

# MANAGEMENT DISCUSSION AND ANALYSIS

## BUSINESS REVIEW

### Influence of SARS on Business

At the beginning of 2003, the global economy recovery as well as the healthy growth of China's economy led to a good development trend of traffic volumes at Beijing Airport.

However, from February to July in 2003, SARS spread globally, and had an unprecedented impact on traffic volumes of Beijing Airport.

SARS affected Beijing Airport mainly from April to August in 2003, with the most severe impact in May during which aircraft movements decreased by 65.5%, passenger throughput decreased by 86.5%, and cargo throughput decreased by 51.2%, as compared with the corresponding period in the previous year. Aircraft movements dropped to the bottom on 14 May, with only 192 movements on that day, which were less than one third of the normal level; and passenger throughput dropped to the bottom on 12 May, with 6,230 passengers, which was only one tenth of the normal level.

In August 2003, the total traffic volumes at Beijing Airport recovered to the level of the corresponding period in the previous year, and began to increase smoothly. In November and December, the growth rates of both aircraft movements and passenger throughput exceeded 20%, which indicated that the traffic volumes at Beijing Airport had already recovered totally and had started a strong growth.

Due to the effects of SARS, the traffic volumes of Beijing Airport did not reach the same level as that of the previous year. Details are as follows:

	2003	2002	Change
<b>Aircraft Movements</b>	<b>235,861</b>	242,338	-2.7%
Domestic	<b>187,338</b>	187,904	-0.3%
International, Hong Kong & Macau	<b>48,523</b>	54,434	-10.9%
<b>Passenger Throughput</b>	<b>24,363,860</b>	27,159,665	-10.3%
Domestic	<b>18,856,884</b>	19,304,027	-2.3%
International, Hong Kong & Macau	<b>5,506,976</b>	7,855,638	-29.9%
<b>Cargo Throughput</b>	<b>662,142</b>	669,347	-1.1%
Domestic	<b>424,130</b>	366,715	15.7%
International, Hong Kong & Macau	<b>238,012</b>	302,632	-21.4%

## Overview of the Aeronautical Business

At present, the main facilities at Beijing Airport are being operated at their full capacity: in 2002, actual passenger throughput of the Terminal Two exceeded its designed annual handling capacity of 26.5 million; while in 2003, for 256 days the number of the aircraft movements in the peak hours exceeded the maximum amount set by CAAC. In order to improve the operating environment, the Company is carrying out improvement projects in both the air-field and the terminal areas. On one hand, the Company plans to build new aircraft stands in addition to the existing 67 stands so as to improve the ground operating and supporting capabilities. On the other hand, the Company renovated the security check channels and immigration counters at Terminal Two, which increased the number of the security check channels from 12 to 19 and increased the number of the immigration counters from 24 to 44, so that the passenger movements can be speeded up. At the same time, the Company is renovating Terminal One and plans to put it into operation in the second half of 2004.

Net aeronautical revenues of the Group in 2003 were Rmb1,469,036,000, while the net aeronautical revenues in 2002 were Rmb1,591,173,000. Details are as follows:

	2003 (Rmb '000)	2002 (Rmb '000)	Change
Passenger charges	<b>448,588</b>	539,743	-16.9%
Aircraft movement fees and related charges	<b>511,872</b>	423,789	20.8%
Airport fee	<b>334,528</b>	361,921	-7.6%
Ground handling facilities charge	<b>96,915</b>	196,582	-50.7%
Ground handling services income	<b>122,567</b>	118,350	3.6%
Total aeronautical revenues	<b>1,514,470</b>	1,640,385	-7.7%
Less: Business tax and levies	<b>(45,434)</b>	(49,212)	-7.7%
Net aeronautical revenues	<b>1,469,036</b>	1,591,173	-7.7%

The major factors affecting the aeronautical revenues of the Group for the year 2003 are as follows:

1. According to the new fee standards for aeronautical charges of airports issued by CAAC in September 2002, the level of the aircraft movement fees charged on domestic airlines increased by 285% on average, and the level of the passenger charges decreased by 18.25%. In addition, the Company will no longer levy the ground handling facilities charges on flights operated by domestic airlines;
2. Due to the effect of SARS, in 2003, aircraft movements and passenger throughput decreased by 2.7% and 10.3% from the previous year respectively;
3. During the SARS period, most airlines made structural changes to their aircraft fleet by using small planes instead of the large ones;

## MANAGEMENT DISCUSSION AND ANALYSIS

- During the SARS period, CAAC made a temporary adjustment on certain aeronautical charges of the airports, which decreased the level of the passenger charges payable by domestic airlines by 38.46% during May and June 2003 and decreased the level of the aircraft movement fee payable by foreign airlines as well as airlines from Hong Kong and Macau by 20% during May to July 2003;
- The flights operated by foreign airlines or by airlines from Hong Kong and Macau decreased more significantly than those by domestic airlines during the SARS period, and their recovery and increase were obviously later and slower than domestic airlines during the post SARS period. The level of charges payable by foreign airlines and airlines from Hong Kong and Macau are also higher than those of the domestic airlines.

In 2003, total aeronautical revenues accounted for 66.8% of the total revenues of the Group, while they accounted for 69.9% in the previous year.

### Major Airlines at Beijing Airport

	Contribution to Aircraft Movements		Contribution to Passenger Throughput		Contribution to Cargo & Mail Throughput		Contribution to Total Aeronautical Revenues	
	2003	2002	2003	2002	2003	2002	2003	2002
Air China Group(CA)	36.1%	32.6%	42.0%	35.9%	4.8%	5.0%	34.5%	34.9%
China Southern Airlines Group(CZ)	20.6%	23.0%	21.2%	21.8%	20.4%	23.5%	12.6%	14.0%
China Eastern Airlines Group (MU)	13.6%	14.6%	13.1%	13.5%	10.9%	11.7%	7.22%	9.1%
Hainan Airlines Group (HU)	12.1%	11.2%	4.5%	6.7%	5.0%	4.2%	6.05%	1.9%

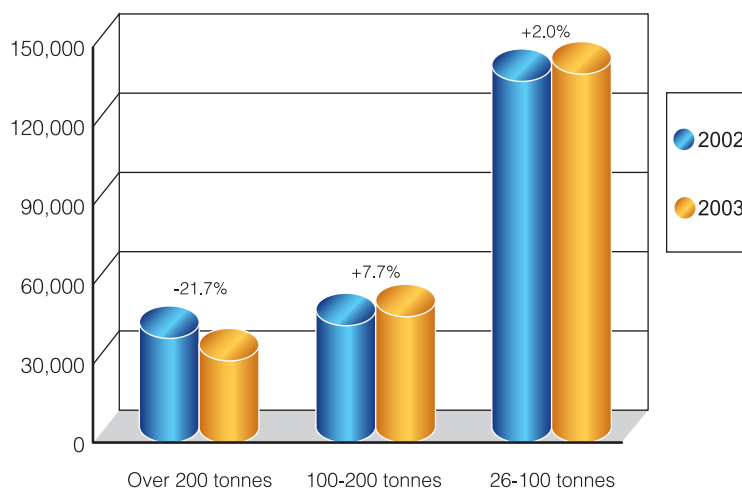
Top 3 Domestic Originating / Destination Locations in 2003 Based on Traffic Volumes:

	Aircraft Movements	Passenger Throughput	Cargo & Mail Throughput
1	Shanghai	Shanghai	Guangzhou
2	Guangzhou	Guangzhou	Shanghai
3	Shenzhen	Shenzhen	Shenzhen

Top 3 International and Regional Originating / Destination Locations in 2003 Based on Traffic Volumes:

	Aircraft Movements	Passenger Throughput	Cargo & Mail Throughput
1	Japan	Europe	Europe
2	Europe	Hong Kong & Macau	Hong Kong & Macau
3	Hong Kong & Macau	Japan	Japan

### Comparison of Fleet Structure in 2003 and 2002



### Overview of the Non-aeronautical Business

In 2003, the Group's net non-aeronautical revenues reached Rmb723,271,000, while those of the previous year were Rmb675,563,000. Details are as follows:

	2003 (Rmb '000)	2002 (Rmb '000)	Change
Retailing	305,205	287,254	6.2%
Air catering	55,889	63,064	-11.4%
Rental	122,588	148,578	-17.5%
Restaurants	75,513	51,349	47.1%
Advertising	89,598	77,693	15.3%
Car parking	34,717	36,925	-6.0%
Repairs and maintenance services	24,329	15,923	52.8%
Others	44,708	24,021	86.1%
<b>Total non-aeronautical revenues</b>	<b>752,547</b>	704,807	6.8%
Less: Business tax and levies	<b>(29,276)</b>	(29,244)	0.1%
<b>Net non-aeronautical revenues</b>	<b>723,271</b>	675,563	7.1%

In 2003, total non-aeronautical revenues accounted for 33.2% of the total revenues of the Group, while they accounted for 30.1% in the previous year.

Retailing revenues of the Group reached Rmb305,205,000 in 2003, representing an increase of 6.2% over the previous year due to the fact that the Company has taken back most of the commercial areas in Terminal two to operate its own retailing businesses since October 2002.

Advertising revenues of the Group in 2003 reached Rmb89,598,000, representing an increase of 15.3% over the previous year. Although certain clients reduced their advertising budgets due to the impact of SARS, most advertising agreements were signed at the beginning of the year and the Group also explored various new advertising media during the year, including automobile exhibition spaces, light boxes with moving pictures on the luggage carousels and on the passenger boarding bridges. Therefore advertising revenues still maintained a good increase.

During the SARS period, cars passing in and out of Beijing Airport decreased dramatically, which severely affected car parking revenue. Although the Company reconstructed the car park building in order to optimize the parking procedures and made adjustments of parking fees to attract more customers. Car parking revenues still decreased by 6.0% from the previous year, amounting to Rmb34,717,000.

Because of the decrease in flights and passengers, the Group's air catering business also suffered severely. Air catering revenues decreased by 11.4% from the previous year, amounting to Rmb55,889,000.

Since October 2002, most restaurants in Terminal Two have been operated by BAFS instead of being rented out separately. Benefiting from this adjustment, the Group's income from restaurants increased by 47.1% from the previous year, reaching Rmb75,513,000.

In respect of rental income, the leases for many retailing shops were terminated and the Group took back most of the commercial areas in Terminal Two for self-operation. In addition, the Company offered its lessees, who were affected by SARS as well, a 30% discount on rental during May to July 2003. The Group's rental income decreased by 17.5% from the previous year, amounting to Rmb122,588,000.

Although the business of Bowei was affected by SARS in the first half of 2003, it gained several substantial orders in the second half of the year. This led to an increase in the Group's revenues from repairs and maintenance by 52.8% over the previous year, amounting to Rmb24,329,000.

In respect of other income, Huaxia which was incorporated in May 2002, operated businesses such as terminal sanitary service and trolley service, leading to an increase in the related income in 2003. In 2003, other income of the Group was Rmb44,708,000, representing an increase of 86.1% over the previous year.

## Operating Costs

In 2003, the operating costs of the Group amounted to Rmb1,514,134,000 while those of the previous year were Rmb1,397,377,000. Details are as follows:

	2003 <i>in Rmb '000</i>	2002 <i>in Rmb '000</i>	Change
Cost of goods and materials	<b>(220,039)</b>	(205,273)	7.2%
Depreciation	<b>(453,868)</b>	(445,668)	1.8%
Staff costs	<b>(303,014)</b>	(264,752)	14.5%
Utilities and power	<b>(142,086)</b>	(142,450)	-0.3%
Repairs and maintenance	<b>(108,991)</b>	(99,419)	9.6%
Other costs	<b>(286,136)</b>	(239,815)	19.3%
<b>Total operating costs</b>	<b>(1,514,134)</b>	(1,397,377)	8.4%

The staff costs of the Group increased by 14.5% over the previous year, which is mainly caused by the following factors:

1. The number of contracted employees of the Group increased over the previous year in line with its business development;
2. The contribution percentage of labor insurance was adjusted ;
3. The housing subsidy offered by the Company's subsidiaries and jointly controlled entities to their employees increased.

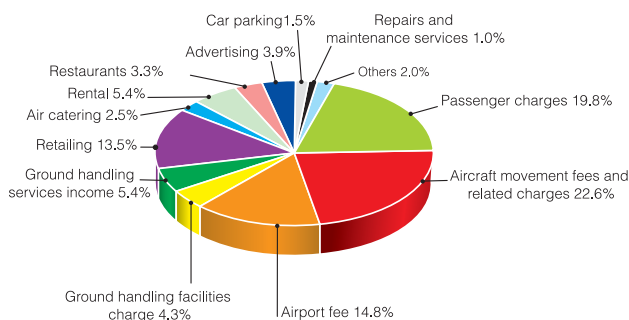
Because of the reduced consumption of steam, air-condition, water and electricity during the SARS period, costs of utilities and power of the Group decreased by 0.3% in 2003 from the previous year.

In 2003, the Group took over the operation of all the retailing shops in Terminal Two and as a result, the cost of goods and materials increased by 7.2% over the previous year.

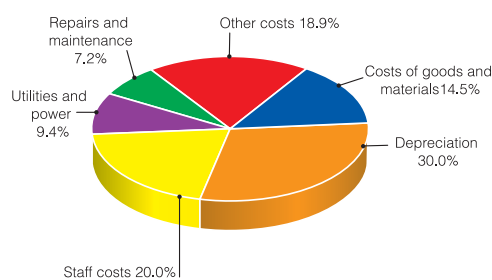
Repairs and maintenance cost of the Group increased by 9.6% over the previous year due to the execution of renovations undertaken by the Group for the optimization of the business resources, such as construction of duty free shopping street and reconstruction of the immigration counters and security check channels.

In 2003, other costs of the Group increased by 19.3% over the previous year. The increase was mainly due to the costs of disinfections against SARS, increased property taxes for new buildings, costs of increased temporary staff and fees for the Group's strategic consultation project.

Revenues of the Group in 2003



Operating costs of the Group in 2003



Major clients of the Group and their respective contribution to total revenues:

Name of the client	Contribution to the Group in 2003	Percentage in total revenues
Air China Group	Rmb557,431,000	24.6%
China Southern Airlines Group	Rmb202,294,000	8.9%
Hainan Airlines Group	Rmb120,651,000	5.3%
China Eastern Airlines Group	Rmb97,502,000	4.3%

Major suppliers of the Group and their respective contribution to total costs:

Name of the supplier	Main items of supply	Corresponding costs to the Company in 2003	Percentage in total costs
Capital Airports Holding Company	Utilities and power; lease of land use rights; lease of properties; etc.	Rmb154,402,000	10.2%
China Duty Free Group Corporation	Duty free merchandises	Rmb85,940,000	5.7%

Other Items in the Income Statement

The net finance costs of the Group were Rmb 56,256,000 in 2003, representing a decrease of 47.5% from the previous year. It was mainly because the Company repaid part of its bank loans, and did not take up new bank loans in 2003.

The share of loss before taxation of associated companies was Rmb1,359,000 in 2003. It was mainly because the business of Global Air Logistics Company Limited, in which the Company has invested, was affected by SARS. The share of loss in 2002 was Rmb16,000.

## Net profit

In 2003, the Group's net profit amounted to Rmb 393,006,000, representing a decrease of 22.5% from the previous year.

## EXPOSURE TO FLUCTUATIONS IN EXCHANGE RATES

The Group's businesses are principally conducted in Rmb, except that purchases of certain equipment, goods and materials and payment of consulting fee are in US dollars. Dividends to shareholders holding H Shares are declared in Rmb and paid in Hong Kong dollars. As at 31 December 2003, the Group's assets and liabilities denominated in foreign currencies, principally in US dollars, HK dollars and Japanese yen, include cash and cash equivalents of approximately Rm180,279,000 (2002: Rmb293,712,000), temporary cash investment of approximately Rmb124,620,000 (2002: Rmb169,696,000), receivables and prepayments of approximately Rmb48,497,000 (2002: Rmb44,721,000), trade and other payables of approximately Rmb22,866,000 (2002: Rmb38,969,000) and long-term bank loans of approximately Rmb35,239,000 (2002: Rmb31,728,000). In 2003, the Group recorded an exchange loss of Rmb2,623,000. The fluctuations in exchange rates did not have a significant impact on the net profit of the Group in 2003, and it is not expected to have an obvious impact on the next year's net profit.

## CONTINGENT LIABILITY

As at 31 December 2003, the Group did not have any significant contingent liability.

## LIQUIDITY AND FINANCIAL RESOURCES

As at 31 December 2003, the Group had total cash and cash equivalents and temporary cash investments amounting to Rmb1,421,328,000, and those as at 31 December 2002 were Rmb1,415,976,000.

As at 31 December 2003, the current ratio of the Group was 1.96, and that as at 31 December 2002 was 1.91. Such ratios were computed by dividing the total current assets by total current liabilities as at the dates respectively.

As at 31 December 2003, the equity of the Group was Rmb7,336,784,000, and that as at 31 December 2002 was Rmb7,201,278,000.

As at 31 December 2003, the liability to asset ratio of the Group was 21.3%, and that as at 31 December 2002 was 24.9%. Such ratios were computed by dividing the total liabilities by the total assets at the relevant dates respectively.



## EMPLOYEES AND EMPLOYEE WELFARE

1. The number of employees of the Group is as follows, together with comparisons in the previous year:

	<b>As at 31 December 2003</b>	As at 31 December 2002
Total employees	<b>8,184</b>	6,669
Contracted employees	<b>3,528</b>	3,406
Temporary employees	<b>4,656</b>	3,263

2. Employees' pension scheme

Details of the employees' pension scheme are set out in note 28 to the financial statements.

3. Employees' housing benefits

Details of the employees' housing benefits are set out in note 29 to the financial statements.

4. Employees' basic medical insurance and commercial medical insurance

With effect from 1 January 2003, the Company and its subsidiaries have complied with the regulation of Beijing Municipal Government for basic medical insurance. According to the regulation, the Group pays the basic medical insurance and mutual insurance for large sum medical expenses for its employees, at 9% and 1% respectively, of the average monthly salary of its employees in the previous year. In addition, the Company and its subsidiaries may provide supplemental medical insurance benefits to their employees on a discretionary basis within 4% of the average monthly salary of its employees in the previous years. At the same time, the Group does not pay the cash medical subsidies or medical compensations to its employees any more. Therefore, the implementation of the above mentioned basic medical insurance does not have any substantial effect on the consolidated balance sheet and the consolidated income statement of the Group.

## OTHER INFORMATION

Other information in relation to those matters set out in Paragraph 32 of Appendix 16 to the Listing Rules has not changed materially for the year of 2003.