

## Chairman's Statement

Dear Shareholders,

Year 2005 was the first year since the Group had acquired (the "CNA/XJA Acquisitions") the airline operations and related assets of China Northern Airlines Company ("CNA") and Xinjiang Airlines Company ("XJA"). As a result of a remarkable increase in fleet capacity, both passenger volume and cargo and mail carried recorded substantial increases. However, the operating conditions remained difficult, especially the price of jet fuel in the global market which had been on the rise. Consequently, the Group's operating costs were significantly increased. In addition, the domestic competition has intensified. The Group's ability to increase passenger and cargo fares came under pressure, which had a direct adverse impact on passenger and cargo yield. The businesses that the Group has acquired from CNA and XJA are still undergoing integration and adjustments. Management expects that the full advantages of operating synergies will be reflected gradually. In addition, the Group has made certain adjustments to its fleet to cope with the high jet fuel price.

During 2005, the economy of the PRC maintained its rapid growth, which in turn gave the civil aviation industry a powerful boost. In particular, the fast expansion of the fleet capacity of the industry encouraged market demand through a number of factors, including improvement of civil aviation facilities and service quality as well as favourable price offers, which in turn drove up the passenger and cargo carried volume, the passenger load factor and overall load factor. On the other hand, as the PRC government expedited the process of 'open sky' policy and relaxed restrictions for investment in domestic airlines, the fleet capacity and number of flights provided have significantly increased, which in turn intensified the competition in domestic and international routes. Together with the soaring jet fuel prices, these have exerted strong pressure on the operating costs for domestic airlines.

In 2005, with the persistent joint efforts of the Company's management and staff, the Group secured an exceptional safe flight operation record, and the enlarged operations after the joint recombination had undergone a smooth transition and gradually began to achieve the benefits from economies of scale. To cope with the increasing competition and the ever-changing demands of the aviation market, the Company is taking advantage of its own economies of scale and the potential market demands to stage a strategic transition from a city-pair operation model to a hubbing network operation model, so as to enhance the operational efficiency of the overall service network, and to maintain and increase its competitive edge in the market.

With the approval of the Board, the Company established a branch company in Beijing and will add wide-body airplanes to the operation base in Beijing from the summer of 2006, with the view to expanding its Beijing aviation business and building another main hub there in addition to its Guangzhou base. The Board believes that the establishment of Guangzhou and Beijing hubs will facilitate the Group's strategic refinement and enhancement of its route network operations in order to better position the Group to explore and seize the opportunities in the regional aviation market to be brought about by the 2008 Beijing Olympic Games.

Year 2006 is the first year of implementation of the PRC government's "Eleventh Five-Year Plan". China's economic and social developments have entered a new and benign stage. Optimising sector structure, improving efficiency and minimising energy consumption will become the main stream of development. With a gradual increase in people's disposable income and changes in their expenditure structure, the speed of urbanisation will accelerate accordingly. The globalisation of world economy has expedited the flow of production elements and the



## Chairman's Statement (Cont'd)

transformation of industries. China's tourism industry is developing rapidly, which provides China's civil aviation industry an excellent opportunity for further development. However, due to instabilities in the Middle East, the global jet fuel price is expected to remain high in the foreseeable future. Intensified market competition will also create price competition for the industry. In view of the challenging operating environment, the Group believes that the only way to maintain its current position in the domestic market and ensure sustainable development is to upgrade its own core competitiveness and reinforce its risk management.

In view of the operating environment and conditions, the Group will focus on the following areas in 2006:

1. On the basis of making a strategic transition, accelerate the adjustment of route network and expansion of domestic airline network, optimise the international route structure, strengthen domestic routes to feed international and regional routes;
2. Strengthen its capabilities in exploring new markets, expand the variety of products, provide innovative services, enhance the brand name effect, improve marketing strategies, promote e-ticketing and direct sales, and gradually set up a direct sales mode which will be mainly based on electronic sales;
3. Punctuality is the fundamental requirement of an aviation company. Efforts will be made to minimise delays caused by operations and more flights will be provided to satisfy irregular flights demands;
4. Efforts will continue to be made to strengthen costs control. The Group will adopt scientific business management models, improve its budgeting management, and endeavour to minimise its operating costs; and
5. Maintain and improve its internal control system, establish an effective accountability system in respect of its internal control system, and enhance its internal supervision of management.

On behalf of the Board, I would like to express our gratitude to our staff and to the shareholders and friends. We also look forward to the continued support of our staff, shareholders and friends, working hand-in-hand with them for a healthy, sustainable growth of the Company.

**Liu Shao Yong**

*Chairman*

Guangzhou, the PRC

19 April 2006