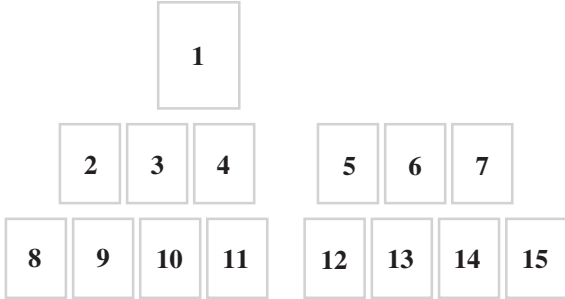


# Report of Directors





- 1 **Ma Tiesheng**
- 2 **Wang Quanhua**
- 3 **Cao Jianxiong**
- 4 **Zhang Xueren**
- 5 **Chow Kwok Wah, James**
- 6 **Wu Jiapei**
- 7 **Lee Kwok Ming, Don**
- 8 **Zhu Yong**
- 9 **Rong Gang**
- 10 **Yang Yatie**
- 11 **Ding Weiping**
- 12 **Song Jinxiang**
- 13 **Li Xiaoguang**
- 14 **Si Yupei**
- 15 **Song Jian**



# Report of Directors

The Board of Directors (the "Board") of the Company is pleased to present its report together with the audited financial statements of the Group for the year ended December 31, 2003.

## GROUP ACTIVITIES

The Group is the dominant provider of information technology solutions for China's air travel and tourism industries. All Chinese commercial airlines outsource their ICS systems to the Group. The core businesses of the Group include ETD, APP, data network, etc..

An analysis of the Group's financial performance is set out under the section "Financial Review".

No analysis of the Group's revenues and contribution to operating profit by geographical areas is presented as revenues and results of the Group during Year 2003 were principally derived from the operations of the Group in the PRC.

## SHARE CAPITAL STRUCTURE

The issued share capital of the Company as at December 31, 2003 amounted to 888,157,500 shares, with a par value of RMB1.00 each. As at December 31, 2003, the share capital structure of the Company was as follows:

Shares	Number of shares as at 31 December 2003	Percentage to the total number of shares in issue as at 31 December 2003 (per cent.)
Domestic Shares	577,303,500	65.00
H Shares	310,854,000	35.00

## SUBSTANTIAL SHAREHOLDERS

As at December 31, 2003, in accordance with the register maintained under Section 336 of the Securities and Futures Ordinance (Chapter 571 of the Laws of Hong Kong) (the "SFO"), the following substantial shareholders held an interest of 5 per cent or more in their respective class of share capital of the Company:

Name of shareholder	Class	Number of shares held	Percentage of respective class of share capital (per cent.)	Percentage of total share capital (per cent.)
J.P. Morgan Chase & Co. (1)	H shares	31,329,600	10.06	3.5
Government of Singapore Investment Corporation Pte Ltd (2)	H shares	15,680,000	5.04	1.8
China TravelSky Holding Company	Domestic	198,496,500	34.4	22.3
China Southern Air Holding Company (3)	Domestic	116,460,500	20.2	13.2
China Eastern Air Holding Company (4)	Domestic	109,414,500	19.0	12.3
China National Aviation Holding Company (5)	Domestic	89,433,500	15.5	10.1

\* Note:

- (1) As at December 31, 2003, according to the Corporate Substantial Shareholder Notice from J.P. Morgan Chase & Co., the Company understands that J.P. Morgan Chase & Co. held approximately 10.06 per cent of the H shares of the Company, representing approximately 3.5 per cent of the Company's total issued share capital.
- (2) As at December 31, 2003, according to the Corporate Substantial Shareholder Notice from Government of Singapore Investment Corporation Pte Ltd, the Company understands that Government of Singapore Investment Corporation Pte Ltd held approximately 5.04 per cent of the H shares of the Company, representing approximately 1.8 per cent of the Company's issued share capital.
- (3) As at December 31, 2003, China Southern Air Holding Company directly held approximately 9.4 per cent of the total issued share capital of the Company and also owned, among other things: (i) 100 per cent interest in China Northern Airlines Co.; and (ii) 100 per cent interest in Xinjiang Airlines Co.. Since China Northern Airlines Co. and Xinjiang Airlines Co. held approximately 2.8 per cent and 1.0 per cent interest respectively in the Company, China Southern Air Holding Company effectively controlled an aggregate interest of approximately 13.2 per cent in the total issued share capital of the Company;

# Report of Directors

- (4) As at December 31, 2003, China Eastern Air Holding Company held approximately 7.7 per cent of the total issued share capital of the Company and also owned, among other things: (i) 100 per cent interest in China Northwest Airlines Co.; and (ii) 100 per cent interest in Yunnan Airlines Co.. Since China Northwest Airlines Co. and Yunnan Airlines Co. held approximately 2.6 per cent and 2.0 per cent interest respectively in the Company, China Eastern Air Holding Company effectively controlled an aggregate interest of approximately 12.3 per cent in the total issued share capital of the Company; and
- (5) As at December 31, 2003, China National Aviation Holding Company owned, among other things: (i) 100 per cent interest in Air China; and (ii) 100 per cent interest in China National Aviation Corporation. Since Air China and China National Aviation Corporation held approximately 9.4 per cent and 0.7 per cent interest respectively in the Company, China National Aviation Holding Company effectively controlled an aggregate interest of approximately 10.1 per cent the total issued share capital of the Company.

Save as disclosed herein, in accordance with the register maintained under Section 336 of the SFO, there were no other shareholders holding an interest of 5 per cent or more in their respective class of share capital of the Company as at December 31, 2003.

## INTERESTS OF DIRECTORS AND SUPERVISORS IN THE SHARE CAPITAL OF THE COMPANY

As at December 31, 2003, none of the Directors, Supervisors or chief executives had any interest or short position in any shares, underlying shares in and debentures of the Company or any of its associated corporations that is required to be notified to the Company and the Stock Exchange in accordance with Section 7 and Section 8 of Part XV of SFO, or any interest required to be recorded and kept in the register of the Company pursuant to Section 352 of SFO, or any interest required to be notified to the Company and the Stock Exchange pursuant to the Model Code for Securities Transactions by Directors of Listed Companies.

During Year 2003, no right was granted by the Company to its Directors, Supervisors or their respective spouses or children below the age of 18 to subscribe for its equity or debt securities.

## SERVICE CONTRACTS OF DIRECTORS AND SUPERVISORS

Each existing member of the Board and Supervisory Committee of the Company has entered into a service agreement with the Company. All existing Directors and Supervisors will serve a term up to December 4, 2006. Directors and Supervisors may serve consecutive terms of three years each if re-elected at general meetings.

## INTERESTS OF DIRECTORS AND SUPERVISORS IN CONTRACTS

Certain existing members of the Board and Supervisory Committee are also members of management of various Chinese commercial airlines which are shareholders of the Company. The contracts or transactions entered into between the Company or any of its subsidiaries with such airline shareholders have been referred to in the section "Connected Transactions" of this Report of Directors. Except as disclosed in that section, none of the Directors or Supervisors of the Company had a material interest in any contract of significance to which the Company or any of its subsidiaries was a party during Year 2003.

## REMUNERATION OF DIRECTORS AND SUPERVISORS

Details of the remuneration of Directors and Supervisors are set out in note 6 to the financial statements.

## INTEREST CAPITALISED

No interest was capitalised for the Group for the year ended December 31, 2003.

## **FIXED ASSETS**

Movements in fixed assets of the Group during the year ended December 31, 2003 are summarized in note 12 to the financial statements.

## **RESERVES**

Details of movements in reserves of the Group for the year ended December 31, 2003 are set out in the consolidated statement of changes in shareholders' equity.

## **DIVIDENDS**

The Board recommends the payment of a final dividend of RMB0.102 per share for the year ended December 31, 2003.

## **STATUTORY PUBLIC WELFARE FUND**

Details in relation to the statutory public welfare fund, such as the nature and application of the fund, and the basis of its calculation, are set out in note 27 to the financial statements. Details of movements of the fund are set out in the consolidated statement of changes in shareholders' equity as part of the statutory reserves.

## **EMPLOYEES' RETIREMENT SCHEME**

Details of the employees' retirement scheme of the Group are set out in note 7 to the financial statements.

## **MAJOR SUPPLIERS AND CUSTOMERS**

Societe Internationale de Telecommunications Aeronautiques S.C. ("SITA S.C.") was the largest supplier to the Group for the year ended December 31, 2003 and the total network usage fees paid to SITA S.C. in Year 2003 accounted for 6.8 per cent of the Group's total operating expenses (excluding depreciation and amortization expenses) for that year. During Year 2003, the total amount paid to the five largest suppliers of the Group accounted for 20.3 per cent of the Group's total operating expenses (excluding depreciation and amortization expenses).

Sales to the largest customer of the Group, China Southern Air Holding Company, accounted for 14.3 per cent of the Group's total revenues for the year ended December 31, 2003. During Year 2003, total sales to the Group's five largest customers accounted for 53.2 per cent of the Group's total revenues. Three of these top five customers, China Southern Air Holding Company, China Eastern Air Holding Company, and China National Aviation Holding Company, are among the principal shareholders of the Company, holding an aggregate of approximately 35.6 per cent of the issued share capital of the Company as at December 31, 2003. The aggregate revenue derived from the above major customers is set out in note 32 to the financial statements.

Save as disclosed above and in note 32 to the financial statements, none of the Directors, Supervisors and their associates nor any shareholder (which to the knowledge of the Directors hold more than 5 per cent of the Company's share capital) had any interest in any of the aforementioned suppliers and customers.

## **SUBSIDIARIES AND ASSOCIATED COMPANIES**

Particulars of the Company's subsidiaries and associated companies as at December 31, 2003 are set out in note 1 to the financial statements.

# Report of Directors

## USE OF PROCEEDS FROM ISSUANCE OF THE H SHARES

The H shares of the Company were listed on the Stock Exchange on February 7, 2001, and the net proceeds from the issuance of H shares amounted to approximately HK\$1,186.0 million. For the year ended December 31, 2003, such amount has been used in the same manner as set out in the prospectus of the Company dated January 29, 2001. In particular:

- approximately RMB659.0 million (HK\$618.4 million) was used to finance a portion of the funding requirements of the ETD plan;
- approximately RMB40.7 million (HK\$38.2 million) was used to finance a portion of the expansion and upgrading of the APP system;
- approximately RMB6.1 million (HK\$5.7 million) was used to finance the expansion of other new businesses of the Company;
- approximately RMB71.3 million (HK\$66.9 million) was used for daily operating activities; and
- the balance of the net proceeds is currently deposited with banks.

The Board believes that the Company currently has sufficient capital for its operations, including future expansion of its businesses in the PRC and potential strategic acquisition or investments which the Company may decide to pursue in the future.

## CONNECTED TRANSACTIONS

### Ongoing Connected Transactions

During Year 2003, the Group continued to carry out the following transactions, which constitute connected transactions as defined in the Listing Rules, and are required to be disclosed in accordance with Chapter 14 of the Listing Rules:

#### (a) Provision of Services and Technological Support by the Group to the Company's promoters

In Year 2003, the Group continued to provide all the promoters/shareholders of the Company (other than CTHC) with services and technological support, including ETD, APP, data network, etc.. Details and financial information relating to the provision of such services by the Group during Year 2003, which are of a material nature, are set out in note 32 to the financial statements.

#### (b) Lease of properties by the Company from CTHC

The Company continued to lease two properties from CTHC in Year 2003. Details and financial information relating to such leases during Year 2003 are set out in note 32 to the financial statements.

#### (c) Transaction between SITA INC. and InfoSky

During Year 2003, SITA INC. provides InfoSky with air cargo information management services in return for payment based on usage at the agreed charges. As Societe Internationale de Telecommunications Aeronautiques Greater China Holdings Limited ("SITAGCH") is a substantial shareholder of InfoSky and SITA INC. is an indirect holding company of SITAGCH, SITA INC. is a connected person of the Company.

For Year 2003, total payments made by InfoSky to SITA INC. amounted to approximately US\$377,034 (2002: US\$1,119,000).

**(d) Network usage fees paid by the Company to SITA S.C.**

During Year 2003, the Company continued to engage SITA S.C. in providing data network services to the Company. The data network usage fees were determined based on the rates agreed between SITA S.C. and the Company. Since both SITA INC. and SITA S.C. are owned and managed by almost the same group of shareholders, SITA S.C. is an associate of SITAGCH, and SITA S.C. is therefore considered as a connected person of the Company.

For Year 2003, the network usage fees payable by the Company to SITA S.C. amounted to approximately RMB33,236,600 (2002: RMB34,911,000).

**(e) Transactions between the Company and the Cares Companies**

The Cares Companies are joint venture companies established between the Company and Chinese commercial airlines and airports for distributing the products of the Company and providing better service to customers in different regions. The Cares Companies will pay fees to the Company, such as the connection and installation fees and physical identified device ("PID") fees, at the rates prescribed by the CAAC.

For Year 2003, the Company received fees from the Cares Companies of approximately RMB45,938,647.

In the opinion of the independent non-executive directors of the Company, such connected transactions:

- (i) were entered into by the Group in the ordinary and usual course of its business;
- (ii) were conducted either
  - (a) on normal commercial terms (which expression shall be applied by reference to transactions of a similar nature and to be made by similar entities); or
  - (b) (where there is no available comparison) on terms that are fair and reasonable so far as the independent shareholders of the Company are concerned; and
- (iii) were entered into either
  - (a) in accordance with the terms of the agreements governing such transactions; or
  - (b) (where there are no such agreements) on terms no less favourable than those available to or from independent third parties;
- (iv) if they fall within any of the following categories, did not exceed the upper limits set out below for the financial year ended December 31, 2003:

Categories of transactions	Cap Amount
Leasing and using properties	RMB40.00 million
Payment to SITA INC. by InfoSky	US\$8.70 million
Revenues from the Service Companies	RMB48.00 million
Expenditure to SITA S.C.	RMB72.00 million



# Report of Directors

In relation to such connected transactions, the Company has received a letter from the auditors stating that such connected transactions:

- (a) have received the approval of the Board;
- (b) were entered into in accordance with the pricing policies as stated in the notes to the financial statements of the Company;
- (c) were entered into in accordance with the terms of the respective agreements and documents governing those transactions; and
- (d) the aggregate amounts of the transactions have not exceeded the upper limits (referred to in (iv) above).

## NEW WAIVER

As the waiver for the Company's existing ongoing connected transactions had expired on December 31, 2003, the Company applied in October 2003 to the Stock Exchange for a new waiver from strict compliance with the relevant requirements of the Listing Rules in relation to them, details of which were set out in the announcement published on October 20, 2003 and the circular dispatched to shareholders on November 10, 2003.

A waiver was granted by the Stock Exchange on December 10, 2003 after the approval of the ongoing connected transactions in respect of the provision of services and technical support by the Company and its Service Subsidiaries (as defined in the circular) to the Company's promoters by the Company's independent shareholders in the Extraordinary General Meeting held on December 5, 2003, and will be effective and valid for a term from January 1, 2004 to October 17, 2005. For the transactions listed in (iv) above, a waiver was granted by the Stock Exchange from strict compliance with the requirement for further disclosure by way of press announcements for the period from January 1, 2004 to December 31, 2006 with the following upper limits:

Categories of transactions	Cap Amount
Leasing and using properties	RMB40.00 million
Payment to SITA INC. by InfoSky	US\$5.00 million
Transactions between the Company and its subsidiaries and associated companies	RMB84.00 million
Transactions between the Company and SITA	RMB72.00 million

The above waivers were granted subject to the conditions set out in the announcement published on October 20, 2003 and the circular dispatched to shareholders on November 10, 2003.

## Other Connected Transaction

The Company entered into two agreements on November 11, 2003 with Shanghai Civil Aviation East China Service System Integration Company Limited ("SCAEC") pursuant to which the Company had agreed to purchase certain computer network hardware and software and related services from SCAEC. As the Company holds 47% of the equity interest in SCAEC, and China Eastern Air Holding Company, a promoter of the Company, controls 37% of the equity interest in SCAEC, SCAEC is a connected person of the Company and the transaction constitutes a connected transaction under the Listing Rules. The total consideration to be paid by the Company under the two agreements is RMB6,664,864, and is less than 3% of the Company's net tangible assets, hence no approval from the Company's independent shareholders was required. The Company considered the purchase to be in line with its strategy of upgrading its information technology to complement the expansion of its business. An announcement was issued by the Company on February 9, 2004 describing the terms of the transaction.

## TRUST DEPOSITS AND IRRECOVERABLE OVERDUE TIME DEPOSITS

As at December 31, 2003, the Group did not have any trust deposits or irrecoverable overdue time deposits. All of the Group's cash deposits are placed with commercial banks and are in compliance with applicable laws and regulations.

## PURCHASE, SALE OR REDEMPTION OF SECURITIES

For the year ended December 31, 2003, the Group did not purchase, sell or redeem any of the Company's securities.

## AUDIT COMMITTEE AND COMPLIANCE WITH CODE OF BEST PRACTICE

The Audit Committee of the Company has discussed and reviewed with the Company's management the financial information contained in the annual report and has also discussed certain other matters including internal control and financial reporting procedures of the Company. The Board is of the opinion that the Company has complied with the requirements of the Code of Best Practice as set out in Appendix 14 to the Listing Rules during Year 2003.

## PRE-EMPTIVE RIGHTS

There is no provision regarding pre-emptive rights under the Articles of Association of the Company or under PRC laws.

## MATERIAL LITIGATION

The Group was not involved in any material litigation or dispute in Year 2003.

## AUDITORS

During the period from the date of incorporation of the Company and up to December 31, 2001, Arthur Andersen & Co in Hong Kong and Arthur Andersen • Hua Qiang in the PRC were the Company's international and PRC auditors, respectively.

PricewaterhouseCoopers (Certified Public Accountants in Hong Kong) and PricewaterhouseCoopers Zhong Tian CPAs Ltd. Co. (Certified Public Accountants in the PRC) are respectively the Company's international and PRC auditors for Year 2002 and Year 2003. A resolution to appoint PricewaterhouseCoopers as the Company's international auditors and PricewaterhouseCoopers Zhong Tian CPAs Ltd. Co. as PRC auditors, respectively, for the year ending December 31, 2004 will be proposed at the Annual General Meeting of the Company to be held on Wednesday, April 28, 2004.

By order of the Board



Chairman

March 11, 2004