution in the relevant month indicated. The decreases in the total numbers of mobile subscribers and mobile billing subscribers were primarily due to our late entry into the 4G services market compared to a major competitor, the adjustments in our sales and marketing model and our initiatives to reduce our sales and marketing expenses, which posed significant challenges for us to retain or attract mobile subscribers. In addition, the decline in our mobile subscriber was also due to our strict implementation of certain PRC Government's policies, such as the real-name registration of telecommunications service subscribers. See D. Risk Factors Risks Relating to the Telecommunications Industry in China Government regulation of the telecommunications industry in China may affect our ability to respond to market conditions or competition, and may have a material adverse effect on our financial condition, results of operations and growth prospects under Item 3.

The total number of our 4G subscribers reached 44.16 million as of December 31, 2015. 4G subscribers are referred generally to subscribers who possess 4G handsets, use our 4G networks and have revenue contribution in the relevant month indicated. The increase in our total number of 4G subscribers was primarily due to (i) our proactive marketing of our 4G services; (ii) the increasing penetration rate of smart phones in the PRC market; and (iii) our efforts in the establishment of an integrated and centralized business operation management system along with innovations on distribution channels, pricing and service packages.

***MOU and ARPU of Mobile Services***

The MOU of our mobile services decreased from 278.1 minutes in 2014 to 261.0 minutes in 2015, and the MOU of our mobile billing subscribers decreased from 299.8 minutes in 2014 to 293.4 minutes in 2015. The overall ARPU of our mobile services decreased by 7.5% from RMB44.1 in 2014 to RMB40.8 in 2015, and the ARPU of our mobile billing subscribers decreased by 3.1% from RMB47.8 in 2014 to RMB46.3 in 2015. The declines in the MOU were mainly due to (i) our late entry into the 4G services market in China compared to a major telecommunications operator and the intensifying competition with other telecommunications operators, both of which had a negative effect on our ability to attract or retain 4G subscribers or other subscribers with higher usage of telecommunications services; and (ii) many of our new subscribers who are users with lower usage of telecommunications services. The decreases in our ARPU were mainly due to: (i) the decrease in our MOU; (ii) the implementation of VAT to replace business tax relating to the telecommunications services in China; and (iii) the implementation of the PRC Government's policy of increasing network speed and reducing tariffs, as well as our mobile data carry-over programs launched on October 1, 2015, which allow subscribers of our data plans with pre-determined monthly data limit to carry over their unused data to the following month with no extra charge.

***Fixed-Line Services***

We are a leading fixed-line broadband and communications operator in northern China. Following our merger with China Netcom in October 2008, which previously provided mainly fixed-line services in 10 provinces in northern China, and our acquisition of the fixed-line business in 21 provinces in southern China from our parent companies in January 2009, we offer a wide range of fixed-line services nationwide in China, including (i) fixed-line broadband services and data communications services, (ii) fixed-line voice services, include local and long-distance fixed-line voice services and value-added services and (iii) other services.

Our total revenue from fixed-line services was RMB91.37 billion in 2015, of which service revenue from our fixed-line services increased by 3.1% from RMB88.48 billion in 2014 to RMB91.26 billion in 2015, accounting for 36.1% and 38.8% of our total service revenue in 2014 and 2015, respectively. In 2015, we achieved stable increase in total revenue from our fixed-line services, mainly attributable to the proactive implementation of fiber-optic broadband network upgrade, the improvement of our network speed, and the promotion of the development of integrated mobile and fixed-line services.



**Table of Contents*****Fixed-Line Broadband Services and Data Communications Services******Fixed-Line Broadband Services***

Fixed-line broadband services are one of our emphases as part of our strategy to focus on high growth services and also the foundation for the development of our mobile network and services. The growth in fixed-line broadband services has been driven by the increasing affordability and rising use of personal computers and other Internet access devices, gradual recognition by businesses of the importance of information and the proliferation of content and applications, such as online games and video-on-demand. We are a leading provider of fixed-line broadband services in our fixed-line northern service region and we seek to maintain this leading position by capitalizing on our extensive fixed-line network, large customer base, experienced sales force, established brand and strategy of multi-service bundling.

In 2015, we continued to upgrade our fiber-optic transmission network and improved access speed. Through strengthening the marketing of integrated mobile and fixed-line services, we promoted IPTV/Internet TV services, which effectively developed fixed-line broadband subscribers and enhanced customer loyalty by creating more value for them. As of December 31, 2015, our fixed-line broadband subscribers increased by 5.1% to 72.33 million, of which subscribers with 4M-and-above bandwidth accounted for 90.4% of all fixed-line broadband subscribers, representing an increase of 2.2 percentage points from the end of 2014. Our fixed-line broadband ARPU increased by 2.3% from RMB62.2 in 2014 to RMB63.6 in 2015.

The following table sets forth the information of our fixed-line broadband subscribers as of the dates indicated:

	<b>As of December 31,</b>		
	<b>2013</b>	<b>2014</b>	<b>2015</b>
Number of fixed-line broadband subscribers (in thousands)	64,647	68,790	72,330

***Data Communications Services***

We are a leading provider of data communications services in our fixed-line northern service region. We offer data products, such as those based on digital data networks, or DDN, frame relay, asynchronous transfer mode, or ATM, and Internet protocol-virtual private network, or IP-VPN. We also offer leased line products, including domestic and international leased circuits. Our customers for these services include government entities, large financial institutions and other domestic and multinational businesses, Internet service providers and other telecommunications operators. In 2015, we continued to offer full-scale data communications services to international operators and domestic and international corporate customers. We have also improved our capabilities to offer cross-border data communications and integrated information services.

***Fixed-Line Voice Services***

Our fixed-line voice services consist of local voice, domestic long-distance, international long-distance, interconnection and PHS services. As domestic mobile operators launched service packages at competitive prices, mobile roaming tariffs were lowered, and the migration of voice usage from fixed-line to mobile continued. In 2015, leveraging on our company's full-service advantage, we enhanced market development in areas of customer premises network, or CPN, and rural markets, as well as strengthened the marketing of integrated services.

The number of our fixed-line subscribers (including PHS subscribers) was 87.64 million, 82.06 million and 73.86 million as of December 31, 2013, 2014 and 2015, respectively. The decrease in the recent years was primarily due to a decrease in the number of our fixed-line telephone service subscribers and our PHS subscribers.

**Table of Contents***Local Voice Services*

As a result of mobile substitution, our fixed-line local voice traffic has continued to decrease in recent years. As fixed-line broadband services further develop, our Internet dial-up usage has also continued to decrease. The total usage of our local calls were 64,793 million times, 69,879 million times and 59,084 million times in 2013, 2014 and 2015, respectively.

*Long-Distance Voice Services*

We offer traditional long-distance services and VoIP long-distance services. In recent years, due to the general decline of our fixed-line services and competition from software applications that allow users to make long-distance calls over the Internet, our long-distance services has been adversely affected.

Total minutes of domestic long-distance calls carried through our long-distance networks for the year ended December 31, 2013, 2014 and 2015 were 15,590, 14,198 and 12,707 million, respectively.

The following table sets forth certain information related to the usage of our international long-distance services for the periods indicated:

	<b>For the Year Ended December 31,</b>		
	<b>2012</b>	<b>2013</b>	<b>2014</b>
<b>International long-distance outbound call minutes (minutes in millions)<sup>(1)(2)</sup></b>			
Traditional	197	74	53
VoIP	199	100	62
Total	396	174	115

(1) Includes calls originated by prepaid phone cards users and VoIP subscribers that are carried over our international long-distance networks.

(2) Includes long-distance outbound calls made to Hong Kong, Macau and Taiwan.

***Fixed-Line Value-Added Services***

In addition to fixed-line telephone voice services, we offer a wide range of value-added services on our fixed-line networks. Our value-added services generate additional usage on our networks and increase our average revenue per fixed-line subscriber. Our major fixed-line value-added services include Personalized Ring and caller-identification services. Personalized Ring services enable our fixed-line subscribers to personalize the ring-back tone for incoming calls.

**Interconnection and Roaming Arrangements*****Interconnection***

Interconnection refers to the arrangements that permit the connection of our telecommunications networks with other networks. Our mobile and fixed-line networks interconnect with Unicom Group's networks. Under current

arrangements, settlement between Unicom Group and us is based on an internal settlement standard that takes into account either the internal costs of the relevant networks or the government standard applicable between third-party operators, whichever is the more favorable to us.

We earn interconnection fees for terminating or transiting calls that originate from other domestic telecommunications operators' networks and pay interconnection fees to other operators for calls originating from our networks that are terminated on their networks. We earn and pay such fees in respect of mobile calls, local and domestic and international long-distance calls and Internet services. We are required to pay the interconnection fees regardless of our ability or inability to collect the tariff from our subscribers. Interconnection charges are accrued on a monthly basis based on the actual call volume and applicable tariff rates.

## **Table of Contents**

All interconnection and settlement arrangements among domestic telecommunications operators in China are governed by the Telecommunications Regulations and the rules on interconnection arrangements and settlement promulgated by the MIIT. Some of the agreements pursuant to which we interconnect with other domestic operators were entered into by Unicom Group. We have entered into an agreement with Unicom Group pursuant to which we have agreed with Unicom Group that the costs and benefits arising under these agreements, as they relate to our operations, will be incurred to our account.

For additional information about our domestic and international interconnection arrangements, see **B. Business Overview** **Regulatory and Related Matters** under Item 4 and **B. Related Party Transactions** under Item 7.

## ***Roaming***

We provide roaming services, which allow our subscribers to access our mobile services while they are physically outside of their registered service area or in the coverage areas of other mobile networks in other countries and regions with which we have roaming arrangements. As of March 31, 2016, we had roaming arrangements for (i) GSM international voice and SMS services with 596 operators in 251 countries and regions, (ii) GPRS international inbound data services with 518 operators in 208 countries and regions and for GPRS international outbound data services with 465 operators in 191 countries and regions, (iii) 3G services with 378 WCDMA operators in 142 countries and regions, and (iv) 4G international inbound data services with 65 operators in 38 countries and regions and for 4G international outbound data services with 55 operators in 33 countries and regions.

A mobile subscriber using roaming services is charged at our roaming usage rate for both incoming and outgoing calls, plus applicable long-distance tariffs. With respect to international roaming, we settle roaming charges with international operators in accordance with roaming agreements between Unicom Group and each of the international operators.

## **Networks**

We operate an advanced network system to support our integrated operations. The backbone of the system is a nationwide fiber-optic transmission network, which serves as the common platform for our mobile, fixed-line telephone, broadband and data services. We generally utilize a centralized network planning and equipment selection process, which ensures uniform nationwide design and network compatibility. After our merger with China Netcom in October 2008, we have actively integrated our network resources to improve our network quality and capacity.

## ***Mobile Networks***

Our mobile network generally consists of:

base station sites, which are physical locations, each equipped with a base station that houses transmitters, receivers and other equipment used to communicate through radio channels with subscribers' mobile handsets within the range of a cell;

base station controllers, which connect to, and control, the base stations;

mobile switching centers, which control the base station controllers and the routing of telephone calls;  
and

a transmission network, which links the mobile switching centers, base station controllers, base stations and the public switched telephone network.

-31-

## **Table of Contents**

We have deployed GSM, WCDMA and LTE mobile networks. Our GSM mobile network mainly operates at 900 MHz and 1800 MHz. We use 2x6 MHz of spectrum in the 900 frequency band and 2x15 MHz of spectrum in the 1800 frequency band for our GSM network in most of our service areas. With the licenses from MIIT to operate the 4G technologies consisting of TD-LTE and LTE FDD technologies in December 2013 and February 2015, respectively, we have deployed TD-LTE networks using 2300-2320 MHz and 2555-2575 MHz of spectrum, with 40 MHz frequency resources in total. The 2300-2320 MHz of spectrum only applies to indoor networks. We have also deployed LTE-FDD networks using 2x15 MHz LTE-FDD frequency resources (uplink frequency of 1750-1765 MHz and downlink frequency of 1845-1860 MHz of spectrum).

We have devoted significant resources in developing and improving our 4G networks to enhance our customer experience and continued to expand our network coverage. As of December 31, 2015, our 4G network base stations reached 399,000 with an increase of 306,000 base stations and our other mobile service base stations reached 1,238,000.

### ***Fixed-Line Networks***

We operate fixed-line networks which provide extensive coverage in China. These networks are technologically advanced and conducive to the introduction of the next generation fixed-line network and mobile technologies. These networks support a wide range of end-to-end fixed-line telecommunications services and enable customized products to be delivered to meet a variety of telecommunications needs in real-time .

Our fixed-line networks consist of fixed-line telephone networks, broadband Internet and data networks, transmission networks, value-added service platforms, IT support systems and related infrastructures. Our transmission networks consist primarily of fiber-optic based networks, which cover our major service regions, supplemented by satellite transmission and digital microwave links.

We have integrated our resources to optimize and improve the transport capabilities of our IP networks and improved our long-distance soft-switch network capability. In addition, by adding seven national Internet backbone nodes, we further increased our Internet bandwidth, and our broadband network capacity was substantially enhanced. By the end of 2015, the number of fixed-line broadband access ports increased by 30.03 million to 164.83 million, up by 22.2% from the end of 2014, of which the number of access ports with FTTX accounted for 93% of total broadband access ports. Our international Internet outbound bandwidth reached 1,278G, our submarine cable capacity reached 5,511G, and our international cross-continental cable capacity reached 2,802G.

### **Marketing, Sales and Distribution**

Our marketing strategy is to establish our image as a full-service telecommunications service provider and utilize our comprehensive services platform and nationwide sales and distribution network. We implement our marketing and sales strategies under a single unified brand WO , and establish a unified operating marketing system based on our online business-to-business platform Woego, and distribute our services through a variety of distribution channels, consisting of (i) self-owned channels, including proprietary sales outlets and direct sales forces targeting retail and corporate customers, (ii) social channels, including cooperative sales outlets, exclusive sales outlets and agency sales outlets, and (iii) electronic distribution channels, including self-owned and third-party channels online e-stores. In recent years, we have continued developing our self-owned sales channels and strategically expanding our social channels. In particular, for our mobile services, in addition to the full use of our self-owned channels, we have also focused on using high-quality social channels, such as large brand name electronics retail chains and electronics outlets in China, to achieve better sales results. Furthermore, we continued promoting and optimizing our nationwide e-sales system, which has effectively supplemented our traditional sales channels and improved our service quality. In

recent years, we have conducted extensive 4G promotion activities to further enhance WO brand value and corporate brand value. In 2014, we established a B2B e-commerce platform Woego , so as to further enhance the productivity and efficiency of our distribution channels. In 2015, we focused on development and expansion of our 4G services, accelerated the network construction and the upgrade of fiber broadband network, launched the WO 4G+ initiatives in addition to our Smart WO Family services, to enhance our integrated brand recognition and service quality.

-32-



## **Table of Contents**

### **Customer Service**

We provide customer services through our nationwide sales outlets, hotline number 10010, online sales outlets, SMSs, handset online stores, self-service service platforms, official micro-blog and other channels. Our customer services typically include inquiries, service initiation and termination, and response to reports of mechanical malfunction as well as customer complaints and suggestions. We provide customer services to our customers travelling outside of China via a dedicated international roaming service hotline number 18618610010 24 hours per day, seven days per week. We implement relevant procedures to ensure that our customer service is provided in a timely manner. For instance, to the extent that we are unable to address certain of our customer's inquiries via our customer hotline, we will make commitments to our customers that we will provide response to their inquiries within a specified timeframe.

We proactively develop and improve our Internet-based customer services. We also continue to improve our customer service system and operations, customer retention and customer service quality. We launch various initiatives to enhance our customer experience by customer service follow-up calls and regular greetings to customers. In addition, we promote the transparency of our broadband services by keeping our customers apprised of each key stage of the service installation process, which includes the service initiation, schedule for installation, and commencement and completion of installation.

### **Information Systems**

We have established multiple information technology support systems at the headquarters level and comprehensive information systems in each province, autonomous region and municipality to support our business and management. For business support, we have established core systems composed of a customer relationship management system and a comprehensive billing and accounting system to support our business operations. In addition, we have established integrated systems, such as integrated ECS, integrated electronic sales management system featuring full services, integrated business support system for corporate group customers, integrated channels management system, integrated account settlement system and integrated partnership management system to achieve integrated and centralized management of our businesses and enhance our sales and services capabilities through electronic channels. For our management support, we focused on the construction and optimization of a comprehensive enterprise resource planning system to optimize our resource allocations and enhance our operational efficiency. For our internal data service capabilities, we have established an integrated data analysis system and launched the construction of a large data platform to support our appraisal management and operational analysis with data. For the application of new technologies, we have launched the construction of our private cloud and tried to enhance the performance of the systems with new technologies to lower the overall cost of information technology.

### **Research and Development**

We focus on technology innovation in coordination with our various business departments in order to provide technical support for our business development. Our research and development activities are focused primarily on fixed-line and mobile technologies and their further development, cloud computing, big data, Internet of things, intelligent channels, SDN and NFV, network and information safety, data center, next generation Internet technologies and businesses, operational planning and development of value-added services. In addition, part of our research and development requirements is fulfilled by our parent company, Unicom Group, in return for a service fee. See B. Related Party Transactions under Item 7 below. We also participate in the national research project on the fifth generation mobile telecommunications, or 5G, closely follow the development of 5G technologies and standards, proactively carry out 5G technology related researches and experiments.



## **Table of Contents**

### **Competition**

As a result of the telecommunications industry restructuring in 2008, the Chinese telecommunications market now has three key providers of basic telecommunications service—China Telecom, China Mobile and us—in addition to thousands of value-added service providers and other companies that provide telecommunications or related services. We compete with China Mobile and China Telecom in virtually all aspects of our services, including mobile services, fixed-line voice services, broadband services and data communications services. As Unicom Group, China Mobile and China Telecom were granted the license to operate TD-LTE mobile service by the PRC Government in December 2013, and Unicom Group and China Telecom were granted the license to operate LTE-FDD mobile service in February 2015, we face intensive competition in the 4G services. In addition, the PRC Government recently published a series of regulations to encourage non-State-owned companies to enter PRC telecommunications industry, including the pilot program to permit companies engaged in the resale of mobile communications services to acquire mobile communications services from China Mobile, China Telecom or us and repackaging and rebranding such services for resale to end-users, and we may face competition from these non-State-owned companies. We also face increasing competition from other service providers, such as cable television companies and Internet service providers, which compete against our broadband access, voice and messaging services and other services by offering telecommunications or related services. See **D. Risk Factors—Risks Relating to Our Business**. We face intense competition from other telecommunications operators, including China Mobile and China Telecom, and other companies that provide telecommunications or related services, which may materially and adversely affect our financial condition, results of operations and growth prospects and **D. Risk Factors—Risks Relating to Our Business**. Competition from foreign-invested operators may further increase the competition for employees, exacerbate price competition and increase our operating expenses, thereby adversely affecting our financial condition, results of operations and growth prospects under Item 3, respectively.

### **The Tower Company**

In July 2014, we, through CUCL, entered into a promoters' agreement with a subsidiary of China Mobile and China Telecom to jointly establish China Tower Company Limited (formerly known as China Communications Facilities Services Corporation Limited), or the Tower Company, with a registered capital of RMB10 billion. Pursuant to the promoters' agreement, we subscribed for 3.01 billion shares at a par value of RMB1.00 per share in the registered capital of the Tower Company in cash, representing 30.1% of the registered capital of the Tower Company, while the remaining 40.0% and 29.9% of the registered capital of the Tower Company are beneficially held by China Mobile and China Telecom, respectively. The Tower Company will be primarily engaged in the construction, maintenance and operation of telecommunications towers. It will also be engaged in the construction, maintenance and operation of ancillary facilities including base station control rooms, power supplies, air conditioning and interior distribution systems, as well as the provision of maintenance services of base station equipment.

In October 2015, we, through our wholly own subsidiaries, CUCL and Unicom New Horizon entered into a transfer agreement with (i) China Mobile Communication Company Limited, a wholly owned subsidiary of China Mobile, (ii) China Telecom, (iii) China Reform Holding Company Limited, a wholly state-owned company, and (iv) the Tower Company, pursuant to which we, China Mobile and China Telecom sold certain telecommunications towers and related assets to the Tower Company, and the Tower Company would issue and allot shares in the Tower Company and/or pay certain cash as consideration for such transfers. As of April 14, 2016, we, through CUCL, owned approximately 28.1% equity interest in the Tower Company, while China Mobile, China Telecom and China Reform Holding Company Limited owned approximately 38.0%, 27.9% and 6.0% equity interest in the Tower Company, respectively. We are in the process of negotiating the final arrangements with the Tower Company with respect to our use of telecommunications towers and related assets of the Tower Company.

### **Strategic Alliances with Telefónica**

On January 30, 2009, we entered into a business cooperation framework agreement with Telefónica. Pursuant to the framework agreement, Telefónica and we agreed to share business experience and strengthen cooperation in the areas of mobile communications, broadband applications, international business, marketing and sales and telecommunications services to corporate clients. On September 6, 2009, we entered into a strategic alliance agreement with Telefónica, pursuant to which Telefónica and we agreed to establish a strategic alliance to strengthen the business of each party and achieve synergies by cooperation in various fields based on our respective networks, business models and experience. On October 21, 2009, we and Telefónica completed a mutual investment in the amount of the equivalent of US\$1 billion in each other, which was implemented by way of the subscription by Telefónica of 693,912,264 new shares in our Company and the contribution by Telefónica of 40,730,735 treasury shares in the capital of Telefónica to us.

## **Table of Contents**

On January 23, 2011, we entered into the Agreement to Enhance the Strategic Alliance with Telefónica. Pursuant to this agreement, we acquired from Telefónica 21,827,499 ordinary shares in the capital of Telefónica for aggregate purchase price of Euro374,559,882.84 on January 25, 2011, and Telefónica, through its wholly owned subsidiary, Telefónica International, acquired 282,063,000 ordinary shares in the capital of our company for an aggregate consideration of approximately US\$500,000,000 in several transactions executed in the period between January 25, 2011 and September 7, 2011. In addition, Wang Xiaochu, our Chairman and Chief Executive Officer, as our designated representative, was appointed in September 2015 as a director on the board of directors of Telefónica.

On June 10, 2012, Unicom Group BVI, a wholly owned subsidiary of Unicom Group, entered into the Share Purchase Agreement for the Sale and Purchase of Shares in China Unicom (Hong Kong) Limited, as amended, pursuant to which it acquired from Telefónica an aggregate of 1,073,777,121 ordinary shares in the capital of our company at a price of HK\$10.02 per share and for an aggregate consideration of HK\$10,759,246,752.42 in July 2012.

On November 13, 2014, Telefónica completed the sale of 597,844,100 ordinary shares in the capital of our company for an aggregate consideration of HK\$6,660 million, and upon the completion of such transaction, Telefónica held less than 5% ordinary shares in the capital of our company.

In addition, in December 2015, we and Telefónica established a joint venture company, Smart Steps Digital Technology Co., Ltd., to engage in big data application services in China.

## **Strategic Cooperation with China Telecom**

In January 2016, we entered into a strategic cooperation agreement with China Telecom in relation to resource-sharing and joint investments. Under the strategic cooperation, we expect that we will share certain telecommunications facilities such as mobile networks and transmission networks with each other, jointly carry out certain network maintenance services and certain marketing initiatives, as well as seek and explore opportunities in joint investments in innovative and emerging business areas. We expect that our strategic cooperation will enhance our service qualities and operating efficiency, and thus improving our customer experience and contributing to our market recognition.

## **Trademarks**

We conduct our businesses under the Unicom name and logo. Unicom Group is the registered proprietor in China of the Unicom trademark in English and the trademark bearing the Unicom logo. Unicom Group is also the registered proprietor of the trademark of the word Unicom in Chinese. Unicom Group has granted us the right to use these trademarks on a royalty-free basis with periodic renewals, and licensed us any trademark that it registers in China in the future which incorporates the word Unicom.

## **Regulatory and Related Matters**

The telecommunications industry in China is subject to a high degree of government regulation. The primary regulatory authority of the Chinese telecommunications industry is the MIIT, established in 2008 as a new ministry under the PRC State Council and the successor of the former Ministry of Information Industry. The NDRC, the Ministry of Commerce and other governmental authorities also maintain regulatory responsibilities over certain aspects of the Chinese telecommunications industry.

The MIIT, under the supervision of the State Council, is responsible for, among other things:

formulating and enforcing industry policies and regulations, as well as technical standards;

granting telecommunications service licenses;

supervising the operations and quality of services of telecommunications service providers;

-35-

## **Table of Contents**

allocating and administering telecommunications resources such as spectrum and number resources;

formulating interconnection and settlement policies between telecommunications networks; and

maintaining fair and orderly market competition among service providers.

The MIIT has established a Telecommunications Administration in each province, autonomous region and municipality in China to oversee the implementation of the MIIT's policies and regulations and exercising regulatory authority delegated by the MIIT within that province, autonomous region or municipality.

The MIIT is in the process of drafting a telecommunications law that, once adopted by the National People's Congress of the PRC, will become the basic telecommunications statute and provide the principal legal framework for telecommunications regulations in China. It is currently uncertain when the law will be adopted and become effective. See D. Risk Factors – Risks Relating to the Telecommunications Industry in China – Regulatory or policy changes relating to the PRC telecommunications industry or any future industry restructuring may materially and adversely affect our financial condition, results of operations and growth prospects – under Item 3.

### ***Telecommunications Regulations***

On September 25, 2000, the PRC State Council promulgated the Telecommunications Regulations of the People's Republic of China, which came into effect on the same date. All telecommunications activities and related activities within China are subject to the Telecommunications Regulations. On August 15, 2014, the PRC State Council amended the Telecommunications Regulations of the People's Republic of China.

According to the PRC Government, its administration and regulation of the Chinese telecommunications industry is based on the principles of the separation of governmental regulation from enterprise management, the elimination of monopolistic behavior, the encouragement of competition and the promotion of the development of the Chinese telecommunications industry, while also taking into account the principles of openness, equality and fairness. The Telecommunications Regulations regulate all major aspects of the telecommunications industry, including licensing, interconnection, tariffs, resources, services, security, facility construction and access to networks.

### ***Licensing***

The PRC Government licenses telecommunications businesses in accordance with their classification. Telecommunications businesses are currently classified into two broad categories of basic services and value-added services. An appendix to the Telecommunications Regulations divides each of the two categories into further sub-categories. On December 28, 2015, the MIIT promulgated the Telecommunications Services Catalogue (2015 edition), or the 2015 Catalogue, which took effect on March 1, 2016. According to the 2015 Catalogue:

basic telecommunications services are classified into Category I basic telecommunications services and Category II basic telecommunications services.

Category I basic telecommunications services include fixed-line telecommunications services (including fixed-line local, domestic long-distance and international long-distance

telecommunications services and services related to maintaining international telecommunications facilities), cellular mobile telecommunications services (including 2G digital cellular mobile telecommunications services, 3G digital cellular mobile telecommunications services and LTE/4G digital cellular mobile telecommunications services), Category I satellite telecommunications services (including satellite mobile telecommunications and satellite fixed-line telecommunications services), Category I data communications services (including Internet international data telecommunications, Internet domestic long-distance data telecommunications, Internet local data telecommunications and International data communications services) and IP telephone services (including domestic and international IP telephone services).



**Table of Contents**

Category II basic telecommunications services include trunking telecommunications services (including digital trunking telecommunications services), wireless paging services, Category II satellite telecommunications services (including lease and sales of satellite transponders and very-small-aperture-terminal, or VSAT, telecommunications services), Category II data telecommunications services (including fixed-line domestic data transmission services), services related to network access facilities (including services related to wireless network access facilities and cable network access facilities, and network services from customer premises), services related to maintaining domestic telecommunications facilities and network hosting services.

value-added telecommunications services are classified into Category I value-added telecommunications services and Category II value-added telecommunications services.

Category I value-added telecommunications services include Internet data center, or IDC, content distribution network, domestic Internet virtual private network and Internet access services.

Category II value-added telecommunications services include on-line data processing and interchange, domestic multi-party telecommunications, store-and-forward, call center (including domestic and offshore call centers), information and coding and protocol conversion (including domain name system) services.

On March 1, 2009, the MIIT promulgated the Measures on the Administration of Telecommunications Business Licenses, which took effect on April 10, 2009 and superseded the previous measures promulgated by the former Ministry of Information Industry on December 26, 2001.

The measures govern the application for, approval of and regulation of telecommunications business licenses in China. The operation of any basic telecommunications business is subject to the MIIT's approval and grant of License for Operation of Basic Telecommunications Businesses. The operation of any value-added business in two or more provinces, autonomous regions or municipalities is subject to the MIIT's approval and grant of License for Inter-Provincial Operation of Value-Added Telecommunications Businesses. The operation of value-added businesses within a single province, autonomous region or municipality is subject to the approval of the telecommunications authority of the relevant province, autonomous region or municipality in China and the grant of the License for Operation of Value-Added Telecommunications Businesses. The measures, among other things, lowered the minimum amount of registered capital required for an applicant to enter the basic telecommunications business in China.

After the PRC's accession to the WTO, on December 11, 2001, the PRC State Council promulgated the Administrative Regulations on Telecommunications Companies with Foreign Investments, which took effect on January 1, 2002, and were amended on September 10, 2008, to implement China's commitments to the WTO. Those commitments include the gradual reduction of restrictions on foreign ownership in telecommunications enterprises in China and the step-by-step opening-up of the Chinese telecommunications market to foreign enterprises. In recent years, China gradually lifted restrictions for foreign investors in telecommunications enterprises in China and fulfilled its commitment to open up the Chinese telecommunications market. However, the following restrictions on investments in mobile, value-added telecommunications and fixed-line services remain:

for fixed-line services, there is no longer any geographic restriction and foreign ownership may be no more than 49%;

for mobile voice and data services, there is no longer any geographic restriction and foreign ownership may be no more than 49%; and

for value-added telecommunications services, there is no longer any geographic restriction and foreign ownership may be no more than 50%.

**Table of Contents*****Spectrum and Network Number Resources***

The MIIT is responsible for the management of the wireless radio frequency spectrum and the allocation of frequencies within the spectrum. The frequency assigned to a telecommunications operator may not be leased or transferred without the MIIT's approval. Standard fees for usage of the frequencies assigned to cellular telecommunications are charged to telecommunications operators: (i) for the nationwide GSM network frequency, an annual rate of RMB17 million per MHz is charged for the 900 MHz band and an annual rate of RMB14 million per MHz is charged for the 1800 MHz band; (ii) for the nationwide WCDMA network frequency, a standard fee at an annual rate of RMB3.75 million per MHz in 2011, RMB7.5 million per MHz in 2012, RMB11.25 million per MHz in 2013 and RMB15 million per MHz in 2014 and onwards will be charged for the 2100 MHz band; (iii) for any local telecommunications network frequency, an annual rate of RMB1.7 million per MHz is charged for each province for the 900 MHz band, an annual rate of RMB1.4 million per MHz is charged for each province for the 1800 MHz band and an annual rate of RMB1.5 million will be charged for each province for the 2100 MHz band. The standard tariffs for TD-LTE and LTE-FDD network frequency have not been announced by the PRC Government.

The MIIT is also responsible for the administration of China's telecommunications network number resources. The telecommunications network number resources are owned by the State, which shall charge fees for the use of such resources. Application for the use of number resources by any telecommunications operator is subject to the approval of the MIIT or the relevant provincial telecommunications authority and the payment of certain usage fees. The measures also provide for the procedures for the application, usage and record-keeping for the telecommunications operators' use of number resources.

***Tariff Setting***

Prior to January 2014, the levels and categories of telecommunications tariffs were subject to regulation by various government authorities, including the MIIT, the NDRC, and, at the local level, the relevant provincial Telecommunications Administration Bureaus and price regulatory authorities.

In January 2014, the State Council announced the removal of the MIIT's approval requirement on the tariff standard of telecommunications services. In addition, pursuant to the amendments to the Telecommunications Regulations dated August 15, 2014, the telecommunications tariffs shall be set by the telecommunications operators based on costs and market conditions.

In May 2015, the PRC government introduced the PRC Government's policy of increasing network speed and reducing tariffs. In response to such policy, we have since then offered discounts to our tariff plans. In addition, in October 2015, we launched our mobile data carry-over programs, which allow subscribers of our data plans with pre-determined monthly data limit to carry over their unused data to the following month with no extra charge. Furthermore, in light of the national policy of achieving coordinated development of Beijing Municipality, Tianjin Municipality and Hebei Province issued in April 2015 by the PRC Government, we cancelled the long-distance and roaming tariffs for voice services within the tariff zones of Beijing Municipality, Tianjin Municipality and Hebei Province so that our customers are only charged with local usage tariff for our voice services provided within the tariff zones.

The following tables set forth the tariff rates of certain services provided by us:

***Mobile Services***

Generally, the categories of tariffs we charge our mobile subscribers include, among others, basic monthly fees and local usage charges, roaming charges, long-distance-call charges and charges for value-added services. The following table summarizes the current tariffs for post-paid and pre-paid mobile services:

	<b>Post-paid Services (RMB)</b>	<b>Pre-paid Services (RMB)</b>
Basic monthly fee	45-50	0
Local usage charge (per minute)	0.36-0.40	0.54-0.6
Domestic roaming charge (per minute)	0.6 for caller	0.6 for caller
	0.4 for receiver	0.4 for receiver

**Table of Contents**

Intensifying competition in our mobile service areas has resulted in tariff discounts and service promotions offered by us and our main competitors from time to time, which may reduce the effective tariffs. These discounts and promotions have taken many forms, including promotional tariff rates, free call minutes, reduced roaming charges, off-peak discounts or discounts for high-usage subscribers and package service plans with fixed monthly fees.

We have introduced a number of package service plans. Under these plans, subscribers typically pay a fixed monthly fee for a specified number of call minutes. The plans vary at the levels of fixed monthly fee, number of specified call minutes and tariff rates for call minutes in excess of the specified call minutes. The terms of these plans also vary depending on the local markets.

*Fixed-Line Voice Services*

For our local voice services, we charge an installation and testing fee that varies depending on whether the subscriber is a residential or a business customer, a fixed monthly fee, local call usage fees based on call duration and fees for certain value-added services. For our domestic long-distance services, our revenue from domestic long-distance services consist of charges based on the duration, time of day and day of the week a call is placed.

The following table sets forth our current tariffs for (i) local voice services provided on our traditional and PHS network, (ii) domestic long-distance telephone services using our traditional network and (iii) our international long-distance telephone services using our traditional network:

	<b>Tariff (RMB)</b>
<b>Local Voice Services</b>	
Monthly fee:	
Residential subscribers in:	
Provincial capitals	20.00 to 25.00
Other cities and counties	12.00 to 18.00
Rural areas	10.00 to 15.00
Business subscribers	25.00 to 35.00
Usage fee:	
Intra-district	0.18 to 0.22 for the first two pulses (first three minutes or less) and 0.09 to 0.11 for each additional pulse (one-minute intervals)
Inter-district	up to 0.30 per pulse (one-minute intervals)
Communication fee:	
Internet dial-up	0.02 per pulse (one-minute intervals)
<b>Domestic long-distance services on our traditional network<sup>(1)</sup></b>	
	0.07 per six seconds
<b>International long-distance services on our traditional network<sup>(1)</sup> :</b>	
To Hong Kong, Macau and Taiwan	0.20 per six seconds
To all international destinations	0.80 per six seconds

- (1) Subject to filing with the provincial telecommunications administrations, our provincial level headquarters may apply a 10% to 50% discount rate to calls made during off-peak hours.

**Table of Contents***Data Services*

Set forth below are the tariffs for our data services consisting of DDN services and frame relay services.

DDN services. The following table sets forth the monthly fees for DDN services at the bandwidths of 64kbps, 128kbps, 512kbps and 1Mbps:

	Monthly Fee (RMB)			
	64kbps	128kbps	512kbps	1Mbps
Intra-district	1,500	2,000	3,800	5,000
Inter-district	2,000	2,500	5,200	7,500
Domestic long-distance	3,500	5,000	7,000	9,000

Frame relay services. The following tables set forth the monthly fees for frame relay services, which include monthly fees for port access and permanent virtual circuits, or PVCs<sup>(1)</sup>:

	Monthly Fee (RMB)			
	64kbps	256kbps	512kbps	1Mbps
Port access				
Monthly fees	260	400	500	750
PVC				
Intra-district	550	800	1,000	1,250
Inter-district	800	1,150	1,450	2,000
Domestic long-distance	1,700	2,200	2,500	3,000

(1) One-way tariff for PVCs frame relay services.

*Leased Line Services*

We charge monthly fees for subscribers to our leased line services based on guidance tariffs set by the PRC Government, which vary based on bandwidth and whether the leased line is local or long-distance. Leased line tariffs have generally decreased in recent years.

The following table sets forth the tariffs for 2Mbps, 8Mbps, 34Mbps and 155Mbps digital circuits:

	Monthly Fee (RMB)			
	2Mbps	8Mbps	34Mbps	155Mbps
Intra-district	2,000	6,000	16,000	44,000
Inter-district	4,000	11,000	31,000	88,000
Domestic long-distance <sup>(1)</sup>	6,000	17,000	47,000	132,000

(1) Does not include the tariffs for local digital circuits and access lines.

***Interconnection Arrangements***

In October 2003, the former Ministry of Information Industry issued Measures on Settlement of Interconnection between Public Telecommunications Networks and Sharing of Relaying Fees, which superseded the Measures on the Settlement of Call Charges between Telecommunications Networks issued by the former Ministry of Information Industry in 2001. These regulations contain specific provisions regarding, among other things, revenue-sharing methods and settlement mechanisms and interconnection agreements among telecommunications service providers. Since November 2005, the former Ministry of Information Industry (or the MIIT after March 2008) has issued a number of administrative measures to adjust the settlement arrangement standards with respect to interconnection fees for certain network interconnections between telecommunications operators. In accordance with various administrative measures, Unicom Group or we, as the case may be, have entered into agreements on interconnection with other telecommunications operators, including China Telecom and China Mobile.



**Table of Contents**

The following table sets forth selected interconnection revenue-sharing and settlement arrangements for local calls:

<b>Operator from Whose Network Calls Are Originated</b>	<b>Operator at Whose Network Calls Are Terminated</b>	<b>Current Main Settlement Arrangement</b>
Mobile operator	Local fixed-line operator	(1) Mobile operator collects the usage fees from its subscribers;  (2) Mobile operator pays RMB0.06 per minute to local fixed-line operator. For calls originated from 157 or 188 prefix phone numbers (TD users) during the period from January 1, 2010 to December 31, 2010, mobile operator (China Mobile) pays RMB0.012 per minute to fixed-line operator. From January 1, 2011, for calls originated from 157 or 188 prefix phone numbers (TD users), mobile operator (China Mobile) continues to pay RMB0.012 per minute to fixed-line operator.
Local fixed-line operator	Mobile operator	(1) Local fixed-line operator collects the usage charge from its subscribers;  (2) No revenue-sharing or settlement prior to June 1, 2010. Local fixed-line operator pays RMB0.001 per minute to mobile operator after June 1, 2010.
Mobile operator A	Mobile operator B	(1) Mobile operator A collects the cellular usage charge from its subscribers;  (2) Mobile operator A pays RMB0.06 per minute to mobile operator B. For calls originated from a mobile user of China Telecom or Unicom to a mobile user of China Mobile (not including 157 or 188 prefix phone numbers (TD users)) during the period from January 1, 2014, Mobile operator A (China Telecom or Unicom) pays RMB0.04

Local fixed-line operator A	Local fixed-line operator B	<p>per minute to mobile operator B (China Mobile). For calls originated from 157 or 188 prefix phone numbers (TD users) during the period from January 1, 2010, mobile operator A (China Mobile) pays RMB0.012 per minute to mobile operator B (China Telecom or Unicom).</p> <p>(1) Operator A collects the usage fees from its subscribers;</p> <p>(2) In the case of intra-district calls, operator A pays operator B 50% of the intra-district usage fees;</p> <p>(3) (i) In the case of local inter-district calls from operator A using operator B's local inter-district trunk circuit, operator A collects the usage charge from its subscribers and pays RMB0.06 per minute to operator B; (ii) In the case of local inter-district calls from operator A not using operator B's local inter-district trunk circuit, operator A collects the usage charge from its subscribers and pays operator B 50% of the intra-district usage fees.</p>
-----------------------------	-----------------------------	---

**Table of Contents**

The following table sets forth selected current major main interconnection revenue-sharing and settlement arrangements for domestic long-distance calls:

<b>Operator at Whose Network Calls</b>	<b>Operator at Whose Network Calls Are</b>	<b>Current Main Settlement</b>
<b>Are Originated</b>	<b>Terminated</b>	<b>Arrangement</b>
Local fixed-line or mobile operator A (through the long-distance network of operator A)	Local fixed-line or mobile operator B	For calls originated from a mobile user of China Telecom or Unicom to a mobile user of China Mobile (not including 157 or 188 prefix phone numbers (TD users)) during the period from January 1, 2014, Mobile operator A (China Telecom or Unicom) pays RMB0.04 per minute to mobile operator B (China Mobile). Other than the above, operator A pays RMB0.06 per minute to operator B.
Fixed-line or mobile operator A	Domestic long-distance calls made without using the carrier identity code of operator B (through the long-distance network of operator B)	<p>(1) Operator A collects the tariff from the subscribers;</p> <p>(2) If Operator A is a fixed-line operator, operator A retains RMB0.06 per minute; if operator A is a mobile operator, operator A retains local usage fee and RMB0.06 per minute; and</p> <p>(3) Operator A pays operator B the rest of the domestic long-distance tariff.</p>
Local fixed-line or mobile operator A	Domestic long-distance calls made by using the carrier identity code of operator B (through the long-distance network of operator B)	<p>Note: Domestic long-distance calls shall be charged at the domestic long-distance call tariff of operator B.</p> <p>(1) Operator B collects the tariff from the subscribers; and</p> <p>(2) Operator B pays operator A RMB0.06 per minute.</p>

The following table sets forth selected current main interconnection revenue-sharing and settlement arrangements for public switched telephone network international long-distance calls, including calls originated from and terminated in Hong Kong, Macau and Taiwan:

Operator at Whose Network Calls Are Originated	Operator at Whose Network Calls Are Terminated	Current Main Settlement Arrangement
Local fixed-line or mobile operator A	International long-distance calls (including to Hong Kong, Macau and Taiwan) made without using the carrier identity code of operator B and directed by operator A from the originating network to operator B.	(1) Operator A collects the tariff from the subscribers;  (2) If operator A is a fixed-line operator, operator A retains no more than RMB0.54 per minute with the remaining paid to operator B; and  (3) If operator A is a mobile operator, operator A retains local usage fees and no more than RMB0.54 per minute with the remaining paid to operator B.
Local fixed-line or mobile operator A	International long-distance calls made by using the carrier identity code of operator B and through the domestic and international long-distance networks of operator B.	Note: International long-distance calls shall be charged at the international long-distance call tariff of operator B.  (1) Operator B collects the tariff from the subscribers; and  (2) Operator B pays operator A RMB0.06 per minute.

**Table of Contents**

The following table sets forth selected current main interconnection revenue-sharing and settlement arrangements for VoIP long-distance calls:

<b>Operator from Whose Network Calls Are Originated</b>	<b>Operator at Whose Network Calls Are Terminated</b>	<b>Current Main Settlement Arrangement</b>
Fixed-line or mobile operator A	Fixed-line or mobile operator B through the VoIP network of operator C	<p>(1) Operator A collects local usage fees;</p> <p>(2) Operator C collects the VoIP long-distance usage fees from its subscribers;</p> <p>(3) Operator C pays RMB0.06 per minute to operator B on the terminating end;</p> <p>(4) No settlement between operator C and operator A on the originating end.</p>

The following table sets forth selected current main interconnection revenue-sharing and settlement arrangements for SMS:

<b>Network from Which SMS Originated</b>	<b>Network at Which SMS Terminated</b>	<b>Current Main Settlement Arrangement</b>
Fixed-line or mobile operator A	Fixed-line or mobile operator B	<p>(1) Operator A collects the tariff from its subscribers;</p> <p>(2) Operator A pays RMB0.01 (RMB0.03 during the period from January 1, 2010 to December 31, 2013; RMB0.05 prior to January 1, 2010) per SMS to Operator B</p>

**Table of Contents**

The following table sets forth selected current main interconnection revenue-sharing and settlement arrangements for MMS:

<b>Network from Which</b>	<b>Network at Which</b>	<b>Current Main Settlement</b>
<b>MMS Originated</b> Mobile operator A	<b>MMS Terminated</b> Mobile operator B	<b>Arrangement</b> (1) Operator A collects the tariff from its subscribers;  (2) Operator A pays RMB0.05 (RMB0.10 during the period from January 1, 2010 to December 31, 2013; RMB0.15 prior to January 1, 2010) per MMS to Operator B

***Technical Standards***

The MIIT is responsible for promulgating the technical standards for China's telecommunications industry and establishing the technical requirements and testing parameters for telecommunications equipment (including network and end-user equipment). The MIIT is also responsible for designating qualified institutes to test telecommunications equipment, which would grant network access licenses (or product standard certificates) for the equipment that has successfully passed the relevant tests. Only telecommunications equipment for which a network access license (or a product standard certificate) has been granted may be sold and used in China.

Most of the standards used in the Chinese telecommunications industry are generally based on the standards issued by the International Telecommunications Union, or ITU, 3rd Generation Partnership Project, Open Mobile Alliance, World Wide Web Consortium, and other international organizations for telecommunications standards, with more specific requirements made in light of China's particular telecommunications industry. On the basis of the technical standards used in China's telecommunications industry, we may formulate our own technical standards based on our own needs and issue additional requirements for telecommunications equipment in order to meet our operational needs. All telecommunications equipment purchased by China's telecommunications operators must have been granted a network access license issued by the MIIT and must meet the standards set forth by the relevant operators.

***Quality of Service***

Under the Telecommunications Regulations, the MIIT and the relevant provincial telecommunications administrations are responsible for supervising and monitoring the quality of services provided by telecommunications operators in China. Under the Telecommunications Regulations, customers of telecommunications operators have the right to submit their complaints to the MIIT and the relevant provincial telecommunications administrations or other relevant government authorities. In addition, the MIIT, together with other governmental authorities, has taken measures to prompt telecommunications operators to screen indecent contents carried through their networks.

***Universal Services***

Telecommunications service providers in China are required to fulfill universal service obligations in accordance with relevant regulations to be promulgated by the PRC Government, and the MIIT has the authority to delineate the scope

of its universal service obligations. The MIIT may also select universal service providers through a tendering process. The MIIT, together with the finance and pricing authorities, is also responsible for formulating administrative rules relating to the establishment of a universal service fund and compensation schemes for universal services. Under the Telecommunications Regulations, all PRC telecommunications operators shall provide universal services, and we expect to perform our duties thereunder accordingly. In December 2015, the Ministry of Finance and the MIIT jointly issued the rules regarding the pilot program for universal services to be implemented in 97 prefecture-level cities across the PRC. Since these rules were recently promulgated, we understand that the local authorities are in the process of formulating detailed plans and guidance to implement such rules.

## **Table of Contents**

The MIIT has required major Chinese telecommunications service providers, including Unicom Group and former Netcom Group, to participate in a project to provide telecommunications services in tens of thousands of remote villages in certain designated provinces in China as transitional measures prior to the formalization of a universal service obligation framework. In participating in this project, Unicom Group has undertaken the universal service obligation to extend telecommunications service coverage to all administrative-level villages primarily through its transmission networks. Currently, with our assistance, Unicom Group is further extending telecommunications service coverage to natural villages in remote areas in China as designated by the MIIT. We have been assisting Unicom Group in providing mobile telecommunications services to these remote villages and are responsible for the operation and maintenance of the relevant network facilities in our service areas. See **D. Risk Factors** **Risks Relating to the Telecommunications Industry in China**. The PRC Government may require us, along with other telecommunications service providers in China, to provide universal services with specified obligations, and we may not be compensated adequately for providing such services under Item 3.

### ***Convergence Policy of Telecom, Broadcasting and Internet Networks***

In January 2010, the PRC Government announced its decision to accelerate the advancement of convergence of television broadcast, telecommunications and Internet access networks to realize interconnection and resource-sharing among the three networks and further develop the provision of voice, data, television and other services. After the implementation of the three-network convergence policy on a trial basis in selective geographic locations during the period from 2010 to 2012, the PRC Government has started to fully implement such policy across-the-board starting from 2013. The PRC Government may amend relevant policies or promulgate new regulations corresponding to the implementation of the three-network convergence policy in the future.

### ***Mobile Telecommunications Resale Business***

In May 2013, the MIIT issued the pilot program for mobile telecommunications resale business that permit non-State-owned companies to purchase mobile services from telecommunications operators and provide mobile services to end-customers after repackaging and rebranding. The trial period ended on December 31, 2015, subject to further adjustment by the MIIT based on the trial results.

### ***VAT Applicable to the Telecommunications Services***

The PRC Government implemented VAT to replace business tax relating to the telecommunications services in China on June 1, 2014. As opposed to the business tax of 3% imposed on the revenue that was applicable to us prior to June 1, 2014, we are subject to the output VAT at the rate of 11% for our basic telecommunications services (including, among others, voice communication, and lease or sale of network resources) and 6% for our value-added telecommunications services (including, among others, Internet access services, short and multimedia messaging services, and transmission and application service of electronic data and information). Sales of our telecommunications terminals and equipment are subject to the output VAT at the rate of 17% before and after June 1, 2014. The Input VAT rate depends on the type of services received and the assets purchased as well as the VAT rate applicable to the vendors' specific industry, and ranges from 6% to 17%.

Output VAT is excluded from operating revenues while input VAT, which is incurred as a result of our receipt of services and purchases of telecommunications equipment and materials, is excluded from operating expenses or the original cost of equipment purchased and can be netted against the output VAT, arriving at the net amount of VAT recoverable or payable. Such net amount of VAT is recorded in the line item of prepayments and other current assets and taxes payable, respectively, on the face of consolidated statements of financial position.



The application of the VAT to the telecommunications industry has had, and is expected to continue to have, an adverse effect on our revenues and operating profits in the short term. See D. Risk Factors Risks Relating to Our Business The implementation of VAT to replace business tax relating to the telecommunications services in China has had, and may continue to have, a negative impact on our results of operations under Item 3. We strive to reduce the adverse effect of the application of VAT to the telecommunications industry on our revenues and profits by taking various measures, including, among other things, optimizing our development and sales models, implementing stringent cost control measure, and enhancing control on purchasing and vendors tax profiles. Following the optimization of our business development and sales models, the proportion of revenues generated from value-added telecommunications services is expected to increase, resulting in a lower effective output VAT rate. As the implementation of VAT to replace business tax is expected to expand to other industries nationwide during 2016, we expect that we may be able to reduce operating costs by claiming input VAT credits in the future. In addition, we will receive a benefit of claiming input VAT credits on our capital expenditures for purchasing certain assets, which resulted in a lower depreciation.

## **Table of Contents**

### ***Others***

As a company with substantially all of our operations in China, we, along with our controlling shareholder, Unicom Group, are subject to various regulations of the PRC Government in addition to those regulating the telecommunications industry. PRC regulatory authorities, such as the State Bureau of Taxation, National Audit Office and SAIC, exercise extensive oversight over various aspects of our businesses and conduct various regular inspections, examinations and/or audits on us and Unicom Group. As required by the relevant PRC laws and regulations, Unicom Group, as one of the key State-owned enterprises under the direct supervision of the SASAC, is also subject to routine audits by the National Audit Office, or the NAO as well as other PRC regulatory authorities.

In addition, the SASAC has an indirect influence over us as our controlling shareholder, Unicom Group, is under the direct supervision of the SASAC. In particular, the SASAC may designate certain nominees and request Unicom Group to propose the appointment of such nominees as our directors and senior management. The SASAC may also request Unicom Group to remove our directors and senior management in accordance with relevant procedures provided by applicable law and our articles of association.

### **Disclosure of Iranian Activities under Section 13(r) of the Securities Exchange Act of 1934**

Section 219 of the Iran Threat Reduction and Syria Human Rights Act of 2012 added Section 13(r) to the Exchange Act of 1934, as amended. Section 13(r) requires an issuer to disclose in its annual or quarterly reports, as applicable, whether it or any of its affiliates knowingly engaged in certain activities, transactions or dealings relating to Iran or with designated natural persons or entities involved in terrorism or the proliferation of weapons of mass destruction. Disclosure is required even where the activities, transactions or dealings are conducted outside the U.S. by non-U.S. affiliates in compliance with applicable law, and whether or not the activities are sanctionable under U.S. law.

As of the date of this report, we are not aware of any activity, transaction or dealing by us or any of our affiliates in 5that requires disclosure in this under Section 13(r) of the Exchange Act of 1934, as amended, except as set forth below.

Our ultimate controlling shareholder, Unicom Group, is a party to the international roaming agreements with Mobile Company of Iran, or MCI, and MTN Irancell, or MTN, respectively. We have been informed by Unicom Group that, in 2015, the estimated gross revenue Unicom Group generated from such inbound international roaming traffic with MCI and MTN was approximately RMB137,500 and RMB300, respectively, and the estimated total amount paid by Unicom Group to MCI and MTN for the outbound international roaming traffic was approximately RMB32,400 and approximately RMB19,200, respectively. Unicom Group does not customarily allocate net profit on a country-by-country or activity-by-activity basis, and therefore it is not possible to determine accurately the precise net profits attributable to such transactions with MCI and MTN. Unicom Group estimates that the net profits attributable to the transactions with MCI and MTN were negligible relevant to its overall net profits. We understand that Unicom Group intends to continue these activities in the future.

**Table of Contents****C. Organizational Structure**

We are incorporated in Hong Kong and as of April 14, 2016, we were 40.61% owned by Unicom BVI, which was 17.90% owned by Unicom Group and 82.10% owned by the A Share Company, which in turn was 62.74% owned by Unicom Group, 33.75% owned by Unicom Group BVI, which in turn was 100% owned by Unicom Group, and 25.64% owned by public shareholders. See A. History and Development of the Company above. Set forth below are details of our wholly owned significant subsidiaries:

<b>Name of Subsidiary</b>	<b>Place of Incorporation</b>	<b>Ownership Interest</b>
China United Network Communications Corporation Limited	China	100%
Unicom Vsens Telecommunications Company Limited	China	100%
Unicom New Horizon Telecommunications Corporation Limited	China	100%
China Unicom (Hong Kong) Operations Limited	Hong Kong	100%
China Unicom (Americas) Operations Limited	United States	100%
China Unicom (Singapore) Operations Pte. Ltd.	Singapore	100%
China Unicom (Europe) Operations Limited	United Kingdom	100%
China Unicom (Japan) Operations Corporation	Japan	100%
Billion Express Investments Limited	British Virgin Islands	100%
China Unicom (South Africa) Operations (Pty) Limited	South Africa	100%
China Unicom (MYA) Operations Company Limited	The Republic of the Union of	
	Myanmar	100%
China Unicom (Australia) Operations Pty Limited	Australia	100%
China Unicom Global Limited	Hong Kong	100%

**D. Properties**

Our principal executive offices are located in Hong Kong. We also maintain executive offices in Beijing. We own and lease a large number of offices, retail outlets, equipment rooms and base stations throughout China. In some cases, we have not entered into formal lease agreements with the lessors or the lessors may not possess requisite title certificates. We believe that it is unlikely that we would be denied our right to use a large number of these properties at any given time.

**Item 4A. Unresolved Staff Comments**

None.

**Item 5. Operating and Financial Review and Prospects**

You should read the following discussion and analysis in conjunction with the selected financial data set forth in Item 3 and our consolidated financial statements, together with the related notes, included elsewhere in this annual report on Form 20-F.

## Overview

We are an integrated telecommunications operator in China providing mobile voice and value-added, fixed-line voice and value-added, fixed-line broadband, data communications and other telecommunications services to our customers. In recent years, we have continued to extend the coverage of all of our services nationwide. We, China Mobile and China Telecom are the three major telecommunications operators in China. See A. History and Development of the Company Restructurings of the Telecommunications Industry under Item 4.

**Table of Contents**

Prior to January 1, 2012, we had two major operating segments, the mobile business and the fixed-line business, and our chief operating decision-maker, or the CODM, evaluated the results of operating segments based on revenue and costs that were directly attributable to them. However, with the continuing integration of our mobile and fixed-line business and the sharing of resources by the two business lines, there have been increasingly significant common costs and expenses that are not attributable directly to any of these two business lines. Therefore, we changed our management structure by centralized functions instead of business lines in 2012. Since January 1, 2012, as a result of the integration of our business lines and new management structure based on function lines, the CODM has no longer assessed our business performance based on the results of operations of each of the mobile services and fixed-line services, i.e., revenue and costs that are directly attributable to each of the two business lines. Instead, the CODM has been making resources allocation decisions based on internal management functions and assessed our business performance as one integrated business instead of by separate business lines or geographical regions. Accordingly, we have had only one operating segment since January 1, 2012.

The table below sets forth revenue from our major services and their respective percentage of our total revenue in 2013, 2014 and 2015.

	For the Year Ended December 31,					
	2013		2014		2015	
	RMB in millions	As % of Total	RMB in millions	As % of Total	RMB in millions	As % of Total
Total revenue	295,038	100.0	284,681	100.0	277,049	100.0
Total service revenue	238,567	80.9	244,878	86.0	235,278	84.9
Include: Mobile services	151,133	51.2	155,095	54.5	142,620	51.5
Fixed-line services	86,487	29.3	88,481	31.1	91,261	32.9
Out of which:						
Broadband service	45,991	15.6	50,201	17.6	53,960	19.5
Total sales of telecommunications products	56,471	19.1	39,803	14.0	41,771	15.1

Our service revenue primarily consists of the following:

usage fees and monthly fees for our mobile and fixed-line telephone services, which are recognized when we render the service to our customers;

revenue from the provision of value-added services, which is recognized when we render the services to our customers;

revenue from the provision of broadband, data and other Internet-related services, which are recognized when the services are provided to customers;

revenue from interconnection with other telecommunications operators for calls made from their networks to our networks. We recognize interconnection revenue when the relevant calls are made by subscribers;

revenue for offerings which include the bundled sale of mobile handsets and provision of services. The total contract consideration of such bundled sale is allocated to service revenue and sales of handsets based on their relative fair values. We recognize revenue allocated to the sale of handset when the title of the handset is passed to the customer and recognize revenue allocated to the service element based upon the actual usage of telecommunications services. The cost of the mobile handset sold is expensed immediately to the statement of income;

revenue from information communications technology services are recognized when goods are delivered to the customers (which generally coincides with the time when the customers have accepted the goods and the related risks and rewards of ownership have been transferred to the customers) or when services are rendered to the customers using the percentage of completion method when the outcome of the services provided can be estimated reliably. If the outcome of the services provided cannot be estimated reliably, the treatment should be as follows: (i) if it is probable that the costs incurred for the services provided is recoverable, service revenue should be recognized only to the extent of reasonable costs incurred, and costs should be recognized as current expenses in the period in which they are incurred, or (ii) if it is probable that costs incurred will not be recoverable, costs should be recognized as current expenses immediately and service revenue should not be recognized;

**Table of Contents**

revenue from sales of telecommunications products (which mainly represent handsets and accessories) that are not bundled with mobile services are recognized when title of such products has been passed to the buyers; and

rental income from leases of customer-end equipment and transmission lines on our networks to business customers and other telecommunications carriers in China. We recognize leased line rental revenue on a straight-line basis over the relevant lease term.

The following table sets forth our major costs and expenses items and income before income tax, both in terms of amount and as a percentage of total revenue in 2013, 2014 and 2015.

	For the Year Ended December 31,					
	2013		2014		2015	
	RMB in		RMB in		RMB in	
	millions	% of Total	millions	% of Total	millions	% of Total
Total revenue	295,038	100.0	284,681	100.0	277,049	100.0
Costs, expenses and others	281,324	95.4	268,750	94.4	263,014	94.9
Interconnection charges	20,208	6.8	14,599	5.1	13,093	4.7
Depreciation and amortization	68,196	23.1	73,868	25.9	76,738	27.7
Network, operation and support expenses	33,704	11.4	37,851	13.3	42,308	15.3
Employee benefit expenses	31,783	10.8	34,652	12.2	35,140	12.7
Selling and marketing	42,991	14.6	40,193	14.1	31,965	11.5
General, administrative and other expenses	18,973	6.4	21,218	7.5	22,995	8.3
Cost of telecommunications products sold	63,416	21.5	43,397	15.2	44,046	15.9
Finance costs, net of interest income	2,940	1.0	4,334	1.5	6,496	2.3
Other income-net	(887)	(0.3)	(1,362)	(0.5)	(9,767)	(3.5)

Our major costs and expenses include the following:

interconnection expenses, representing amounts paid to other operators for calls from our networks to their networks and for calls made by our subscribers roaming in their networks;

depreciation and amortization expenses, mainly relating to our property, plant and equipment and other assets;

network, operation and support expenses (including usage fees for telecommunications towers and related assets), mainly relating to lease, repair, maintenance and operations of our networks;

employee benefit expenses, representing staff salaries and wages, bonuses and medical benefits, contributions to defined contribution pension schemes, housing benefits and share-based compensation costs amortized over the vesting period of options;

selling and marketing expenses, including commissions, promotion and advertising expenses, direct incremental costs for activating subscriber services and customer retention costs;

general, administrative and other expenses, primarily including provision for doubtful debts, utilities, general office expenses and travel expenses;



## **Table of Contents**

cost of telecommunications products sold; and

finance costs, net of interest income, primarily including interest expenses, net of interest income.

### **Critical Accounting Policies**

The preparation of our financial statements and this annual report on Form 20-F requires us to make estimates and judgments that affect the reported and disclosed amounts of assets and liabilities, including contingent assets and liabilities, as of the relevant dates and revenue and expenses for the relevant periods. We have identified below the areas involving a higher degree of judgment or complexity, or areas where assumptions are significant to the accounting policies and estimates, as critical to our business operations and an understanding of our results of operations and financial position. The impact and any associated risks related to these policies on our business operations are discussed throughout this Item 5 where such policies affect our reported and expected financial results. For a discussion of the application of these and other accounting policies, see Note 2 and Note 4 to our consolidated financial statements included elsewhere in this annual report on Form 20-F. There can be no assurance that actual results will not differ from those estimates and assumptions.

### ***Significant Accounting Policies***

#### ***Revenue Recognition***

Revenue comprises the fair value of the consideration received or receivable for the services and sales of goods or telecommunications products in the ordinary course of our business activities.

We recognize revenue when the amount of revenue can be reliably measured, it is probable that future economic benefits will flow to the entity and specific criteria have been met for each of our activities as described below. We base our estimates on historical results, taking into consideration the type of customer, the type of transaction and the specifics of each arrangement.

#### ***Sales of services and goods***

Usage fees and monthly fees are recognized when the service is rendered;

Revenue from the provision of broadband, data and other Internet-related services is recognized when the services are provided to customers;

Lease income from leasing of lines and customer-end equipment are treated as operating leases with rental income recognized on a straight-line basis over the lease term;

Interconnection fees, which represent revenue received or receivables from other domestic and foreign telecommunications operators for the use of our telecommunications network, are recognized when service is rendered;

Value-added services revenue, which mainly represents revenue from the provision of services such as SMSs, Cool Ringtone, personalized ring, caller number display and secretarial services to subscribers, is recognized when service is rendered;

Standalone sales of telecommunications products, which mainly represent handsets and accessories, are recognized when title has been passed to the buyers;

-50-

## **Table of Contents**

For offerings of preferential packages to the customers, which include the bundled sale of mobile handsets and provision of services, the total contract consideration of such preferential packages is allocated to service revenue and sales of handsets based on their relative fair values. Revenue relating to the sale of the handset is recognized when the title is passed to the customer whereas service revenue is recognized based upon the actual usage of telecommunications services. The cost of the mobile handset is expensed immediately to the statement of income upon revenue recognition; and

Revenue from information communications technology services is recognized when goods are delivered to the customers (which generally coincides with the time when the customers have accepted the goods and the related risks and rewards of ownership have been transferred to the customers) or when services are rendered to the customers using the percentage of completion method when the outcome of the services provided can be estimated reliably. If the outcome of the services provided cannot be estimated reliably, the treatment should be as follows: (i) if it is probable that the costs incurred for the services provided will be recoverable, services revenue should be recognized only to the extent of recoverable costs incurred, and costs should be recognized as current expenses in the period in which they are incurred; or (ii) if it is probable that costs incurred will not be recoverable, costs should be recognized as current expenses immediately and services revenue should not be recognized.

### *Dividend income*

Dividend income is recognized when the right to receive payment is established.

### *Deferred Revenue, Advances from Customers and Subscriber Points Reward Program*

#### *Deferred revenue*

Deferred revenue mainly represents upfront non-refundable fees, including installation fees of fixed-line services, which are deferred and recognized over the expected customer service period. Deferred revenue expected to be recognized in one year or less is classified as current liabilities. If not, they are presented as non-current liabilities.

#### *Advances from customers*

Advances from customers are mainly amounts paid by customers for prepaid cards, other calling cards and prepaid service fees, which cover future telecommunications services. Advances from customers are stated at the amount of proceeds received less the amount already recognized as revenue upon the rendering of services.

#### *Subscriber points reward program*

The fair value of providing telecommunications services and the subscriber points reward is allocated based on their relative fair values. The allocated portion of fair value for the subscriber points reward is recorded as deferred revenue when the rewards are granted and recognized as revenue when the points are redeemed or expired.

## ***Critical Accounting Estimates and Judgments***

### *Depreciation on Property, Plant and Equipment*

Depreciation on our property, plant and equipment is calculated using the straight-line method to allocate cost up to residual values over the estimated useful lives of the assets. We review the useful lives and residual values periodically to ensure that the method and rates of depreciation are consistent with the expected pattern of realization of economic benefits from property, plant and equipment. We estimate the useful lives of property, plant and equipment based on historical experience, taking into account anticipated technological changes. If there are significant changes from previously estimated useful lives, the amount of depreciation expenses may change.

-51-

## **Table of Contents**

### *Impairment of Non-Financial Assets*

We test whether non-financial assets have suffered from any impairment, in accordance with the accounting policy stated in Note 2.12 to the audited consolidated financial statements contained elsewhere in this annual report on Form 20-F. The recoverable amount of an asset is the higher of its fair value less costs to sell and its value in use. Management estimates value in use based on estimated discounted pre-tax future cash flows of the cash generating unit at the lowest level to which the asset belongs. If there is any significant change in management's assumptions, including discount rates or growth rates in the future cash flow projection, the estimated recoverable amounts of the non-financial assets and our results would be significantly affected. Such impairment losses are recognized in the statement of income. Accordingly, there will be an impact to the future results if there is a significant change in the recoverable amounts of the non-financial assets.

### *Write-Down of Inventories*

The net realizable value of inventories is under management's regular review, and as a result, write-down of inventories is recognized for the excess of inventories' carrying amounts over their net realizable value. When making estimates of net realizable value, we take into consideration the use of inventories held on hand and other information available to form the underlying assumptions, including the inventories' market prices and our historical operating costs. The actual selling price of inventories, the costs of completion and the costs necessary to make the sale and relevant taxes may vary based on the changes in market conditions and product salability, manufacturing technology and the actual use of inventories, resulting in the changes in write-down of inventories. The net profit or loss may then be affected in the period when the write-down of inventories is adjusted.

### *Allowance for Doubtful Debts*

Management estimates an allowance for doubtful debts resulting from the inability of the customers to make the required payments. Management bases its estimates on the aging of the accounts receivable balance, customer credit-worthiness, and historical write-off experience. If the financial condition of the customers were to deteriorate, additional allowance may be required.

### *Subscriber Points Reward Program*

The fair value of subscriber points reward is estimated based on (i) the value of each bonus point awarded to subscribers, (ii) the number of bonus points related to subscribers who are qualified or expected to be qualified to exercise their redemption right at each of the date of the consolidated statement of financial position, and (iii) the expected bonus points redemption rate. The fair value of the outstanding subscriber points reward is subject to review by management on a periodic basis.

### *Income Tax and Deferred Taxation*

We estimate our income tax provision and deferred taxation in accordance with the prevailing tax rules and regulations, taking into account any special approvals obtained from relevant tax authorities and any preferential tax treatment to which we are entitled in each location or jurisdiction in which we operate. There are many transactions and calculations for which the ultimate tax determination is uncertain during the ordinary course of business. We recognize liabilities for anticipated tax audit issues based on estimates of whether additional taxes will be due. Where the final tax outcome of these matters is different from the amounts that were initially recorded, such differences will impact the income tax and deferred tax provisions in the period in which such determination is made.

For temporary differences which give rise to deferred tax assets, we have assessed the likelihood that the deferred tax assets could be recovered. Major deferred tax assets relate to unrecognized revaluation surplus on prepayments for the leasehold land determined under PRC regulations, accruals of expenses not yet deductible for tax purpose, and allowance for doubtful debts. Due to the effects of these temporary differences on income tax, we have recorded deferred tax assets amounting to approximately RMB5,642 million as of December 31, 2015. Deferred tax assets are recognized based on our estimates and assumptions that they will be recovered from taxable income arising from continuing operations in the foreseeable future.

**Table of Contents**

We believe we have recorded adequate income tax provision and deferred taxes based on the prevailing tax rules and regulations and our current best estimates and assumptions. In the event that future tax rules and regulations or related circumstances change, adjustments to income tax and deferred taxation may be necessary which would impact our results or financial position.

***Recently Issued International Financial Reporting Standards***

The IASB has issued a number of amendments to IFRSs that are first effective for the current accounting period commencing January 1, 2015 or are available for early adoption. See Note 2.2(d) to our consolidated financial statements included elsewhere in this annual report on Form 20-F.

Up to the date of issue of our 2015 financial statements, the following amendments and new standards have been issued but not yet effective for the annual accounting period ended December 31, 2015 and has not been adopted by us:

	<b>Effective for annual accounting period beginning on or after</b>
Annual Improvements to IFRS 2012-2014 Cycle	January 1, 2016
Amendments to IFRS 10 and IAS 28, Sale or contribution of assets between an investor and its associate or joint venture	January 1, 2016
Amendments to IFRS 11, Accounting for acquisitions of interests in joint operations	January 1, 2016
Amendments to IAS 1, Disclosure initiative	January 1, 2016
Amendments to IAS 16 and IAS 38, Clarification of acceptable methods of depreciation and amortization	January 1, 2016
Amendments to IAS 27, Equity method in separate financial statements	January 1, 2016
Amendments to IFRS 10, IFRS 12, IAS 28, Investment entities: Applying the consolidation exception	January 1, 2016
IFRS 15, Revenue from Contracts with Customer	January 1, 2018

**Operating Results****Year Ended December 31, 2015 Compared to Year Ended December 31, 2014*****Revenue***

In 2015, we continued to actively develop full-service operation with a focus on 4G services and fixed-line broadband services. Revenue in 2015 was RMB277.05 billion, representing a decrease of 2.7% from RMB284.68 billion in 2014, of which our service revenue was RMB235.28 billion in 2015, representing a decrease of 3.9% from RMB244.88 billion in 2014. As our revenue is presented after excluding any output VAT in accordance with IFRS and we do not pass on the cost of any VAT to our subscribers for telecommunications services, the implementation of VAT in the PRC telecommunications industry since June 1, 2014 has had a negative impact on our revenue recognized afterwards.

**Table of Contents***Mobile Services Revenue*

Total revenue from our mobile services decreased by 5.4% from RMB194.84 billion in 2014 to RMB184.29 billion in 2015. Of the total revenue from our mobile services in 2014 and 2015, RMB155.10 billion and RMB142.62 billion, respectively, was from service revenue. Service revenue from our mobile services as a percentage of our total service revenue was 63.3% and 60.6% in 2014 and 2015, respectively. The overall ARPU for our mobile subscribers decreased from RMB44.1 in 2014 to RMB40.8 in 2015. The decrease in total revenue from our mobile services was primarily driven by a decrease in our usage fees and monthly fees. The decrease in ARPU for our mobile subscribers also contributed to the decrease of our mobile service revenue. The decrease in ARPU for our mobile subscribers was primarily due to the factors including (i) the implementation of VAT in the PRC telecommunications industry; (ii) the implementation of the PRC Government's policy of increasing network speed and reducing tariffs, as well as our mobile data carry-over programs launched on October 1, 2015, which allow subscribers of our data plans with pre-determined monthly data limit to carry over their unused data to the following month with no extra charge; (iii) our late entry into the 4G services market in the PRC compared to a major telecommunications operators and the intensifying competition with other telecommunications operators, both of which had a negative effect on our ability to attract or retain 4G subscribers or other subscribers with higher usage of telecommunications services; and (iv) many of our new subscribers who are users with lower usage of telecommunications services.

The table below sets forth the revenue composition of our mobile services and each revenue item's respective share of total revenue for the years ended December 31, 2014 and 2015.

	2014		2015	
	RMB in millions	% of total	RMB in millions	% of total
Total revenue from mobile services	194,838	100.0	184,285	100.0
Service revenue	155,095	79.6	142,620	77.4
Usage fees and monthly fees	62,152	31.9	45,901	24.9
Value-added services revenue	79,814	41.0	83,529	45.3
Interconnection fees	12,398	6.4	11,847	6.4
Other service revenue	731	0.4	1,343	0.7
Sales of mobile telecommunications products	39,743	20.4	41,665	22.6

*Usage Fees and Monthly Fees.* Primarily as a result of (i) the implementation of VAT in the PRC telecommunications industry (ii) the intensifying competition among the major PRC telecommunications operators and (iii) the implementation of the PRC Government's policy of increasing the network speed and reducing tariffs, as well as our mobile data carry-over programs starting from October 1, 2015, usage fees and monthly fees for our mobile services were RMB45.90 billion in 2015, representing a decrease of 26.1% from RMB62.15 billion in 2014.

*Value-Added Services Revenue.* Value-added services revenue consists primarily of revenue from our mobile value-added services. Due to our active promotion of mobile data services of our 4G services, revenue from our mobile value-added services was RMB83.53 billion in 2015, representing an increase of 4.7% from RMB79.81 billion in 2014. The increase was partially offset by the negative effect of the implementation of VAT in the PRC telecommunications industry, the implementation of the PRC Government's policy of the raising network speed and reducing tariffs and our unused mobile data carry-over policy. As a percentage of total revenue from mobile services, revenue from our mobile value-added services increased from 41.0% in 2014 to 45.3% in 2015. Of the total revenue from mobile value-added services, revenue from mobile Internet services increased by 17.2% from RMB49.84 billion in 2014 to RMB58.39 billion in 2015, revenue from our SMS services decreased by 20.2% from RMB7.61 billion in 2014 to RMB6.07 billion in 2015, and revenue from Cool Ringtone services decreased by 18.6% from RMB2.40



billion in 2014 to RMB1.96 billion in 2015.

*Interconnection Fees.* Our interconnection fees decreased by 4.4% from RMB12.40 billion in 2014 to RMB11.85 billion in 2015, and represented 6.4% of total revenue from mobile services in 2015, remaining stable compared with 2014. The decrease in our interconnection fees was primarily as a result of (i) the implementation of VAT in the PRC telecommunications industry; (ii) the decrease in the volume of the interconnection voice calls primarily due to a substitution trend that mobile subscribers use certain value-added telecommunications applications or services in lieu of voice calls for communication purposes; and (iii) the decrease in the number of our mobile subscribers.

**Table of Contents**

*Sales of Telecommunications Products.* Revenue from our sales of mobile telecommunications products increased by 4.8% from RMB39.74 billion in 2014 to RMB41.67 billion in 2015, mainly due to the increase in the sales amount of telecommunications products.

*Fixed-Line Services Revenue*

In 2015, we continued to develop our fixed-line broadband services and promoted our mobile and fixed-line bundled services. The trend of mobile substitution continued to have a negative impact on the growth of revenue from our fixed-line voice services. Our total revenue from fixed-line services increased by 3.2% from RMB88.54 billion in 2014 to RMB91.37 billion in 2015, of which service revenue increased by 3.1% from RMB88.48 billion in 2014 to RMB91.26 billion in 2015. The increase of our total revenue from fixed-line services was partially offset by the negative effect of the implementation of VAT in the PRC telecommunications industry. See D. Risk Factors Risks Relating to Our Business The industry trends of mobile service substitution and mobile service migration from old generations to new generations may continue to have a material adverse effect on our fixed-line local telephone services and old generations mobile services, which may materially and adversely affect our financial condition, results of operations and growth prospects under Item 3.

The table below sets forth the revenue composition of our fixed-line services and each revenue item's respective share of total revenue from our fixed-line services for the years ended December 31, 2014 and 2015.

	For the Year Ended December 31,			
	2014		2015	
	RMB in millions	As % of Total	RMB in millions	As % of Total
Total revenue from fixed-line services	88,541	100.0	91,367	100.0
Service revenue	88,481	99.9	91,261	99.9
Usage fee and monthly fee	14,357	16.2	11,130	12.2
Broadband, data and other				
Internet-related services revenue	52,579	59.4	56,629	62.0
Interconnection fees	3,979	4.5	3,667	4.0
Value-added services revenue	4,324	4.9	5,132	5.6
Leased line income	8,879	10.0	9,404	10.3
Information communication technology services revenue	3,469	3.9	4,334	4.7
Other service revenue	894	1.0	965	1.1
Sales of fixed-line telecommunications products	60	0.1	106	0.1

*Usage Fees and Monthly Fees.* Usage fees include local usage fees charged for local telephone calls and VoIP long-distance calls, long-distance usage fees for domestic and international long-distance calls originated by our fixed-line subscribers, users of our pre-paid phone cards and certain other customers. Monthly fees represent the fixed amount of service charges to our customers for using our fixed-line telephone services.

In 2015, we experienced continuing decline in the number of fixed-line local telephone subscribers and revenue due to the continuing effect of mobile substitution. Our local telephone subscribers decreased in 2015 by 10.0% from 82.06 million at the end of 2014 to 73.86 million at the end of 2015. ARPU of the local telephone services decreased by 5.4% from RMB18.5 in 2014 to RMB17.5 in 2015. Total usage of local calls decreased by 15.4% from 69.78 billion pulses in 2014 to 59.03 billion pulses in 2015 (excluding Internet dial-up usage) and total usage of long-distance calls

decreased by 10.9% from 14.44 billion minutes in 2014 to 12.88 billion minutes in 2015. Revenue from our usage fees and monthly fees in 2014 decreased by 22.5% from RMB14.36 billion in 2014 to RMB11.13 billion in 2015.

*Broadband, Data and Other Internet-Related Services Revenue.* Revenue from our broadband, data and other Internet-related services include revenue generated from DSL, LAN, and broadband-related value-added services, fees that we charge for our DDN, frame relay, ATM, MPLS-VPN and X.25 services and revenue from the provision of Internet dial-up services (other than communication fees) and dedicated Internet access services. Revenue from our broadband, data and other Internet-related services increased by 7.7% from RMB52.58 billion in 2014 to RMB56.63 billion in 2015, primarily as a result of the increase in revenue from fixed-line broadband services. The increase of our revenue from our broadband, data and other Internet-related services was partially offset by the negative effect of the implementation of VAT in the PRC telecommunications industry.

**Table of Contents**

In light of the continuing effect of mobile substitution, fixed-line broadband service has become the main growth driver of our total revenue from fixed-line services. In 2015, our fixed-line broadband services continued to maintain growth as a result of our efforts in improving broadband access speed, adopting multi-service bundling strategy, enriching application contents and implementing diversified sales strategies. The number of our fixed-line broadband subscribers increased by 5.1% from 68.79 million in 2014 to 72.33 million in 2015. ARPU of our fixed-line broadband services increased by 2.3% from RMB62.2 in 2014 to RMB63.6 in 2015. Revenue from our fixed-line broadband services increased by 7.5% from RMB50.20 billion in 2014 to RMB53.96 billion in 2015, and as a percentage of the total fixed-line revenue increased from 56.7% in 2014 to 59.1% in 2015. Revenue from our data and other Internet-related services increased by 12.2% from RMB2.38 billion in 2014 to RMB2.67 billion in 2015.

*Interconnection Fees.* Our interconnection fees consist of interconnection fees charged to other domestic telecommunications operators, principally China Mobile and China Telecom, for both local and long-distance calls. Our interconnection fees decreased by 7.8% from RMB3.98 billion in 2014 to RMB3.67 billion in 2015. The decrease in our interconnection fees was primarily due to (i) the implementation of VAT in the PRC telecommunications industry; and (ii) the decrease in the volume of the interconnection voice calls primarily as a result of the mobile substitution effect.

*Value-Added Services Revenue.* Revenue from our value-added services consists of fees that we charge our customers for the provision of caller-identification, personalized ring, telephone information services, video- and tele-conferencing and other value-added services. Revenue from our value-added services increased by 18.7% from RMB4.32 billion in 2014 to RMB5.13 billion in 2015.

*Leased Line Income.* Our leased line income consists of fees that we receive from our government, corporate and carrier customers for leasing circuit capacity to them, including the lease of digital circuits, digital trunk lines and optic fibers. Our leased line income increased by 5.9% from RMB8.88 billion in 2014 to RMB9.40 billion in 2015, which was primarily due to the increased demand of leased line services from our local government and corporate customers. The increase of our leased line income was partially offset by the negative effect of the implementation of VAT in the PRC telecommunications industry.

*Information Communication Technology Services Revenue.* Information communication technology services revenue increased by 24.9% from RMB3.47 billion in 2014 to RMB4.33 billion in 2015, mainly as a result of our growing information communication technology services with new system integration projects in 2015 for government and large corporate customers.

*Other Service Revenue.* Other service revenue mainly consists of miscellaneous revenue items. Other service revenue increased by 7.8% from RMB0.89 billion in 2014 to RMB0.96 billion in 2015.

*Sales of Telecommunications Products.* Revenue from our sales of fixed-line telecommunications products increased by 76.7% from RMB60 million in 2014 to RMB106 million in 2015, mainly due to the increase in the sales amount of telecommunications products such as optical network unit terminals.

***Costs, Expenses and Others***

Total costs, expenses and others in 2015 were RMB263.01 billion, representing a decrease of 2.1% from RMB268.75 billion in 2014. The implementation of VAT in the PRC telecommunications industry reduced our costs and expenses to the extent we are entitled to claim certain input VAT credits for the purchase of goods and services. In addition, we receive a benefit of claiming input VAT credits on our capital expenditures for purchasing certain assets, which resulted in a lower depreciation. However, certain costs and expenses, such as employee benefit expenses and finance

costs are not subjected to VAT and therefore do not qualify for input VAT credits. For the year ended December 31, 2015, the decrease in our costs and expenses was smaller than the decrease in our revenue due to the implementation of VAT in the PRC telecommunications industry.

**Table of Contents**

The table below sets forth the major items of costs, expenses and others and their respective percentage of the total telecommunications services revenue for the years 2014 and 2015:

	<b>For the Year Ended December 31,</b>			
	<b>2014</b>		<b>2015</b>	
	<b>RMB in millions</b>	<b>% of Total</b>	<b>RMB in millions</b>	<b>% of Total</b>
Total telecommunications services revenue	244,878	100.0	235,278	100.0
Costs, expenses and others	268,750	109.7	263,014	111.8
Interconnection charges	14,599	6.0	13,093	5.6
Depreciation and amortization	73,868	30.2	76,738	32.6
Network, operation and support expenses	37,851	15.5	42,308	18.0
Employee benefit expenses	34,652	14.2	35,140	14.9
Selling and marketing	40,193	16.4	31,965	13.6
General, administrative and other expenses	21,218	8.7	22,995	9.8
Cost of telecommunications products sold	43,397	17.7	44,046	18.7
Finance costs, net of interest income	4,334	1.8	6,496	2.8
Other income-net	(1,362)	(0.6)	(9,767)	(4.2)

*Interconnection Charges.* Interconnection charges were RMB13.09 billion in 2015, down by 10.3% from 2014, primarily due to (i) the decrease in volume of the interconnection voice calls and (ii) the implementation of VAT in the PRC telecommunications industry to the extent that we are entitled to input VAT credits. Interconnection charges as a percentage of telecommunications service revenue decreased from 6.0% in 2014 to 5.6% in 2015.

*Depreciation and Amortization.* Our depreciation and amortization expenses were RMB76.74 billion in 2015, up by 3.9% from 2014. The increase was primarily due to an increase in our capital expenditures in connection with the expansion of our 4G and fixed-line broadband network coverage and improvement of our network quality in 2015, partially offset by the decrease in the depreciation and amortization expenses as a result of the disposal of telecommunications towers and related assets to the Tower Company in October 2015. As a percentage of telecommunications service revenue, our depreciation and amortization expenses increased from 30.2% in 2014 to 32.6% in 2015.

*Network, Operation and Support Expenses.* We incurred network, operation and support expenses of RMB42.31 billion in 2015, up by 11.8% from 2014, primarily due to (i) the usage fees payable to the Tower Company with respect to certain telecommunications towers and related assets; (ii) the expansion of networks, facilities and base stations and (iii) the increases in other rental expenses and utilities charges. In general, the implementation of VAT in the PRC telecommunications industry reduces our network, operation and support expenses to the extent we are entitled to the input VAT credits. Network, operation and support expenses, as a percentage of telecommunications service revenue, increased from 15.5% in 2014 to 18.0% in 2015. With the expansion of our network, we had an increased demand of leased lines and the related telecommunications line leasing fees was RMB3.35 billion, up by 22.3% from 2014.

*Employee Benefit Expenses.* Due to the increases in salaries and wages as well as contributions to defined contribution pension schemes, medical insurance and housing benefits, our employee benefit expenses increased by 1.4% from RMB34.65 billion in 2014 to RMB35.14 billion in 2015, and as a percentage of telecommunications service revenue, increased from 14.2% in 2014 to 14.9% in 2015.

*Selling and Marketing Expenses.* Primarily due to (i) our strengthened management of the selling and marketing expenses and the adjustment of our sales and marketing model and (ii) the implementation of VAT in the PRC telecommunications industry, our selling and marketing expenses were RMB31.97 billion in 2015, down by 20.5% from 2014, and as a percentage of telecommunications service revenue, decreased from 16.4% in 2014 to 13.6% in 2015.

-57-

## **Table of Contents**

*General, Administrative and Other Expenses.* Our general, administrative and other expenses were RMB23.00 billion in 2015, up by 8.4% from 2014, and as a percentage of telecommunications service revenue, increased from 8.7% in 2014 to 9.8% in 2015, primarily due to the increases in expenses associated with disposals of our fiber-optic transmission assets and costs relating to information communications technologies services.

*Cost of Telecommunications Products Sold.* In 2015, the cost of telecommunications products sold amounted to RMB44.05 billion, up by 1.5% from 2014, primarily due to the increase in sales of telecommunications terminal products in 2015.

*Finance Costs, Net of Interest Income.* Our finance costs, net of interest income, increased by 49.9% from RMB4.33 billion in 2014 to RMB6.50 billion in 2015, which was primarily due to losses of foreign exchange settlement as a result of fluctuations in exchange rate of Renminbi against the other currencies.

*Other Income-Net.* In 2015, other income-net was RMB9.77 billion, representing a significant increase from 2014, primarily as a result of the one-off effect of the net gain in an amount of RMB9.25 billion (before tax) on disposal of telecommunication towers to the Tower Company, which was completed by October 31, 2015.

### ***Income Before Income Tax***

In 2015, our income before income tax was RMB14.04 billion, down by 11.9% from 2014, mainly due to (i) the decrease in service revenue from our mobile services as a result of the impact of the implementation of the PRC Government's policy of increasing network speed and reducing tariffs, our mobile data carry-over programs launched in October 2015, the implementation of VAT to replace business tax relating to the telecommunications services in China, the intensifying competition with other major telecommunications operators and (ii) exchange loss incurred in 2015.

### ***Income Tax***

Our income tax was RMB3.47 billion in 2015, down by 10.4% from 2014, and our effective tax rate in 2015 was 24.7%, slightly up by 0.4 percentage point from 2014. The decrease in our income tax was largely due to the decrease in our income before income tax.

### ***Net Income for the Year***

In 2015, our net income reached RMB10.56 billion, down by 12.4% from 2014. Our basic earnings per share was RMB0.44 in 2015, down by 12.7% from 2014.

## **Year Ended December 31, 2014 Compared to Year Ended December 31, 2013**

### ***Revenue***

In 2014, we continued to actively develop full-service operation with a focus on mobile broadband services that include our 3G and 4G services, and fixed-line broadband services. Revenue for 2014 was RMB284.68 billion, representing a decrease of 3.5% from RMB295.04 billion for 2013, of which our service revenue was RMB244.88 billion in 2014, representing an increase of 2.6% from 2013. As our revenue is presented after excluding any output VAT in accordance with IFRS and we do not pass on the cost of any VAT to our subscribers for telecommunications services, the implementation of VAT in the PRC telecommunications industry has a negative impact on our revenue.



*Mobile Services Revenue*

Total revenue from our mobile services decreased by 6.1% from RMB207.53 billion in 2013 to RMB194.84 billion in 2014. Of the total revenue from our mobile services in 2013 and 2014, RMB151.13 billion and RMB155.10 billion, respectively, was from service revenue. Service revenue from our mobile services as a percentage of our total service revenue was 63.4% and 63.3% in 2013 and 2014, respectively. The overall ARPU for our mobile subscribers decreased from RMB48.2 in 2013 to RMB44.1 in 2014. The decrease in total revenue from our mobile services was primarily driven by a decrease in the revenue of our mobile telecommunications products. The decrease in the ARPU for our mobile subscribers also contributed to the decrease of our mobile service revenue. The decrease in the ARPU for our mobile subscribers was primarily due to the factors including (i) the intensifying competition with other telecommunications operators in China; (ii) the implementation of VAT in the PRC telecommunications industry; (iii) the change in our subsidies towards a model of lesser handset subsidies and more rebates or discounts on service charges to our subscribers, which resulted in a direct reduction of our mobile service revenue; and (iv) many of our new subscribers who are users with lower usage of telecommunications services.

**Table of Contents**

The total number of our mobile subscribers was 299.10 million as of December 31, 2014, with a net addition of 18.11 million subscribers (including a net addition of 26.51 million mobile broadband subscribers) from the end of 2013. ARPU of our mobile broadband services was RMB63.6 in 2014, representing a decrease of 15.3% from RMB75.1 in 2013, primarily due to our business strategy to increase the number of our mobile broadband subscribers, which resulted in an increased proportion of new subscribers who are users with relatively lower usage of mobile broadband services. ARPU of our GSM mobile services was RMB26.6 in 2014, representing a decrease of 15.8% from RMB31.6 in 2013, primarily due to (i) the migration of certain mid- and high-end 2G subscribers to mobile broadband network, (ii) the intensifying competition among the telecommunications operators in China and (iii) the fact that a significant portion of our new users consists of users from rural areas, many of whom tend to have less usage of telecommunications services and to be more cost-sensitive than users from urban areas.

The table below sets forth the revenue composition of our mobile services and each revenue item's respective share of total revenue for the years ended December 31, 2013 and 2014.

	2013		2014	
	RMB in millions	As % of total	RMB in millions	As % of total
Total revenue from mobile services	207,526	100.0	194,838	100.0
Service revenue	151,133	72.8	155,095	79.6
Usage fees and monthly fees	68,626	33.1	62,152	31.9
Value-added services revenue	67,975	32.8	79,814	41.0
Interconnection fees	13,635	6.6	12,398	6.4
Other service revenue	897	0.4	731	0.4
Sales of mobile telecommunications products	56,393	27.2	39,743	20.4

*Usage Fees and Monthly Fees.* Primarily as a result of (i) the implementation of VAT in the PRC telecommunications industry; and (ii) the intensifying competition among the major PRC telecommunications operators, usage fees and monthly fees for our mobile services were RMB62.15 billion in 2014, representing a decrease of 9.4% from RMB68.63 billion in 2013.

*Value-Added Services Revenue.* Value-added services revenue consists primarily of revenue from our mobile value-added services. Due to our active promotion of mobile data services of our mobile broadband services as well as the increase in the number of our mobile subscribers, revenue from our mobile value-added services was RMB79.81 billion in 2014, representing an increase of 17.4% from RMB67.98 billion in 2013. The increase was partially offset by the negative effect of the implementation of VAT in the PRC telecommunications industry. As a percentage of total revenue from mobile services, revenue from our mobile value-added services increased from 32.8% in 2013 to 41.0% in 2014. Of the total revenue from mobile value-added services, revenue from mobile Internet services increased by 29.9% from RMB38.35 billion in 2013 to RMB49.84 billion in 2014, revenue from our SMS services decreased by 1.2% from RMB7.71 billion in 2013 to RMB7.61 billion in 2014, and revenue from Cool Ringtone services decreased by 13.9% from RMB2.79 billion in 2013 to RMB2.40 billion in 2014.

*Interconnection Fees.* Our interconnection fees decreased by 9.1% from RMB13.64 billion in 2013 to RMB12.40 billion in 2014, and represented 6.4% of total revenue from mobile services in 2014 as compared with 6.6% in 2013. The decrease in our interconnection fees was primarily as a result of (i) the downward adjustment of interconnection fee charges by MIIT; and (ii) the implementation of VAT in the PRC telecommunications industry.

*Sales of Telecommunications Products.* Revenue from our sales of mobile telecommunications products decreased from RMB56.39 billion in 2013 to RMB39.74 billion in 2014, mainly due to the decrease in the sales amount of telecommunications products.

**Table of Contents***Fixed-Line Services Revenue*

In 2014, we continued to develop our fixed-line broadband services and promoted our mobile and fixed-line bundled services. The trend of mobile substitution continued to have a negative impact on the growth of revenue from our fixed-line voice services. Our total revenue from fixed-line services increased by 2.3% from RMB86.57 billion in 2013 to RMB88.54 billion in 2014, of which service revenue increased by 2.3% from RMB86.49 billion in 2013 to RMB88.48 billion in 2014. The increase of our total revenue from fixed-line services was partially offset by the negative effect of the implementation of VAT in the PRC telecommunications industry. See D. Risk Factors Risks Relating to Our Business The industry trends of mobile service substitution and mobile service migration from old generations to new generations may continue to have a material adverse effect on our fixed-line local telephone services and mobile services, which may materially and adversely affect our financial condition, results of operations and growth prospects under Item 3.

The table below sets forth the revenue composition of our fixed-line services and each revenue item's respective share of total revenue from our fixed-line services for the years ended December 31, 2013 and 2014.

	<b>For the Year Ended December 31,</b>			
	<b>2013</b>		<b>2014</b>	
	<b>RMB in millions</b>	<b>As % of Total</b>	<b>RMB in millions</b>	<b>As % of Total</b>
Total revenue from fixed-line services	86,565	100.0	88,541	100.0
Service revenue	86,487	99.9	88,481	99.9
Usage fee and monthly fee	17,698	20.4	14,357	16.2
Broadband, data and other				
Internet-related services revenue	48,278	55.8	52,579	59.4
Interconnection fees	4,146	4.8	3,979	4.5
Value-added services revenue	3,996	4.6	4,324	4.9
Leased line income	8,389	9.7	8,879	10.0
Information communication technology				
services revenue	2,991	3.5	3,469	3.9
Other service revenue	989	1.1	894	1.0
Sales of fixed-line telecommunications				
products	78	0.1	60	0.1

*Usage Fees and Monthly Fees.* Usage fees include local usage fees charged for local telephone calls and VoIP long-distance calls, long-distance usage fees for domestic and international long-distance calls originated by our fixed-line subscribers, users of our pre-paid phone cards and certain other customers. Monthly fees represent the fixed amount of service charges to our customers for using our fixed-line telephone services.

In 2014, we experienced continuing decline in the number of fixed-line local telephone subscribers and revenue due to the continuing effect of mobile substitution. Our local telephone subscribers decreased in 2014 by 6.4% from 87.64 million at the end of 2013 to 82.06 million at the end of 2014. ARPU of the local telephone services decreased by 9.8% from RMB20.5 in 2013 to RMB18.5 in 2014. Total usage of local calls increased by 8.0% from 64.63 billion pulses in 2013 to 69.78 billion pulses in 2014 (excluding Internet dial-up usage) and total usage of long-distance calls decreased by 9.7% from 15.99 billion minutes in 2013 to 14.44 billion minutes in 2014. Revenue from our usage fees and monthly fees in 2014 decreased by 18.9% from RMB17.70 billion in 2013 to RMB14.36 billion in 2014.

*Broadband, Data and Other Internet-Related Services Revenue.* Revenue from our broadband, data and other Internet-related services include revenue generated from DSL, LAN, and broadband-related value-added services, fees that we charge for our DDN, frame relay, ATM, MPLS-VPN and X.25 services and revenue from the provision of Internet dial-up services (other than communication fees) and dedicated Internet access services. Revenue from our broadband, data and other Internet-related services increased by 8.9% from RMB48.28 billion in 2013 to RMB52.58 billion in 2014, primarily as a result of the increase in revenue from fixed-line broadband services. The increase of our revenue from our broadband, data and other Internet-related services was partially offset by the negative effect of the implementation of VAT in the PRC telecommunications industry.

**Table of Contents**

In light of the continuing effect of mobile substitution, fixed-line broadband service has become the main growth driver of our total revenue from fixed-line services. In 2014, our fixed-line broadband services continued to maintain growth as a result of our efforts in improving broadband access speed, adopting multi-service bundling strategy, enriching application contents and implementing diversified sales strategies. The number of our fixed-line broadband subscribers increased by 6.4% from 64.65 million in 2013 to 68.79 million in 2014. ARPU of our fixed-line broadband services increased by 1.3% from RMB61.4 in 2013 to RMB62.2 in 2014. Revenue from our fixed-line broadband services increased by 9.2% from RMB45.99 billion in 2013 to RMB50.20 billion in 2014, and as a percentage of the total fixed-line revenue increased from 53.1% in 2013 to 56.7% in 2014. Revenue from our data and other Internet-related services increased by 3.9% from RMB2.29 billion in 2013 to RMB2.38 billion in 2014.

*Interconnection Fees.* Our interconnection fees consist of interconnection fees charged to other domestic telecommunications operators, principally China Mobile and China Telecom, for both local and long-distance calls. Our interconnection fees decreased by 4.0% from RMB4.15 billion in 2013 to RMB3.98 billion in 2014. The decrease in interconnection revenue was mainly due to a decrease in voice traffic from other telecommunications operators as a result of the mobile substitution effect.

*Value-Added Services Revenue.* Revenue from our value-added services consists of fees that we charge our customers for the provision of caller-identification, personalized ring, telephone information services, video- and tele-conferencing and other value-added services. Revenue from our value-added services increased by 8.2% from RMB4.00 billion in 2013 to RMB4.32 billion in 2014.

*Leased Line Income.* Our leased line income consists of fees that we receive from our government, corporate and carrier customers for leasing circuit capacity to them, including the lease of digital circuits, digital trunk lines and optic fibers. Our leased line income increased by 5.8% from RMB8.39 billion in 2013 to RMB8.88 billion in 2014, which was primarily due to the increased demand of leased line services from our local government and corporate customers. The increase of our leased line income was partially offset by the negative effect of the implementation of VAT in the PRC telecommunications industry.

*Information Communication Technology Services Revenue.* Information communication technology services revenue increased by 16.0% from RMB2.99 billion in 2013 to RMB3.47 billion in 2014, mainly as a result of our growing information communication technology services with new system integration projects in 2014 for government and large corporate customers.

*Other Service Revenue.* Other service revenue mainly consists of miscellaneous revenue items. Other service revenue decreased by 10.1% from RMB0.99 billion in 2013 to RMB0.89 billion in 2014.

*Sales of Telecommunications Products.* Revenue from our sales of fixed-line telecommunications products decreased by 23.1% from RMB78 million in 2013 to RMB60 million in 2014, mainly due to (i) the decrease in the sales of telecommunications terminal products such as telephone sets associated with local voice services in 2014; and (ii) the implementation of VAT in the PRC telecommunications industry.

***Costs, Expenses and Others***

Total costs, expenses and others in 2014 were RMB268.75 billion, representing a decrease of 4.5% from RMB281.32 billion in 2013. The implementation of VAT in the PRC telecommunications industry reduced our costs and expenses to the extent we are entitled to claim certain input VAT credits for the purchase of goods and services. However, on the one hand, certain costs and expenses, such as employee benefit expenses and finance costs are not subjected to VAT and therefore do not qualify for input VAT credits. On the other hand, the decrease in depreciation and

amortization expenses due to the ability to claim input VAT credits is realized over the estimated useful life of such assets. For the year ended December 31, 2014, the decrease in our costs and expenses was smaller than the decrease in our revenue due to the implementation of VAT in the PRC telecommunications industry.

**Table of Contents**

The table below sets forth the major items of costs, expenses and others and their respective percentage of the total telecommunications services revenue for the years 2013 and 2014:

	For the Year Ended December 31, 2013		2014	
	RMB in millions	% of Total	RMB in millions	% of Total
Total telecommunications services revenue	238,567	100.0	244,878	100.0
Costs, expenses and others	281,324	117.9	268,750	109.7
Interconnection charges	20,208	8.5	14,599	6.0
Depreciation and amortization	68,196	28.6	73,868	30.2
Network, operation and support expenses	33,704	14.1	37,851	15.5
Employee benefit expenses	31,783	13.3	34,652	14.2
Selling and marketing	42,991	18.0	40,193	16.4
General, administrative and other expenses	18,973	8.0	21,218	8.7
Cost of telecommunications products sold	63,416	26.6	43,397	17.7
Finance costs, net of interest income	2,940	1.2	4,334	1.8
Other income-net	(887)	(0.4)	(1,362)	(0.6)

*Interconnection Charges.* Interconnection charges were RMB14.60 billion in 2014, down by 27.8% from 2013, primarily due to (i) the downward adjustment of interconnection settlement policy and (ii) the implementation of VAT in the PRC telecommunications industry to the extent that we are entitled to input VAT credits. Interconnection charges as a percentage of telecommunications service revenue decreased from 8.5% in 2013 to 6.0% in 2014.

*Depreciation and Amortization.* Our depreciation and amortization expenses were RMB73.87 billion in 2014, up by 8.3% from 2013. The increase was primarily due to the increase in our capital expenditures in connection with the expansion of our mobile broadband and fixed-line broadband network coverage and improvement of our network quality in 2014. These capital expenditures increased the relevant fixed assets that are subject to depreciation. As a percentage of telecommunications service revenue, our depreciation and amortization expenses increased from 28.6% in 2013 to 30.2% in 2014.

*Network, Operation and Support Expenses.* Due to various factors, including the expansion of networks, facilities and base stations and the increases in utilities charges and rental expenses, we incurred network, operation and support expenses of RMB37.85 billion in 2014, up by 12.3% from 2013. In general, the implementation of VAT in the PRC telecommunications industry reduces our network, operation and support expenses to the extent we are entitled to the input VAT credits. Network, operation and support expenses, as a percentage of telecommunications service revenue, increased from 14.1% in 2013 to 15.5% in 2014. With the expansion of our network, we had an increased demand of leased lines, and the related line leasing fees was RMB2.74 billion, up by 14.9% from 2013.

*Employee Benefit Expenses.* Due to the increases in salaries and wages as well as contributions to defined contribution pension schemes, medical insurance and housing benefits, our employee benefit expenses increased by 9.0% from RMB31.78 billion in 2013 to RMB34.65 billion in 2014, and as a percentage of telecommunications service revenue, increased from 13.3% in 2013 to 14.2% in 2014.

*Selling and Marketing Expenses.* Primarily due to (i) our strengthened management of the selling and marketing expenses and the adjustment of our sales and marketing model and (ii) the implementation of VAT in the PRC telecommunications industry, our selling and marketing expenses were RMB40.19 billion in 2014, down by 6.5% from 2013, and as a percentage of telecommunications service revenue, decreased from 18.0% in 2013 to 16.4% in



2014.

*General, Administrative and Other Expenses.* Our general, administrative and other expenses were RMB21.22 billion in 2014, up by 11.8% from 2013, and as a percentage of telecommunications service revenue, slightly increased from 8.0% in 2013 to 8.7% in 2014.

*Cost of Telecommunications Products Sold.* In 2014, the cost of telecommunications products sold amounted to RMB43.40 billion, down by 31.6% from 2013, primarily due to the decrease in sales of telecommunications terminal products in 2014.

-62-

## **Table of Contents**

*Finance Costs, Net of Interest Income.* Our finance costs, net of interest income, increased from RMB2.94 billion in 2013 to RMB4.33 billion in 2014, which was primarily due to a decrease in our gains of foreign exchange settlement.

*Other Income-Net.* In 2014, other income-net was RMB1.36 billion, up by 53.6% from 2013. The increase was primarily due to (i) the liquidated damages we received from our contract counterparties; and (ii) an increase of dividend income received from our investment in Telefónica and others.

### ***Income Before Income Tax***

In 2014, our income before income tax was RMB15.93 billion, up by 16.2% from 2013, mainly due to the decrease in our costs and expenses.

### ***Income Tax***

Our income tax was RMB3.88 billion in 2014, up by 17.3% from 2013, and our effective tax rate in 2014 was 24.3%, slightly up by 0.2 percentage point from 2013. The increase in our income tax was largely due to the increase in our income before income tax.

### ***Net Income for the Year***

In 2014, our net income reached RMB12.06 billion, up by 15.8% from 2013. Our basic earnings per share was RMB0.51 in 2014, up by 14.8% from 2013.

## **Liquidity and Capital Resources**

### ***Working Capital and Cash Flows***

As of December 31, 2015, we had RMB21.76 billion of cash and cash equivalents, as compared with RMB25.31 billion as of December 31, 2014 and RMB21.51 billion as of December 31, 2013. As of December 31, 2015, we had RMB0.2 billion of short-term bank deposits, as compared with RMB0.06 billion as of December 31, 2014 and RMB0.05 billion as of December 31, 2013. As of December 31, 2015, we had a working capital deficit (current liabilities less current assets) of RMB279.40 billion, representing an increase by 18.7% from the working capital deficit of RMB235.35 billion as of December 31, 2014. The increase in working capital deficit in 2015 primarily resulted from an increase of RMB47.03 billion in accounts payable and accrued liabilities resulting from an increase in the investments in fixed assets and a decrease of RMB3.79 billion in our net cash inflow from operating activities.

In recent years, although the PRC Government introduced measures to avoid overheating of the economy, including tightening bank lending policies, we, due to our enterprise nature and our good credit records with PRC banks, generally have not experienced and do not expect to experience in the foreseeable future significant difficulties in obtaining bank financing in China. As of December 31, 2015, we had RMB346.4 billion revolving banking facilities and registered quota of commercial papers, promissory notes and corporate bonds, of which RMB227.2 billion was unutilized. There is no term of the facilities that materially restricts our ability to draw down the unutilized banking facilities. In addition, we believe we have the ability to raise funds from short-, medium- and long-term perspectives and maintain reasonable financing costs through appropriate financing portfolio. Therefore, we believe that we will be able to fund our anticipated capital and liquidity needs with our access to debt and equity financing, in particular bank financing in China, and net cash inflows from our operations.

The following table sets forth cash inflows and outflows in 2013, 2014 and 2015.

	<b>For the Year Ended December</b>		
	<b>2013</b>	<b>2014</b>	<b>2015</b>
	<b>(RMB in millions)</b>		
Net cash inflow from operating activities	78,482	88,094	84,301
Net cash outflow from investing activities	(77,110)	(75,319)	(91,354)
Net cash inflow/(outflow) from financing activities	1,926	(8,973)	3,427
<b>Net increase/(decrease) in cash and cash equivalents</b>	<b>3,298</b>	<b>3,802</b>	<b>(3,626)</b>

-63-

**Table of Contents**

Our net cash inflow from operating activities increased by 12.2% from RMB78.48 billion in 2013 to RMB88.09 billion in 2014, primarily due to an increase in cash generated from our growing mobile services and fixed-line broadband services, which was partially offset by the increases in interest paid and income tax paid. Our net cash inflow from operating activities decreased by 4.3% from RMB88.09 billion in 2014 to RMB84.30 billion in 2015, primarily due to a decrease in cash generated from our mobile and fixed-line services.

Our net cash outflow from investing activities decreased by 2.3% from RMB77.11 billion in 2013 to RMB75.32 billion in 2014, mainly due to relatively moderate investment activities, including acquisitions of property, plant and equipment in 2013 and 2014. Our net cash outflow from investing activities increased by 21.3% from RMB75.32 billion in 2014 to RMB91.35 billion in 2015, mainly due to a substantial increase in our capital expenditure mainly as a result of the expansion of our 4G networks.

Our net cash inflow from financing activities was RMB1.93 billion in 2013 and our net cash outflow from financing activities was RMB8.97 billion in 2014, primarily due to our repayment of interest-bearing debts. Our net cash inflow from financing activities was RMB3.43 billion in 2015, primarily due to an increase in the amount of our interest-bearing debts.

***Indebtedness and Capital Structure***

The following table sets forth the amount of cash, cash equivalents, assets, short-term and long-term debt and equity as well as debt-to-capitalization and debt-to-equity ratios as of the end of 2013, 2014 and 2015.

	<b>As of December 31,</b>		
	<b>2013</b>	<b>2014</b>	<b>2015</b>
	<b>(RMB in millions, except percentages)</b>		
Cash and cash equivalents and short-term bank deposits	21,560	25,364	21,957
Total assets	529,171	545,072	610,346
Short-term debt	130,975	114,679	107,998
Short-term bank loans	94,422	91,503	83,852
Commercial papers	35,000	9,979	19,945
Current portion of long-term bank loans	48	45	84
Amounts due to related parties		473	
Amounts due to ultimate holding company	1,344	1,344	1,344
Current portion of obligations under finance lease included in other obligations	161	168	274
Current portion of promissory notes			2,499
Current portion of corporate bonds			
Convertible bonds		11,167	
Long-term debt	13,639	23,998	40,944
Promissory notes		21,460	36,928
Corporate bonds	2,000	2,000	2,000
Convertible bonds	11,002		
Non-current portion of long-term bank loans	481	420	1,748
Non-current portion of obligations under finance lease included in other obligations	156	118	268

Equity attributable to equity shareholders	218,899	227,541	231,216
Debt-to-capitalization ratio <sup>(1)</sup>	39.8%	37.9%	39.2%
Debt-to-equity ratio <sup>(2)</sup>	66.1%	60.9%	64.4%

- (1) Debt-to-capitalization ratio = (long-term interest-bearing debt + short-term interest-bearing debt)/(long-term interest-bearing debt + short-term interest-bearing debt + equity attributable to equity shareholders).
- (2) Debt-to-equity ratio = (long-term interest-bearing debt + short-term interest-bearing debt)/(equity attributable to equity shareholders).

## **Table of Contents**

Our debt-to-capitalization ratio was 39.2% at the end of 2015, compared to 37.9% at the end of 2014 and 39.8% at the end of 2013. Our debt-to-equity ratio was 64.4% at the end of 2015, compared to 60.9% at the end of 2014 and 66.1% at the end of 2013. The sum of our long-term and short-term interest-bearing debt exceeds the amount of our cash and cash equivalents and short-term bank deposits by RMB126.99 billion as of December 31, 2015, compared to RMB113.31 billion as of December 31, 2014 and RMB123.05 billion as of December 31, 2013. The decreases in our debt-to-capitalization ratio and debt-to-equity ratio from 2013 to 2014 were mainly due to the increase in equity attributable to equity shareholders. The increases in our debt-to-capitalization ratio and debt-to-equity ratio from 2014 to 2015 were mainly due to the increase in the amount of our interest-bearing debts. We continue to seek to optimize our capital structure, develop multiple financing sources and reduce overall financing costs. In addition, we seek to increase our capital turnover ratio and control the amount of monetary assets.

Our outstanding short-term and long-term bank loans, denominated in RMB, U.S. dollar, HK dollar and Euro, was RMB85.68 billion at the end of 2015, compared to RMB91.97 billion at the end of 2014 and RMB94.95 billion at the end of 2013. The decrease from 2013 to 2015 was mainly due to our repayment of certain bank loans. As of December 31, 2015, no short-term bank loans or long-term bank loans were guaranteed by Unicom Group.

In order to further rationalize our debt structure and reduce our interest expense, we may continue to finance a portion of our business operations and capital expenditures through issuance of debt securities. Our liquidity in the future will primarily depend on our ability to maintain adequate cash inflow from operations and obtain adequate external financing to meet our debt service obligations and planned capital expenditures. Our operating cash flows could be adversely affected by numerous factors beyond our control, including, but not limited to, decreased demand for our telecommunications services and further intensifying competition. Our ability to obtain external financing also depends on numerous factors, including, but not limited to, our financial condition and creditworthiness as well as our relationship with lenders. See D. Risk Factors Risks Relating to Our Business If we are unable to fund our capital expenditure and debt service requirements, our financial condition, results of operations and growth prospects will be materially and adversely affected under Item 3.

On June 8, 2007, we issued RMB2 billion 10-year corporate bonds, bearing interest at 4.5% per annum. The corporate bonds are secured by a guarantee issued by Bank of China Limited. On September 3, 2008, we issued another RMB5 billion 5-year corporate bonds, bearing interest at 5.29% per annum. The corporate bonds are secured by a guarantee issued by State Grid Corporation of China. The aforementioned corporate bonds were fully repaid in September 2013.

On April 1, 2010, CUCL completed the issue of the first tranche of commercial paper for the year 2010 in an amount of RMB15 billion, with a maturity period of 365 days and at an interest rate of 2.64% per annum. The commercial paper was fully repaid in March 2011. On April 2, 2010, CUCL completed the issue of the first tranche of promissory note for the year 2010 in an amount of RMB3 billion, with a maturity period of three years and at an interest rate of 3.73% per annum. The promissory note was fully repaid in April 2013.

On September 20, 2010, CUCL completed the issue of the second tranche of commercial paper for the year 2010 in an amount of RMB8 billion, with a maturity period of 365 days and at an interest rate of 2.81% per annum. The commercial paper was fully repaid in September 2011. On the same date, CUCL completed the issue of the second tranche of promissory note for the year 2010 in an amount of RMB12 billion, with a maturity period of three years and at an interest rate of 3.31% per annum. The promissory note was fully repaid in September 2013.

On October 18, 2010, Billion Express Investments Limited, a wholly owned subsidiary of our company, issued the 2015 Convertible Bonds in aggregate principal amount of US\$1,838,800,000 (at the fixed exchange rate of US\$1 equivalent to HK\$7.7576), which are guaranteed by our company and are exchangeable into ordinary shares of our company. On October 18, 2015, the 2015 convertible bonds matured and all the outstanding amounts were paid in

full.

On July 12, 2012, CUCL completed the issue of the first tranche of commercial paper for the year 2012 in an amount of RMB15 billion, with a maturity period of 365 days and at an interest rate of 3.45% per annum. The first tranche of commercial paper was fully repaid in July 2013.

-65-

## **Table of Contents**

On October 24, 2012, CUCL completed the issue of the second tranche of commercial paper for the year 2012 in an amount of RMB15 billion, with a maturity period of 365 days and at an interest rate of 4.20% per annum. The second tranche of commercial paper was fully repaid in October 2013.

On October 25, 2012, CUCL completed the issue of the third tranche of commercial paper for the year 2012 in an amount of RMB8 billion, with a maturity period of 365 days and at an interest rate of 4.20% per annum. The third tranche of commercial paper was fully repaid in October 2013.

On July 10, 2013, CUCL completed the issue of the first tranche of super and short-term commercial paper for the year 2013 in an amount of RMB15 billion, with a maturity period of 60 days and at an interest rate of 4.20% per annum. The first tranche of super and short-term commercial paper was fully repaid in September 2013.

On September 17, 2013, CUCL completed the issue of the second tranche of super and short-term commercial paper for the year 2013 in an amount of RMB15 billion, with a maturity period of 180 days and at an interest rate of 4.63% per annum. The second tranche of super and short-term commercial paper was fully repaid in March 2014.

On October 12, 2013, CUCL completed the issue of the third tranche of super and short-term commercial paper for the year 2013 in an amount of RMB10 billion, with a maturity period of 180 days and at an interest rate of 4.68% per annum. The third tranche of super and short-term commercial paper was fully repaid in April 2014.

On October 21, 2013, CUCL completed the issue of the fourth tranche of super and short-term commercial paper for the year 2013 in an amount of RMB10 billion, with a maturity period of 180 days and at an interest rate of 4.68% per annum. The fourth tranche of super and short-term commercial paper was fully repaid in April 2014.

On March 24, 2014, CUCL completed the issue of the first tranche of super and short-term commercial paper for the year 2014 in an amount of RMB10 billion, with a maturity period of 270 days and at an interest rate of 5.10% per annum. The first tranche of super and short-term commercial paper was fully repaid in December 2014.

On April 3, 2014, the Company established a Medium-Term Note Program, or the Program, under which the Company could offer and issue notes of aggregate principal amount of up to RMB10.0 billion. Notes issued under the Program will be denominated in Renminbi and issued to professional investors outside the United States. On April 16, 2014, the Company completed the issue of notes in an aggregate nominal amount of RMB4 billion pursuant to the Program, with a maturity period of three years and at an interest rate of 4.00% per annum.

On April 16, 2014, CUCL completed the issue of the first tranche of promissory note for the year 2014 in an amount of RMB5 billion, with a maturity period of three years and at an interest rate of 5.35% per annum.

On July 14, 2014, CUCL completed the issue of the second tranche of promissory note for the year 2014 in an amount of RMB5 billion, with a maturity period of three years and at an interest rate of 4.84% per annum.

On July 15, 2014, CUCL completed the issue of the first tranche of commercial paper for the year 2014 in an amount of RMB10 billion, with a maturity period of 365 days and at an interest rate of 4.60% per annum. The first tranche of commercial paper was fully repaid in July 2015.

On July 24, 2014, the Company completed the issue of notes in an aggregate nominal amount of RMB2.5 billion pursuant to the Program, with a maturity period of two years and at an interest rate of 3.80% per annum.



On November 28, 2014, CUCL completed the issue of the third tranche of promissory note for the year 2014 in an amount of RMB5 billion, with a maturity period of three years and at an interest rate of 4.20% per annum.

On March 19, 2015, CUCL completed the issue of the first tranche of super and short-term commercial paper for the year 2015 in an amount of RMB10 billion, with a maturity period of 270 days and at an interest rate of 4.40% per annum. The first tranche of super and short-term commercial paper was fully paid in December 2015.

**Table of Contents**

On June 15, 2015, CUCL completed the issue of the first tranche of promissory note for the year 2015 in an amount of RMB4 billion, with a maturity period of three years and at an interest rate of 3.85% per annum.

On June 18, 2015, CUCL completed the issue of the second tranche of promissory note for the year 2015 in an amount of RMB4 billion, with a maturity period of three years and at an interest rate of 3.85% per annum.

On November 20, 2015, CUCL completed the issue of the second tranche of super and short-term commercial paper for the year 2015 in an amount of RMB10 billion, with a maturity period of 270 days and at an interest rate of 3.15% per annum.

On November 27, 2015, CUCL completed the issue of the first tranche of short-term commercial paper for the year 2015 in an amount of RMB10 billion, with a maturity period of 366 days and at an interest rate of 3.15% per annum.

On November 30, 2015, CUCL completed the issue of the third tranche of promissory note for the year 2015 of an amount of RMB3.5 billion, the fourth tranche of promissory note for the year 2015 of an amount of RMB3.5 billion and the fifth tranche of promissory note for the year 2015 of an amount of RMB3 billion, all with a maturity period of three years and at an interest rate of 3.30% per annum.

**Contractual Obligations and Commercial Commitments**

The following table sets forth the amounts of our outstanding contractual cash obligations as of December 31, 2015.

	<b>Total</b>	<b>Less than 1 year</b>	<b>Between 1 and 3 years</b>	<b>Between 3 and 5 years</b>	<b>Over 5 years</b>
		<b>(RMB in millions)</b>			
Short-term bank loans <sup>(1)*</sup>	85,095	85,095			
Commercial papers <sup>(2)*</sup>	20,482	20,482			
Long-term bank loans <sup>(3)*</sup>	2,574	109	252	249	1,964
Corporate bonds <sup>(4)*</sup>	2,129	90	2,039		
Promissory notes <sup>(5)*</sup>	42,596	4,071	38,525		
Other obligations*	3,184	2,816	291	11	66
Capital commitments <sup>(6)</sup>	39,980	25,599	8,421	5,575	385
Operating leases commitments <sup>(6)</sup>	14,141	4,838	6,531	1,041	1,731
Amounts due to ultimate holding company <sup>(7)</sup>	1,470	1,470			
Amounts due to related parties <sup>(7)</sup>	3,930	3,930			
Amounts due to domestic carriers	1,300	1,300			
Accounts payable and accrued liabilities <sup>(8)</sup>	167,396	167,396			
<b>Total obligations</b>	<b>384,277</b>	<b>317,196</b>	<b>56,059</b>	<b>6,876</b>	<b>4,146</b>

\* Interest included

(1) See Note 26 Short-Term Bank Loans to our consolidated financial statements included elsewhere in this annual report on Form 20-F.

- (2) See Note 27 Commercial Papers to our consolidated financial statements included elsewhere in this annual report on Form 20-F.
- (3) See Note 21 Long-Term Bank Loans to our consolidated financial statements included elsewhere in this annual report on Form 20-F.
- (4) See Note 24 Corporate Bonds to our consolidated financial statements included elsewhere in this annual report on Form 20-F.
- (5) See Note 22 Promissory Notes to our consolidated financial statements included elsewhere in this annual report on Form 20-F.
- (6) See Note 41 Contingencies and Commitments to our consolidated financial statements included elsewhere in this annual report on Form 20-F.
- (7) See Note 40 Related Party Transactions to our consolidated financial statements included elsewhere in this annual report on Form 20-F.
- (8) See Note 28 Accounts Payable and Accrued Liabilities to our consolidated financial statements included elsewhere in this annual report on Form 20-F.

**Table of Contents*****Trend Information***

Please refer to the discussion in sections headed **Overview** and **Operating Results** under this Item 5.

***Off-Balance-Sheet Arrangements***

As of December 31, 2015, we did not have any other off-balance-sheet arrangement.

***Capital Expenditures***

The following table sets forth our historical capital expenditure requirements for the periods indicated.

	For the Year Ended December 31, 2014		2015	
	(RMB in billions)	As a Percentage	(RMB in billions)	As a Percentage
Mobile services	36.95	43.5%	61.02	45.6%
Broadband and data services	19.00	22.4%	33.76	25.2%
Infrastructure and transmission network	22.92	27.0%	31.16	23.3%
Others <sup>(1)</sup>	6.01	7.1%	7.94	5.9%
<b>Total</b>	<b>84.88</b>	<b>100.0%</b>	<b>133.88</b>	<b>100.0%</b>

(1) Other expenditures consist of innovation and value-added platform, IT system, fixed-line services and procurement of miscellaneous assets, equipment and spare parts.

Our capital expenditure totaled RMB133.88 billion in 2015, which mainly consisted of investment in mobile services, broadband and data services, and infrastructure and transmission network. In 2015, capital expenditure attributable to mobile services was RMB61.02 billion; capital expenditure attributable to broadband and data services was RMB33.76 billion; capital expenditure attributable to infrastructure and transmission network was RMB31.16 billion.

We expect to continue incurring significant capital expenditure in 2016. We expect our capital expenditure in 2016 to include primarily investments in 4G services and fixed-line broadband services as well as infrastructure and transmission networks that support the development of our 4G services and fixed-line broadband services.

We expect to fund our capital expenditure needs through a combination of cash generated from operating activities, granted and unused banking facilities and other available financing sources. See **D. Risk Factors** **Risks Relating to Our Business**. If we are unable to fund our capital expenditure and debt service requirements, our financial condition, results of operations and growth prospects will be materially and adversely affected under Item 3.

**Item 6. Directors, Senior Management and Employees**

**A. Directors and Senior Management**

The following table sets forth certain information concerning our current directors and executive officers.

<b>Name</b>	<b>Age</b>	<b>Position</b>
Wang Xiaochu	57	Chairman of the Board of Directors and Chief Executive Officer
Lu Yimin	52	Executive Director and President
Li Fushen	53	Executive Director and Chief Financial Officer
Zhang Junan	59	Executive Director and Senior Vice President

-68-

**Table of Contents**

<b>Name</b>	<b>Age</b>	<b>Position</b>
Cesareo Alierta Izuel	70	Non-Executive Director
Cheung Wing Lam Linus	67	Independent Non-Executive Director
Wong Wai Ming	58	Independent Non-Executive Director
Chung Shui Ming Timpson	64	Independent Non-Executive Director
Law Fan Chiu Fun Fanny	63	Independent Non-Executive Director
Jiang Zhengxin	58	Senior Vice President
Shao Guanglu	51	Senior Vice President
Xiong Yu	46	Senior Vice President

**Mr. Wang Xiaochu** was appointed in September 2015 as an Executive Director, Chairman and Chief Executive Officer of the Company. Mr. Wang, a professor level senior engineer, graduated from Beijing Institute of Posts and Telecommunications in 1989 and received a doctorate degree in business administration from the Hong Kong Polytechnic University in 2005. Mr. Wang served as Deputy Director General and Director General of the Hangzhou Telecommunications Bureau in Zhejiang province; Director General of the Tianjin Posts and Telecommunications Administration; Chairman and Chief Executive Officer of China Mobile (Hong Kong) Limited; Vice President of China Mobile Communications Corporation; an Executive Director, Chairman and Chief Executive Officer of China Telecom Corporation Limited; President and Chairman of China Telecommunications Corporation; and Chairman and a Non-executive Director of China Communications Services Corporation Limited. Mr. Wang has served as a Director of Telefónica (listed on various stock exchanges including Madrid, New York and London) since September 2015. Mr. Wang also serves as the Chairman of China United Network Communications Group Company Limited, A Share Company and CUCL. Mr. Wang has extensive experience in management and telecommunications industry.

**Mr. Lu Yimin** was appointed as an Executive Director of the Company in October 2008 and President of the Company in February 2009. Mr. Lu, a researcher level senior engineer, graduated from Shanghai Jiao Tong University with a bachelor's degree in computer science in 1985 and then was awarded a master's degree in public administration by the John F. Kennedy School of Government at Harvard University. Mr. Lu joined Netcom Group in December 2007, serving as senior management. Mr. Lu has served as a Non-Executive Director of PCCW Limited (listed on the Hong Kong Stock Exchange with an American Depositary Receipts trading on OTC Markets Group Inc. in the U.S.) since May 2008 and the Deputy Chairman of PCCW Limited since November 2011. Mr. Lu has served as a Non-Executive Director of HKT Limited (HKT Trust and HKT Limited are listed on the Hong Kong Stock Exchange) and HKT Management Limited (the trustee-manager of the HKT Trust) since November 2011. Prior to joining the Netcom Group, Mr. Lu was a member of the Secretary Bureau of the General Office of the Chinese Communist Party Central Committee, serving as the Deputy Director and the Director of the Information Processing Office since 1992, Secretary at deputy director general level since 2001 and Secretary at director general level since 2005. Mr. Lu is Vice Chairman and President of Unicom Group. Mr. Lu is also a Director and President of A Share Company, and a Director and President of CUCL. Mr. Lu has extensive experience in administration and business management in the government and the telecommunications industry.

**Mr. Li Fushen** was appointed in March 2011 as an Executive Director and Chief Financial Officer of the Company. Mr. Li graduated from the Jilin Engineering Institute with a degree in engineering management in 1988, and from the Australian National University with a master's degree in management in 2004. From November 2001 to October 2003, Mr. Li served as Deputy General Manager of the former Jilin Provincial Telecommunications Company and Jilin Communications Company. From October 2003 to August 2005, Mr. Li served as General Manager of the Finance Department of Netcom Group. Since October 2005, he has served as the Chief Accountant of Netcom Group. He has served as Chief Financial Officer of China Netcom since September 2005 and has served as Executive Director of China Netcom since January 2007. From December 2006 to March 2008, Mr. Li served as Joint Company Secretary of China Netcom. From February 2009 to March 2011, Mr. Li served as a Senior Vice President of the Company. In addition, Mr. Li has served as a Non-Executive Director of PCCW Limited (listed on the Hong Kong Stock Exchange

with an American Depositary Receipts trading on OTC Markets Group Inc.) since July 2007, and a Non-Executive Director of HKT Limited (HKT Trust and HKT Limited are listed on the Hong Kong Stock Exchange) and HKT Management Limited (the trustee-manager of the HKT Trust) since November 2011. Mr. Li is a Vice President and Chief Accountant of Unicom Group, a Director of A Share Company, as well as Director and Senior Vice President of CUCL. Mr. Li has worked in the telecommunications industry for a long period of time and has extensive management experience.

**Table of Contents**

**Mr. Zhang Junan** was appointed in August 2014 as an Executive Director. Mr. Zhang was appointed as Vice President of the Company in April 2006 and Senior Vice President of the Company in February 2009. Mr. Zhang graduated from the Nanjing University of Posts and Telecommunications majoring in carrier communication in 1982. He received a master's degree in business administration from the Australian National University in 2002 and a doctor's degree in business administration from the Hong Kong Polytechnic University in 2008. He previously served as a Director of the Bengbu Municipal Posts and Telecommunications Bureau in Anhui Province and a Deputy Director of the Anhui Provincial Posts and Telecommunications Bureau. From 2000 to 2005, he served as a Deputy General Manager and General Manager of the Anhui Provincial Telecommunications Company and the Chairman and General Manager of the Anhui Provincial Telecommunications Co., Limited. Mr. Zhang joined the China United Telecommunications Corporation in December 2005 and served as Vice President. In December 2008, China United Telecommunications Corporation changed its company name to China United Network Communications Group Company Limited (Unicom Group). From April 2006 to October 2008, Mr. Zhang served as the Executive Director of the Company. Mr. Zhang has served as a Non-Executive Director of PCCW Limited (listed on the Hong Kong Stock Exchange with an American Depositary Receipts trading on OTC Markets Group Inc. in the U.S.) since August 2014. In addition, Mr. Zhang serves as a Non-Executive Director of China Communications Services Corporation Limited (listed on the Hong Kong Stock Exchange). Mr. Zhang also serves as a Vice President of Unicom Group, a Director of A Share Company, as well as Director and Senior Vice President of CUCL. Mr. Zhang has worked in the telecommunications industry for a long period of time and has extensive management experience.

**Mr. Cesareo Alierta Izuel** was appointed in October 2008 as a Non-Executive Director of the Company. Mr. Alierta has been a member of the Board of Directors of Telefónica (listed on various stock exchanges including Madrid, New York and London) from January 1997. Mr. Alierta is a member of the Board of Directors of International Consolidated Airlines Group (IAG, listed on the stock exchanges of Madrid and London) and a member of the Board of trustees of the Caixa d'Estalvis i Pensions de Barcelona la Caixa Banking Foundation. He is also the Chairman of the Social Board of the UNED (National Long Distance Spanish University), the Chairman of the Consejo Empresarial para la Competitividad (Business Competitiveness Council) and a member of the Columbia Business School Board of Overseers. Between 1970 and 1985, he was the General Manager of the Capital Markets division at Banco Urquijo in Madrid. He has been the founder and Chairman of Beta Capital. As from 1991, he has also acted as the Chairman of the Spanish Financial Analysts' Association. He has also been a member of the Board of Directors and the Standing Committee of the Madrid Stock Exchange. Between 1996 and 2000, he held the post of Chairman of Tabacalera, S.A., and subsequently Altadis following the company's merger with the French group Seita. Between July 2000 and April 2016, he served as an Executive Chairman of Telefónica. Mr. Alierta served as a Non-Executive Director of China Netcom during the period from December 2007 to November 2008. From April 2008 to December 2013 he was a member of the Board of Directors of Telecom Italia, S.p.A. In September 2005, Mr. Alierta received The Global Spanish Entrepreneur award from the Spanish/US Chamber of Commerce. Mr. Alierta holds a degree in law from the University of Zaragoza and received a master's degree in business administration at the University of Columbia (New York) in 1970.

**Mr. Cheung Wing Lam Linus** was appointed in May 2004 as an Independent Non-Executive Director of the Company. Mr. Cheung is Chairman of the Council of Centennial College of the University of Hong Kong and an Independent Non-Executive Director of HKR International Limited (listed on the Hong Kong Stock Exchange). Mr. Cheung was Chairman of the Board of Governors of Centennial College, Chairman of the University of Hong Kong School of Professional and Continuing Education, Chairman of Asia Television Limited, Deputy Chairman of PCCW Limited, an Independent Non-Executive Director of Taikang Life Insurance Company Limited, as well as President of the Chartered Institute of Marketing (Hong Kong Region). Prior to the merger of Pacific Century Cyberworks Limited and Cable & Wireless HKT Limited, or Hongkong Telecom, Mr. Cheung was the Chief Executive of Hongkong Telecom and an Executive Director of Cable & Wireless plc in the United Kingdom. Mr. Cheung worked at Cathay Pacific Airways for 23 years, before departing as Deputy Managing Director. He was appointed an Official Justice of



the Peace in 1990 and a Non-official Justice of the Peace in 1992. Mr. Cheung received a bachelor's degree in social sciences and a diploma in management studies from the University of Hong Kong. He is also an Honorary Fellow of the University of Hong Kong and of The Chartered Institute of Marketing in the United Kingdom.

-70-

## **Table of Contents**

**Mr. Wong Wai Ming** was appointed in January 2006 as an Independent Non-Executive Director of the Company. Mr. Wong is Executive Vice President and Chief Financial Officer of Lenovo Group Limited (listed on the Hong Kong Stock Exchange and the New York Stock Exchange). Prior to his current executive position at Lenovo Group Limited, Mr. Wong was the Chief Executive Officer and Executive Director of Roly International Holdings Limited and an Executive Director of Linmark Group Limited (currently known as Daohe Global Group Limited and listed on the Hong Kong Stock Exchange). Mr. Wong served as a Non-Executive Director of Linmark Group Limited. Mr. Wong was previously an investment banker with over 15 years of experience in investment banking business in Greater China and was a member of the Listing Committee of the Hong Kong Stock Exchange. Mr. Wong is a chartered accountant and holds a bachelor's degree (with Honors) in management science from the Victoria University of Manchester in the United Kingdom.

**Mr. Chung Shui Ming Timpson** was appointed in October 2008 as an Independent Non-Executive Director of the Company. Mr. Chung is a member of the National Committee of the 12<sup>th</sup> Chinese People's Political Consultative Conference. He is also the Chairman of the Advisory Committee on Arts Development. Besides, Mr. Chung is an Independent Non-Executive Director of Glorious Sun Enterprises Limited, The Miramar Hotel & Investment Co. Limited, China Overseas Grand Oceans Group Limited, China Everbright Limited, Henderson Land Development Company Limited, China Construction Bank Corporation, Jinmao Investments and Jinmao (China) Investments Holdings Limited (all listed on the Hong Kong Stock Exchange). Mr. Chung is also an Independent Director of China State Construction Eng. Corp. Ltd. (listed on the Shanghai Stock Exchange). From October 2004 to October 2008, Mr. Chung served as an Independent Non-Executive Director of China Netcom. Formerly, he was the Chairman of China Business of Jardine Fleming Holdings Limited and the Deputy Chief Executive Officer of BOC International Limited. He was also the Director-General of Democratic Alliance for the Betterment and Progress of Hong Kong, the Chairman of the Council of the City University of Hong Kong, the Chairman of the Hong Kong Housing Society, a member of the Executive Council of the Hong Kong Special Administrative Region, the Vice Chairman of the Land Fund Advisory Committee of Hong Kong Special Administrative Region Government, a member of the Managing Board of the Kowloon-Canton Railway Corporation, a member of the Hong Kong Housing Authority, a member of the Disaster Relief Fund Advisory Committee, an Independent Non-Executive Director of Nine Dragons Paper (Holdings) Limited, an Independent Director of China Everbright Bank Company Limited and an Outside Director of China Mobile Communications Corporation. Mr. Chung holds a bachelor of science degree from the University of Hong Kong and a master's degree in business administration from the Chinese University of Hong Kong. Mr. Chung also received an honorary doctoral degree in Social Science from the City University of Hong Kong in 2010. Mr. Chung is a fellow member of the Hong Kong Institute of Certified Public Accountants.

**Mrs. Law Fan Chiu Fun Fanny** was appointed in November 2012 as an Independent Non-Executive Director of the Company. Mrs. Law is currently Chairman of the Board of Directors of Hong Kong Science and Technology Parks Corporation, a Deputy of the Hong Kong Special Administrative Region, or HKSAR, to the National People's Congress of the People's Republic of China, a Member of the Executive Council of the Government of HKSAR, the Special Adviser to the China-US Exchange Foundation, a Director of the Fan Family Trust Fund and the Honorary Principal of Ningbo Huizhen Academy. Besides, Mrs. Law is an Independent Non-Executive Director of CLP Holdings Limited and DTXS Silk Road Investment Holdings Company Limited (formerly known as UDL Holdings Limited) (both listed on the Hong Kong Stock Exchange) and an Independent Non-Executive Director of Nameson Holdings Ltd. Prior to her retirement from the civil service in 2007, Mrs. Law was the Commissioner of the Hong Kong Independent Commission Against Corruption. During her 30 years as an Administrative Officer, Mrs. Law has worked in many fields, including medical and health, economic services, housing, land and planning, home affairs, social welfare, civil service, transport and education. Mrs. Law graduated from the University of Hong Kong with an Honours degree in Science, and in 2009 was named an outstanding alumnus of the Science Faculty of the University of Hong Kong. She received a Master degree in Public Administration from Harvard University and was named a Littauer Fellow of Harvard University. She also holds a Master degree in Education from the Chinese University of

Hong Kong and is a Fellow of The Hong Kong Institute of Directors.

**Table of Contents**

**Mr. Jiang Zhengxin** was appointed as Senior Vice President of the Company in February 2009. Mr. Jiang is a senior engineer of professor level. He received a bachelor's degree in radio engineering from Beijing University of Posts and Telecommunications in 1982, a master's degree in business administration from Jilin University in 2001, and a PhD in political economy from Jilin University in 2006. Mr. Jiang served as Deputy Director of the Bureau of Telecommunications Administration in Changchun of Jilin Province from February 1998 to July 1999. He was the Deputy General Manager of Jilin Mobile Communication Company from July 1999 to March 2004. He served as the Deputy General Manager of South Communication Co. Limited of Netcom Group from March 2004 to June 2004, and he was the General Manager of Zhejiang Branch of Netcom Group from June 2004 to September 2007. He has served as Deputy General Manager of Netcom Group since September 2007. Mr. Jiang is a Vice President of Unicom Group, as well as Director and Senior Vice President of CUCL. Mr. Jiang has worked in the telecommunications industry for a long period of time and has extensive management experience.

**Mr. Shao Guanglu** was appointed as Senior Vice President of the Company in April 2011. Mr. Shao is a senior engineer. He received a bachelor's degree from Harbin Institute of Technology in 1985, a master's degree in engineering and a master's degree in economics from Harbin Institute of Technology in 1988 and 1990, respectively, a master's degree in management from BI Norwegian Business School in 2002 and a doctor's degree in management from Nankai University in 2009. Mr. Shao joined China United Telecommunications Corporation in February 1995. In December 2008, China United Telecommunications Corporation changed its company name to China United Network Communications Group Company Limited (Unicom Group). Mr. Shao was Deputy General Manager of Tianjin Branch, Deputy General Manager of Henan Branch, General Manager of Guangxi Branch, as well as General Manager of Human Resource Department of Unicom Group. Mr. Shao also serves as a Vice President of Unicom Group, and a Director and Senior Vice President of CUCL. Mr. Shao has worked in the telecommunications industry for a long period of time and has extensive management experience.

**Mr. Xiong Yu** was appointed as Senior Vice President of the Company in October 2014. Mr. Xiong is a senior engineer. He received a bachelor's degree in radio technology from Southeast University in 1991 and a master's degree in business administration from Central South University in 2009. Mr. Xiong joined China United Telecommunications Corporation in January 2003. In December 2008, China United Telecommunications Corporation changed its company name to China United Network Communications Group Company Limited (Unicom Group). Mr. Xiong was General Manager of Chenzhou Branch, General Manager of Changsha Branch, General Manager of Nanjing Branch, General Manager of Hubei Branch, as well as General Manager of Marketing and Sales Department of Unicom Group. Mr. Xiong also serves as a Vice President of Unicom Group. Mr. Xiong has worked in the telecommunications industry for a long period of time and has extensive management experience.

**B. Compensation**

The aggregate compensation and other benefits paid by us to our directors as a group in 2015 was approximately RMB4.488 million, which included the retirement benefits in the amount of approximately RMB391,000. Each of our executive directors participated in a bonus scheme with us that ties the amount of bonus he or she will receive at the end of a year to our operating results of the year and his or her job performance. As of the date of this annual report, none of our directors hold any outstanding options to purchase shares in our company. See "E. Share Ownership" below for detailed descriptions of our share option scheme.

Name	Compensation for 2015 (RMB in thousands)
------	---

<b>Directors</b>	
Wang Xiaochu <sup>(1)</sup>	232
Chang Xiaobing <sup>(2)</sup>	456
Lu Yimin	676
Li Fushen	610
Zhang Junan	610
Cesareo Alierta Izuel	241
Cheung Wing Lam Linus	330
Wong Wai Ming	338

**Table of Contents**

<b>Name</b>	<b>Compensation for 2015</b>
John Lawson Thornton <sup>(3)</sup>	56
Chung Shui Ming Timpson	330
Cai Hongbin	311
Law Fan Chiu Fun Fanny	298
<b>Total</b>	<b>4,488</b>

- (1) Mr. Wang Xiaochu was appointed as executive director on September 1, 2015.
- (2) Mr. Chang Xiaobing resigned as executive director on August 24, 2015 as Mr. Chang was appointed the chairman of China Telecommunications Corporation. In December 2015, the Central Commission for Discipline Inspection of the Communist Party of China and the Ministry of Supervision of the PRC initiated an investigation on Mr. Chang for alleged unlawful conduct and violations of the disciplinary rules of the Communist Party of the PRC. As of April 14, 2016, the relevant investigating authorities had not notified us of the incidents underlying the investigation.
- (3) Mr. John Lawson Thornton resigned as executive director on March 4, 2015.
- (4) Mr. Cai Hong resigned as executive director on November 25, 2015.

**C. Board Practices**  
**General**

Pursuant to our articles of association, at each annual general meeting, one-third of our directors retire from office by rotation. The retiring directors are eligible for re-election. The Board may at any time appoint a new director to fill a vacancy or as an additional director. The Board may also appoint and remove our executive officers. No benefits are payable to our directors or executive officers upon termination of their service with us in accordance with the provisions of their service agreements, except certain statutory compensation. The following table sets forth certain information concerning our current directors and former directors who resigned in 2015.

**Table of Contents**

<b>Name</b>	<b>Appointment Date</b>	<b>Re-appointment Date</b>	<b>Resignation or Retirement Date</b>
<b>Current Directors</b>			
Wang Xiaochu	September 1, 2015		
Lu Yimin	October 15, 2008	May 26, 2009, May 24, 2011 and April 16, 2014	
Li Fushen	March 30, 2011	May 24, 2011 and May 21, 2013	
Zhang Junan	August 8, 2014	May 8, 2015	
Cesareo Alierta Izuel	October 15, 2008	May 26, 2009, May 24, 2011, May 21, 2013 and May 8, 2015	
Cheung Wing Lam Linus	May 12, 2004	May 12, 2006, May 16, 2008, May 12, 2010, May 29, 2012 and April 16, 2014	
Wong Wai Ming	January 19, 2006	May 12, 2006, May 26, 2009, May 24, 2011 and April 16, 2014	
Chung Shui Ming Timpson	October 15, 2008	May 26, 2009, May 29, 2012 and May 8, 2015	
Law Fan Chiu Fun Fanny	November 21, 2012	May 21, 2013	
<b>Former Directors</b>			
Chang Xiaobing <sup>(1)</sup>	December 21, 2004	May 12, 2006, May 26, 2009, May 29, 2012 and May 8, 2015	August 24, 2015
John Lawson Thornton	October 15, 2008	May 26, 2009, May 29, 2012 and April 16, 2014	March 4, 2015
Cai Hongbin	May 13, 2010	May 24, 2011 and May 21, 2013	November 25, 2015

(1) Mr. Chang Xiaobing resigned as executive director on August 24, 2015 as Mr. Chang was appointed the chairman of China Telecommunications Corporation.

**Audit Committee**

The audit committee reviews and supervises our financial reporting process, risk management and internal controls. The duties of the audit committee include, among others:

as the key representative body for overseeing our relationship with the independent auditor, considering and approving the appointment, resignation and removal of our independent auditor and the auditor's fees;

reviewing our quarterly, interim and annual financial statements before submission to the board of directors;

-74-



## **Table of Contents**

coordinating and discussing with the independent auditor with respect to any issues identified and recommendations made during the audits;

reviewing any correspondence from the independent auditor to our management and the responses of our management;

reviewing the relevant reports concerning our risk management, internal controls and procedures;

discussing our risk management and internal control system with our management to ensure that our management performs its duties to have effective systems in place;

pre-approving the audit and non-audit services to be provided by the external auditor, and determining whether any non-audit services would affect the independence of the auditor;

discussing with our management the schedule and procedures for the rotation of the partner of the auditing firm who will principally be responsible for the audit of our company and the partners who will actively participate in the audit of our company;

supervising the internal audit department, which will directly report to the committee; and

having the right to approve the appointment or removal of the head of internal audit department.

As of April 14, 2016, the members of the audit committee were Mr. Wong Wai Ming (Chairman of the audit committee), Mr. Cheung Wing Lam Linus, Mr. Chung Shui Ming Timpson and Mrs. Law Fan Chiu Fun Fanny, all being independent non-executive directors of our company.

## **Remuneration Committee**

The remuneration committee meets regularly to consider human resources issues, issuance of options and other matters relating to compensation. The primary duties of the remuneration committee include considering and approving the remuneration policies and structure for directors and senior management's remuneration, considering and making recommendations to the Board regarding the remuneration packages of the directors and senior management, and considering and approving our Company's share option schemes. The remuneration committee also conducts performance review of the Chief Executive Officer and determines the Chief Executive Officer's year-end bonus pursuant to the performance target contract entered into between the Board and the Chief Executive Officer. The Chief Executive Officer is responsible for the performance review and determination of performance-based year-end bonuses for the other members of our management, which is subject to the review of the remuneration committee. In addition, the remuneration committee consults the Chairman of the Board on the remuneration proposals for other executive directors. As of April 14, 2016, the members of the remuneration committee were Mr. Cheung Wing Lam Linus (Chairman of the remuneration committee), Mr. Wong Wai Ming and Mr. Chung Shui Ming Timpson, all being independent non-executive directors of our company.

## **Nomination Committee**

The nomination committee meets regularly to consider the nomination of our directors and senior management personnel. The primary duties of the nomination committee are to (i) review the structure, size and composition (including skills, knowledge and experience) of the Board at least annually and make recommendations on any proposed changes to the Board to complement our corporate strategy; (ii) identify individuals suitably qualified to become Board members and select or make recommendations to the Board; (iii) formulate and review the policy of diversity of Board members as appropriate; (iv) give due regards to the benefits of diversity on the Board against the criteria set out in the policy of diversity of Board members when performing its duties; (v) assess the independence of independent non-executive directors; (vi) make recommendations to the Board on the appointment or re-appointment of directors and succession planning for directors; and (vii) provide opinion to the Board on candidates nominated by our Chief Executive Officer to become our senior management personnel and on changes to our senior management personnel. As of April 14, 2016, the members of the nomination committee were Mr. Chung Shui Ming Timpson (Chairman of the nomination committee), Mr. Wang Xiaochu, and Mrs. Law Fan Chiu Fun Fanny. Except for Mr. Wang Xiaochu, who is our Chairman and Chief Executive Officer, the other members of the nomination committee are independent non-executive directors of our company.

**Table of Contents****D. Employees**

As of December 31, 2013, 2014 and 2015, we had a total number of 283,596, 281,403 and 268,887 employees, respectively. The employees as of December 31, 2015 are classified by function as follows:

By Function	Number of Employees
Employees	231,299
Management and administration	21,956
Sales and customer service	79,075
Product and Marketing	19,467
Network construction and maintenance	76,140
Support	25,715
Others	8,946
Temporary employees	37,588
<b>Total</b>	<b>268,887</b>

**E. Share Ownership**

As of April 14, 2016, our directors who own shares in our company are listed as follows:

Name	Capacity and Nature	Ordinary Shares Held	Percentage of Total Issued Shares
Cheung Wing Lam Linus	Beneficial Owner ( <i>Personal</i> )	200,000	0.0008%
Chung Shui Ming Timpson	Beneficial Owner ( <i>Personal</i> )	6,000	0.0000%

Apart from those disclosed herein, as of April 14, 2016, our other directors as a group do not own any shares in our company and none of our directors hold any outstanding options for our shares.

**Stock Incentive Scheme**

We adopted a share option scheme on April 16, 2014. The scheme provides for the grant of options to our employees, including executive directors and non-executive directors. Any grant of options to a connected person (as defined in the HKSE Listing Rules) of Unicom requires approval by our independent non-executive directors, excluding any independent non-executive director who is the grantee of the option. The option period commences on any date after the date on which an option is offered, but may not exceed 10 years from the offer date, after which period no further option may be granted under the share option scheme, but the provisions of the share option scheme will remain in full force and effect to the extent necessary to give effect to the exercise of the options granted prior to the expiry or otherwise as may be required in accordance with the provisions of the share option scheme. The subscription price of a share in respect of any particular option granted under this share option scheme will be determined by our board of directors in its discretion at the grant date, which shall be no less than the higher of: (i) the closing price of the shares on the HKSE on the grant date of such option; and (ii) the average closing price of the shares on the HKSE for the five trading days immediately preceding the grant date. As of April 14, 2016, no options had been granted or agreed to be granted by us under the share option scheme.



---

**Table of Contents**

**Item 7. Major Shareholders and Related Party Transactions**

***A. Major Shareholders***

As of April 14, 2016, our controlling shareholder, Unicom Group, through its 17.90% direct interest in Unicom BVI, 62.74% direct interest in the A Share Company (which in turn holds 82.10% of Unicom BVI) and 100% direct interest in Unicom Group BVI, indirectly and beneficially owned approximately 17.8 billion shares of Unicom, or 74.36% of our total outstanding shares. See *A. History and Development of the Company* under Item 4. Unicom Group's shares are held by the SASAC and a group of companies, most of which are state-owned enterprises in China. Shares beneficially owned by Unicom Group do not carry voting rights different from our other issued shares.

As of April 14, 2016, most of our shareholders of record were located outside of the United States. In addition, as of April 14, 2016, there were approximately 33,648,662 ADSs outstanding, each representing 10 shares and together representing 1.41% of our total outstanding shares or 5.48% of our total outstanding shares not beneficially owned by our controlling shareholder.

***B. Related Party Transactions***

**Establishment of a Finance Company**

On December 6, 2013, CUCL and Unicom Group entered into a capital contribution agreement regarding the establishment of a joint venture company, or the JV Company, for the purposes of providing various financial services to our company and subsidiaries.

Pursuant to the capital contribution agreement and the Measures for Administration of Finance Companies of Enterprise Groups issued by China Banking Regulatory Commission, or the CBRC, the JV Company may carry out all or part of the following businesses: to provide financial advice, credit verification and related consultancy services and agency services, to handle payment and collection of transaction money, to conduct approved insurance agency business, to grant guarantees, to handle entrusted loans and entrusted investments, to carry out bill acceptance and discounting businesses, to handle fund transfers and settlement and advise on the relevant settlement options and structures, to accept internal money deposits, to arrange for loans and finance leases, to conduct inter-bank lending and borrowing, and to carry out any other businesses approved by the CBRC. The final scope of business of the JV Company will be subject to the approval by the CBRC and the registration with the relevant departments of SAIC in the PRC.

Pursuant to the capital contribution agreement, the registered capital of the JV Company will be RMB3,000 million, and CUCL and Unicom Group agreed to invest RMB2,730 million and RMB270 million in the JV Company, which represent 91% and 9% of the total registered capital of the JV Company, respectively. The capital contribution agreement became effective upon approval from the CBRC on August 18, 2015.

**Continuing Related Party Transactions under the 2010 Comprehensive Services Agreement and the 2013 Comprehensive Services Agreement**

Under the two-step approach described under *A. History and Development of the Company* *Two-Step Voting Arrangements* under Item 4, the continuing transactions between CUCL and Unicom Group under the comprehensive services agreement entered into in 2006 were amended, or the amended comprehensive services agreement, effective upon the completion of our merger with China Netcom, with CNC China added as party to such transactions. In

January 2009, CNC China merged into CUCL. Pursuant to the amended comprehensive services agreement, Unicom Group agreed to provide certain services to CUCL and CNC China, being the supply of telephone cards, the provision of equipment procurement services, interconnection arrangements, the mutual provision of premises, the provision of international telecommunications network gateway, the provision of operator-based value-added services, the provision of value-added telecommunications services, the provision of 10010/10011 customer services, the provision of agency services and the provision of engineering design and technical services, until December 31, 2010.

-77-

## **Table of Contents**

On October 29, 2010, CUCL and Unicom Group entered into the 2010 comprehensive services agreement to renew certain continuing related party transactions for a term of three years commencing on January 1, 2011 and expiring on December 31, 2013. Unless CUCL notifies Unicom Group at least 60 days prior to the expiration of such agreement of their intention not to renew the 2010 comprehensive services agreement, such agreement shall automatically be renewed for a further period of three years.

On October 24, 2013, CUCL and Unicom Group entered into a new comprehensive services agreement, or the 2013 comprehensive services agreement, to renew the relevant continuing related party transactions under the 2010 comprehensive services agreement for a term of three years commencing on January 1, 2014 and expiring on December 31, 2016.

On August 21, 2015, CUCL and Unicom Group entered into an amendment agreement of the 2013 comprehensive services agreement to change the transaction caps for the comprehensive support services in 2015 and 2016 from RMB1 billion each to RMB2 billion and RMB3.5 billion, respectively. Other provisions of the original agreement remain the same.

Details of the continuing related party transactions under the 2010 comprehensive services agreement and the 2013 comprehensive services agreement are summarized below.

### ***Telecommunications Resources Leasing***

Unicom Group agrees to lease to CUCL certain international telecommunications resources and certain other telecommunications facilities required by CUCL for its operations.

The rental charges for the leasing of international telecommunications resources and other telecommunications facilities are based on the annual depreciation charges of such resources and telecommunications facilities, provided that such charges would not be higher than market rates. CUCL will be responsible for the on-going maintenance of the leased international telecommunications resources. CUCL and Unicom Group will determine and agree which party is to provide maintenance service to the leased telecommunications facilities. Unless otherwise agreed by CUCL and Unicom Group, such maintenance service charges would be borne by CUCL. If Unicom Group is responsible for maintaining any leased telecommunications facilities, CUCL will pay to Unicom Group the relevant maintenance service charges which will be determined with reference to market rates, or where there are no market rates, be agreed between the parties and determined on a cost-plus basis. The net rental charges and service charges due to Unicom Group for the provision of the leased telecommunications resources leasing will be settled between CUCL and Unicom Group on a quarterly basis. In 2015, the total charges paid by CUCL to Unicom Group amounted to approximately RMB283 million.

### ***Property Leasing***

CUCL and Unicom Group agree to lease to each other properties and ancillary facilities belonging to CUCL or Unicom Group (including their respective branch companies and subsidiaries).

The rental charges payable by CUCL or Unicom Group are based on market rates or the depreciation charges and taxes in respect of each property, provided that such rental charges will not be higher than the market rates. The rental charges are payable quarterly in arrears and are subject to review every year to take into account the then prevailing market rates of the properties leased in that year. In 2015, the rental charges paid by CUCL to Unicom Group amounted to approximately RMB929 million and the rental charges paid by Unicom Group to CUCL was negligible.

***Provision of Value-added Telecommunications Services***

Unicom Group (or its subsidiaries) agrees to provide the customers of CUCL with various types of value-added telecommunications services.

-78-



## **Table of Contents**

CUCL will settle the revenue generated from the value-added telecommunications services with the branches of Unicom Group (or its subsidiaries) on the condition that such settlement will be based on the average revenue for independent value-added telecommunications content providers who provide value-added telecommunications content to CUCL in the same region. The revenue will be settled on a monthly basis. In 2015, the total revenue allocated to Unicom Group in relation to value-added services amounted to approximately RMB62 million.

### ***Provision of Materials Procurement Services***

Unicom Group agrees to provide comprehensive procurement services for imported and domestic telecommunications materials and other domestic non-telecommunications materials to CUCL. Unicom Group also agrees to provide services on management of tenders, verification of technical specifications, installation, consulting and agency services.

In addition, Unicom Group will sell cable, modem and other materials operated by itself to CUCL and will also provide storage and logistics services in relation to the above materials procurement.

Charges for the provision of materials procurement services are calculated at the rate of:

- (a) up to 3% of the contract value of those procurement contracts in the case of domestic equipment procurement; and
- (b) up to 1% of the contract value of those procurement contracts in the case of imported equipment procurement.

The charges for the provision of materials operated by Unicom Group are determined by reference to the following pricing principles:

- (A) the government fixed price, if any;
- (B) where there is no government fixed price but a government guidance price exists, the government guidance price;
- (C) where there is neither a government fixed price nor a government guidance price, the market price; or
- (D) where none of the above is applicable, the price to be agreed between the parties and determined on a cost-plus basis.

The charges for the provision of storage and logistics services are determined by reference to the market price, which is determined by reference to the following:

- (I) the price charged by an independent third party providing the services in the same or nearby location in an ordinary business transaction; or
- (II) the price charged by an independent third party providing the services in mainland China in an ordinary business transaction.

The service charges due to Unicom Group will be settled on a monthly basis. In 2015, the total charges paid by CUCL to Unicom Group amounted to approximately RMB125 million.

***Provision of Engineering Design and Construction Services***

Unicom Group agrees to provide engineering design, construction and supervision services and IT services to CUCL. Engineering design services include planning and design, engineering inspection, telecommunications electronic engineering, telecommunications equipment engineering and corporate telecommunications engineering. Construction services include services relating to telecommunications equipment, telecommunications routing, power supplies, telecommunications conduit, and technical support systems. IT services include services relating to office automation, software testing, network upgrading, research and development, and development of support systems.

---

**Table of Contents**

The charges for the provision of engineering design and construction services are determined by reference to the market price, which is determined by reference to the following:

- (a) the price charged by an independent third party providing the services in the same or nearby location in an ordinary business transaction; or
- (b) the price charged by an independent third party providing the services in mainland China in an ordinary business transaction.

The service charges will be settled between CUCL and Unicom Group as and when the relevant services are provided. In 2015, the total charges paid by CUCL to Unicom Group amounted to approximately RMB5,018 million.

***Provision of Ancillary Telecommunications Services***

Unicom Group agrees to provide ancillary telecommunications services to CUCL. These services include certain telecommunications pre-sale, on-sale and after-sale services such as assembling and repairing of certain telecommunications equipment, sales agency services, printing and invoice delivery services, maintenance of telephone booths, customers acquisitions and servicing and other customers services.

The charges payable for the provision of ancillary telecommunications services are determined by reference to the following pricing principles:

- (a) the government fixed price, if any;
- (b) where there is no government fixed price but a government guidance price exists, the government guidance price;
- (c) where there is neither a government fixed price nor a government guidance price, the market price; or
- (d) where none of the above is applicable, the price to be agreed between the parties and determined on a cost-plus basis.

The service charges will be settled between CUCL and Unicom Group as and when the relevant services are provided. In 2015, the total charges paid by CUCL to Unicom Group amounted to approximately RMB2,504 million.

***Provision of Comprehensive Support Services***

Unicom Group and CUCL agree to provide comprehensive support services to each other, including dining services, facilities leasing services (excluding those facilities which are provided under the paragraph headed "Provision of Telecommunications Resources Leasing" above), vehicle services, health and medical services, labor services, security services, hotel and conference services, gardening services, decoration and renovation services, sales services, construction agency, equipment maintenance services, market development, technical support services, research and

development services, sanitary services, parking services, staff trainings, storage services, advertising services, marketing, property management services, information and communications technology services (including construction and installation services, system integration services, software development, product sales and agent services, operation and maintenance services, and consultation services).

The service charges are determined by reference to the following pricing principles:

- (a) the government fixed price, if any;

-80-

## **Table of Contents**

- (b) where there is no government fixed price but a government guidance price exists, the government guidance price;
- (c) where there is neither a government fixed price nor a government guidance price, the market price; or
- (d) where none of the above is applicable, the price to be agreed between the parties and determined on a cost-plus basis.

The service charges will be settled between CUCL and Unicom Group as and when the relevant services are provided. In 2015, the total services charges paid by CUCL to Unicom Group amounted to approximately RMB1,455 million and the total services charges paid by Unicom Group to CUCL was RMB12 million.

### ***Provision of Shared Services***

Unicom Group and CUCL agree to provide shared services to each other, including, but not limited to, the following:

- (a) CUCL will provide headquarter human resources services to Unicom Group;
- (b) Unicom Group and CUCL will provide central business support services to each other;
- (c) CUCL will provide trust services related to the services referred to in paragraphs (a) and (b) above to Unicom Group; and
- (d) Unicom Group will provide premises to CUCL and other shared services requested by its headquarters.

In relation to the central business support services, CUCL will provide support services, such as billing and settlement services provided by the business support center and operational statistics reports. Unicom Group will provide support services, including telephone card production, development and related services, maintenance and technical support and management services in relation to the telecommunications card operational system.

Unicom Group and CUCL will share the costs related to the shared services proportionately in accordance with their respective total assets value, except that the total assets value of the overseas subsidiaries and the listed company of Unicom Group will be excluded from the total asset value of Unicom Group, and the shared costs proportion will be agreed between Unicom Group and CUCL in accordance with the total assets value set out in the financial statements provided to each other, as adjusted in accordance with their respective total assets value on an annual basis. In 2015, the total services charges paid by CUCL to Unicom Group amounted to approximately RMB107 million and the total services charges paid by Unicom Group to CUCL was negligible.

### **Transfer of Telecommunications Tower and Related Assets to the Tower Company**

In October 2015, we, through our wholly own subsidiaries, CUCL and Unicom New Horizon entered into a transfer agreement with (i) China Mobile Communication Company Limited, a wholly owned subsidiary of China Mobile, (ii) China Telecom, (iii) China Reform Holding Company Limited, a wholly state-owned company, and (iv) the Tower

Company, pursuant to which we, China Mobile and China Telecom sold certain telecommunications towers and related assets to the Tower Company, and the Tower Company would issue and allot shares in the Tower Company and/or pay certain cash as consideration for such transfers. In January 2016, CUCL and the Tower Company entered into a share subscription agreement to settle the number of share subscribed by CUCL and the amount of consideration. As of April 14, 2016, we, through CUCL, owned approximately 28.1% equity interest in the Tower Company, while China Mobile, China Telecom and China Reform Holding Company Limited owned approximately 38.0%, 27.9% and 6.0% equity interest in the Tower Company, respectively.

## **Table of Contents**

### **Arrangement Relating to Telecommunications Towers, Related Assets and Other Services**

As of April 14, 2016, we, through CUCL, owned approximately 28.1% equity interest in the Tower Company, and therefore the Tower Company is treated as an related party to us. We are in the process of negotiating the final arrangements with the Tower Company with respect to our use of telecommunications towers and related assets of the Tower Company. Based on the preliminary negotiation results, we estimated that the usage fees to the Tower Company with respect to certain telecommunications towers and related assets in 2015 to be RMB2,926 million. In 2015, we also provided certain engineering design and construction services to Tower Company and the total service fees were RMB50 million.

### **Certain Agreements Relating to Our Initial Public Offering**

#### ***The Reorganization Agreement***

In relation to the restructuring in connection with our initial public offering, our wholly owned subsidiary, CUCL, entered into a reorganization agreement with Unicom Group, dated April 21, 2000. This agreement includes the following terms:

Unicom Group's agreement to transfer to CUCL certain assets and liabilities;

mutual warranties and indemnities given by Unicom Group and CUCL in relation to the assets and liabilities transferred to CUCL and in relation to the restructuring;

undertakings by Unicom Group in favor of CUCL, including, among other things:

to hold and maintain all licenses received from the former Ministry of Information Industry in connection with any of our businesses for our benefit, and to allocate spectrum and to provide other resources to us;

subject to applicable Chinese laws and regulations in effect at the relevant time, to take all actions necessary to obtain, maintain, renew and otherwise extend to or for our benefit such governmental or regulatory licenses, consents, permits or other approvals as we shall require to continue to operate our businesses;

to arrange for us to participate in its international roaming arrangements;

not to engage in any business that competes with our businesses, except for the existing competing businesses of Unicom Group;

to grant us a right of first refusal in relation to any governmental authorization, license or permit, or other business opportunity to develop any new telecommunications technology, product or service;

to ensure that we can continue to use the premises for which title documentation cannot be obtained at this time, for a period of three years following the restructuring;

not to dispose of any of our shares it beneficially owns or to take or permit any other actions, including primary issuances of securities by us or CUCL, which would result in us or CUCL no longer constituting majority-owned subsidiaries of Unicom Group; and

not to seek an overseas listing for any of its businesses or the businesses of its subsidiaries in which we are engaged or may engage in the future except through us;

an option granted by Unicom Group to us to acquire Unicom Group's interest in any telecommunications interest, such as Unicom Paging, Unicom Xingye and Unicom Group's CDMA telephony license and business; and



## **Table of Contents**

a commitment by Unicom Group that it will provide continuous financial support to us when necessary.

The 2010 comprehensive services agreement provides that the determination of whether we or CUCL would constitute majority-owned subsidiaries of the Unicom Group shall be made in accordance with the PRC Enterprise Accounting Standards, as amended by the MOF from time to time.

## ***Trademark Agreement***

Unicom Group is the registered owner of the Unicom trademark in English, the trademark bearing the Unicom logo and the trademark of the word Unicom in Chinese which are registered at the PRC State Trademark Bureau. Under a PRC trademark license agreement entered into on May 25, 2000 between Unicom Group and CUCL, CUCL and our affiliates were granted the right to use these trademarks on a royalty-free basis for an initial period of five years, renewable at the option of CUCL. CUCL has elected to renew the trademark license agreement and the trademark license agreement is currently valid. Under the terms of this agreement, we and our affiliates are the exclusive licensees of these trademarks, provided that Unicom Group may also license these trademarks to any of its existing or future subsidiaries. Unicom Group also agreed to license to CUCL any trademark that it registers in China in the future that incorporates the word Unicom .

## **C. Interests of Experts and Counsel**

Not Applicable.

## **Item 8. Financial Information**

See Item 18 Financial Statements . Other than as disclosed elsewhere in this annual report, no significant change has occurred since the date of the annual financial statements.

## **Legal Proceedings**

We are not involved in any material litigation, arbitration or administrative proceedings. We are not aware of any pending or threatened litigation, arbitration or administrative proceedings expected to have a material effect on our financial condition and results of operations.

## **Policy on Dividend Distribution**

The objective of our dividend policy is to achieve a long-term, sustainable and steadily increasing dividend, with a view to maximizing our shareholders' value. The declaration and payment of future dividends will depend upon, among other things, financial condition, business prospects, future earnings, cash flow, liquidity level and cost of capital. We believe such policy will provide our shareholders with a stable return in the long term along with the growth of our company. We may only pay dividends out of our distributable profits.

Based on the Company's financial position in 2015 and taking into account the development needs of the mobile and fixed-line broadband services, our board of directors recommended the payment of a final dividend of RMB0.17 per share for the year ended December 31, 2015, compared to RMB0.20 per share for the fiscal year ended December 31, 2014.

**Item 9. The Offer and Listing**  
**Market Price Information**

Our ADSs, each representing 10 ordinary shares, are listed and traded on the NYSE. Our ordinary shares are listed and traded on the HKSE. The NYSE and the HKSE are the principal trading markets for our ADSs and ordinary shares, which are not listed on any other exchanges in or outside the United States.

-83-

**Table of Contents**

The high and low closing prices of our ordinary shares on the HKSE and of our ADSs on the NYSE since listing are as follows:

	Price per Ordinary Share (HK\$)		Price per ADS (US\$)	
	High	Low	High	Low
<b>Annual:</b>				
2011	17.40	11.04	22.39	14.11
2012	16.78	9.50	21.58	12.26
2013	13.34	9.51	17.40	12.21
2014	14.14	9.17	18.03	11.73
2015	15.46	9.08	19.80	11.53
<b>Quarterly:</b>				
First Quarter, 2014	11.66	9.17	14.83	11.73
Second Quarter, 2014	12.72	10.00	16.27	12.89
Third Quarter, 2014	14.14	11.60	18.03	15.03
Fourth Quarter, 2014	11.82	10.10	15.36	13.11
First Quarter, 2015	13.22	10.40	17.02	13.49
Second Quarter, 2015	15.46	11.90	19.80	15.40
Third Quarter, 2015	12.20	9.55	15.64	12.40
Fourth Quarter, 2015	10.84	9.08	14.69	11.53
First Quarter, 2016	10.24	8.00	13.16	10.38
<b>Monthly:</b>				
October 2015	10.84	9.49	14.69	12.24
November 2015	10.18	9.40	12.99	12.22
December 2015	9.68	9.08	12.45	11.53
January 2016	9.45	8.00	11.80	10.38
February 2016	9.06	8.06	11.71	10.44
March 2016	10.24	8.85	13.16	11.59
April 2016 (through April 14, 2016)	10.06	9.86	13.06	12.59

**Item 10. Additional Information****A. Share Capital**

Not Applicable.

**B. Articles of Association****General**

Under our Articles of Association, we have the capacity, rights, powers and privileges of a natural person and, in addition to and without limiting the foregoing, we may do anything which is permitted or required to be done by any

enactment or rule of law. The following is a summary of selected provisions of our Articles of Association.

## **Table of Contents**

### **Directors**

#### ***Material Interests and Voting***

A director shall not vote (or be counted in the quorum) on any resolution of our board of directors in respect of any transaction, contract or arrangement or proposal in which he or any of his close associates (and if required by the HKSE Listing Rules, his other associates) (as defined in the HKSE Listing Rules) is materially interested, and if he shall do so, his vote shall not be counted (nor shall he be counted in the quorum for that resolution), but this prohibition does not apply to any transaction, contract, arrangement or other proposal for or concerning:

the giving of any security or indemnity either (i) to the director or any of his close associates (and if required by the HKSE Listing Rules, his other associates) in respect of money lent or obligations incurred or undertaken by him or any of them at the request of or for the benefit of Unicom or any of its subsidiaries or (ii) to a third party in respect of a debt or obligation of Unicom or any of its subsidiaries for which the director or any of his close associates (and if required by the HKSE Listing Rules, his other associates) has assumed responsibility in whole or in part and whether alone or jointly under a guarantee or indemnity or by the giving of security;

an offer of shares or debentures or other securities of or by Unicom (or any other company which Unicom may promote or be interested in) where the director or any of his close associates (and if required by the HKSE Listing Rules, his other associates) is or will be an interested participant in the underwriting or sub-underwriting of the offer;

any transaction, contract or arrangement in which the director or any of his close associates (and if required by the HKSE Listing Rules, his other associates) is interested in the same manner as other holders of shares or debentures or other securities of Unicom by virtue only of his interest in shares or debentures or other securities of Unicom;

any other company in which the director or any of his close associates (and if required by the HKSE Listing Rules, his other associates) is interested only, whether directly or indirectly, as an officer or shareholder or in which the director or any of his close associates (and if required by the HKSE Listing Rules, his other associates) is beneficially interested in shares of that company, provided that he, together with any of his close associates (and if required by the HKSE Listing Rules, his other associates), is not beneficially interested in 5% or more of (i) the issued shares of any class of such company (or of any third company through which such interest is derived), or (ii) the voting rights attached to such issued shares or securities (excluding for the purpose of calculating such 5% interest, any indirect interest of such director or any of his close associates (and if required by the HKSE Listing Rules, his other associates) by virtue of Unicom's interest in such company); or

the benefit of employees of Unicom or any of its subsidiaries, including (i) the adoption, modification or operation of a pension fund or retirement, death or disability benefits scheme which relates to directors, their close associates (and if required by the HKSE Listing Rules, their other associates) and

employees of Unicom or any of its subsidiaries and does not provide in respect of the director or any of his close associates (and if required by the HKSE Listing Rules, his other associates) any privilege or advantage not generally accorded to the class of persons to which such scheme or fund relates; or (ii) the adoption, modification or operation of any employee share scheme involving the issue or grant of options over shares or other securities by Unicom to, or for the benefit of, the employees of Unicom or its subsidiaries under which the director or any of his close associates (and if required by the HKSE Listing Rules, his other associates) may benefit.

***Remuneration and Pensions***

The directors of Unicom are entitled to receive by way of remuneration for their services such sum as is from time to time determined by Unicom in a general meeting. The directors are also entitled to have reimbursed all traveling, hotel and other expenses reasonably incurred by them in or about the performance of their duties as directors. The board of directors may grant special remuneration to any director who performs services that, in the opinion of the board, are outside the scope of the ordinary duties of a director.

## **Table of Contents**

The board may establish and maintain or procure the establishment and maintenance of any contributory or non-contributory pension or superannuation funds for the benefit of, or give donations, gratuities, pensions, allowances or emoluments to, any persons (i) who are or were at any time in the employment or service of Unicom, or of any company which is a subsidiary of Unicom, or is allied or associated with Unicom or with any such subsidiary company, or (ii) who are or were at any time directors or officers of Unicom or of any such other company above, and have or who have had any salaried employment or had held office in Unicom or such other company, and the wives, widows, families and dependents of any such persons. The board may also establish and subsidize or subscribe to any institutions, associations, clubs or funds calculated to be for the benefit of or to advance the interests and well being of Unicom or of any such other company above or of any such persons above, and may make payments for or towards the insurance of any such persons, and subscribe or guarantee money for charitable or benevolent objects or for any exhibition or for any public, general or useful object. Any director holding any such employment or office is entitled to participate in, and retain for his own benefit, any such donation, gratuity, pension, allowance or emolument.

### ***Borrowing Powers***

The directors may exercise all the powers of Unicom to borrow money and to mortgage or charge all or any part of the undertaking, property and assets (present and future) and uncalled capital of Unicom and to issue debentures, debenture stocks, bonds and other securities, whether outright or as collateral security for any debt, liability or obligation of Unicom or of any third party.

### ***Qualification of Directors***

A director of Unicom is not required to hold any qualification shares.

### ***Rotation of Directors***

At every annual general meeting, one-third of the directors for the time being, or, if the number is not three or a multiple of three, then the number nearest one-third, shall retire from office by rotation, except for any director holding office as chairman or chief executive officer. The directors to retire in every year shall be those who have been in office the longest since their last election. In addition, a director appointed by the board to fill in a casual vacancy or as an addition to the board shall retire at the next following annual general meeting and shall then be eligible for re-election, but shall not be taken into account in determining the number of directors who are to retire by rotation at each annual general meeting. The retiring directors shall be eligible for re-election.

### ***Rights Attached to Ordinary Shares***

#### ***Voting Rights***

Under the Companies Ordinance, any action to be taken by the shareholders at a general meeting requires an affirmative vote by either an ordinary or a special resolution passed at the meeting. An ordinary resolution is one passed by the majority of such shareholders as are entitled to, and do, vote in person or by proxy at a general meeting. A special resolution is one passed by not less than three-quarters of such shareholders as are entitled to, and do, vote in person or by proxy at a general meeting. Most shareholders' decisions are passed by ordinary resolutions. However, the Companies Ordinance and our Articles of Association stipulate that certain matters may only be passed by special resolutions.

At any general meeting a resolution put to the vote of the meeting shall be decided on a poll is demanded by:

the Chairman of the meeting;

at least five members present in person (or in the case of a member being a corporation, by its duly authorized representative) or by proxy and entitled to vote at the meeting; or

any member or members present in person (or in the case of a member being a corporation, by its duly authorized representative) or by proxy and representing in the aggregate not less than five per cent. of the total voting rights of all members having the right to attend and vote at the meeting;

-86-



## **Table of Contents**

provided that a resolution put to the vote of the meeting may be decided on a show of hands to the extent permitted by the Listing Rules and other applicable laws, rules and regulations.

Subject to any special rights, privileges or restrictions as to voting for the time being attached to any class or classes of shares, every member who (being an individual) is present in person or by proxy or (being a corporation) is present by a representative duly authorized under Section 606 of the Companies Ordinance at any general meeting shall be entitled, on a show of hands, to one vote only and, on a poll, to one vote for every fully paid-up share of which he is the holder.

On a poll, votes may be given either personally or by proxy and a member entitled to more than one vote need not use all his votes or cast all the votes he uses in the same way.

## ***Issue of Shares***

A general meeting resolving upon the creation of any new shares may direct that the same or any of them shall be offered in the first instance to all the holders for the time being of any class of shares in the capital of Unicom, in proportion to the number of shares of such class held by them respectively, or make any other provisions as to the issue and allotment of the new shares, and in default of any such direction, or so far as the same shall not extend, the new shares shall be at the disposal of the Directors, and Article 10 of our Articles of Association shall apply thereto.

## ***Dividends***

Subject to the Companies Ordinance and as set out in our Articles of Association, our shareholders at a general meeting may by ordinary resolution declare dividends but no dividend shall be declared in excess of the amount recommended by our board of directors.

In addition to any dividends declared at a general meeting upon the recommendation of the board of directors, our board of directors may, as they deem appropriate, from time to time resolve to pay to our shareholders such interim dividends as appear to our board of directors to be justified by our financial position. Our board of directors may also pay any fixed dividend that is payable on any of our shares on any other dates, whenever our financial position, in the opinion of our board of directors, justifies such payments.

All dividends unclaimed for one year after having become payable may be invested or otherwise made use of by the board for the benefit of Unicom until claimed. All dividends unclaimed for six years after having become payable may be forfeited by the board and will revert to Unicom.

## ***Winding Up***

If we are wound up, the surplus assets remaining after payment to all creditors shall be divided among the shareholders in proportion to the capital paid up on the shares held by them, subject to the rights of the holders of any shares that may be issued on special terms or conditions.

If we are wound up, the liquidator may, with the sanction of a special resolution, divide among our shareholders in specie or in kind the whole or any part of our assets or vest any part of our assets in trustees upon such trusts for the benefit of our shareholders or any of them as the resolution shall provide.

## ***Miscellaneous***

Shareholders are not entitled to any redemption rights, conversion rights or preemptive rights on the transfer of ordinary shares.

The transfer agent and registrar for the shares is Hong Kong Registrars Limited, 46<sup>th</sup> Floor, Hopewell Centre, 183 Queen's Road East, Hong Kong.

-87-

## **Table of Contents**

### ***Modification of Rights***

Whenever the share capital of Unicom is divided into different classes of shares, the special rights attached to any class may, subject to the Company Ordinance, be varied or abrogated either with the consent in writing of the holders of not less than seventy-five per cent. of the total voting rights of holders of the shares of the class or with the sanction of a special resolution passed at a separate general meeting of the holders of the shares of the class (but not otherwise) and may be so varied or abrogated either whilst Unicom is a going concern or during or in contemplation of a winding up. To every such separate general meeting, all the provisions of our Articles of Association relating to general meetings and to the proceedings thereat shall mutatis mutandis apply, except that the necessary quorum shall be two persons present in person or by proxy together holding at least one-third of the total voting rights of holders of the shares of the class (but so that, if at any adjourned meeting a quorum as above defined is not present, any one holder of shares of the class present in person or proxy shall be a quorum) and that any holder of shares of the class present in person or by proxy may demand a poll and that every such holder shall on a poll have one vote for every share of the class held by him.

### **Annual General and Extraordinary General Meetings**

We must hold in each year a general meeting as our annual general meeting in accordance with Section 610 of the Company Ordinance in addition to any other meetings in that year. The annual general meeting is held at such time and place as may be determined by the board of directors and subject to our Articles of Association. All other general meetings are called extraordinary general meetings. The board of directors may call an extraordinary general meeting at any time or upon request from the members in accordance with the Companies Ordinance.

Under the Companies Ordinance, an annual general meeting can be called by not less than 21 days' notice in writing, and any other general meeting can be called by not less than 14 days' notice in writing. The notice must specify the place, date and time of the meeting, and, in the case of special business, the general nature of that business.

### **Limitations on Rights to Own Securities**

There are no limitations on the rights to own securities, including the rights of non-resident or foreign shareholders to hold or exercise voting rights on the securities, imposed by Hong Kong law or by our Articles of Association.

### **Changes in Capital**

We may exercise any powers conferred or permitted by the Companies Ordinance to buy-back our own shares and warrants (including any redeemable share) at any price or to give, directly or indirectly, by means of a loan, guarantee, the provision of security or otherwise, financial assistance for the purpose of or in connection with a buy-back made or to be made by any person of any shares or warrants in Unicom. Buy-backs of our own shares may be made either by way of a general offer to all shareholders in proportion to their shareholdings, by purchasing our shares on a stock exchange or by an off-market contract with individual shareholders. Any such share buy-back or financial assistance must be made or given in accordance with any relevant rules or regulations issued by the HKSE or the Securities and Futures Commission of Hong Kong.

We may, from time to time, on more than one occasion or at a specified time or in specified circumstances alter our share capital in accordance with the Company Ordinance and as the resolution shall prescribe. Subject to the Companies Ordinance, we may from time to time by ordinary resolution:

consolidate all of our shares into smaller number of shares than the existing number;

divide our shares into several classes and attach to them any preferential, deferred, qualified or special rights, privileges or conditions;

cancel any shares that at the date of the passing of the resolution have not been taken or agreed to be taken by any person, or have been forfeited in accordance with our Articles of Association;

-88-

