

## Management Discussion and Analysis

Phase II expansion of the airport will pave solid foundation to the Group





## Civil Aviation Industry in China

Civil aviation industry sustained its robust growth in 2004 and its profit reached RMB8.69 billion, which illustrated enjoyable economic return. At the same time, as the PRC economy continued its uptrend development, strong demand of the PRC civil aviation industry will continue and expects to continue its growth in 2005.

In order to maintain favourable development of civil aviation, the industry implemented many revolutions and the PRC airport implemented localised revolution. New airport business model will develop in professional and diversified direction. Many airports proceeded restructuring and consolidation after the localised revolution, optimising resources allocation, adopted professional management, further enhance safety and services quality, resulting to the favourable competition in the civil aviation industry. It developed an aggressive external environment and enabled the Company to be the regional airport management company.

2004 is the second year of the opening of the aviation rights of Hainan province and it has already achieved significant development. Until the end of 2004, 10 domestic and international airline companies launched 50 international (region) routes and attracted 6 international airlines to establish routes to Hainan. It also launched 12 international routes and added 306 international flights. At the same time, many airlines and agents eager to the flight to Hainan and is in negotiation with Hainan Provincial Government for the flight arrangement. Besides, Hainan Provincial Government sent the invitation to the airlines of Russia, Japan, Korea, Germany, etc. The opening of the aviation rights is a positive sign and development which is favorable to the Company to develop its business and enhance its reputation.

## Tourism in Hainan Province

Hainan Island, being well-known as "Healthy Island" and "Sunshine Island" in the world, is one of the major tourist destinations in the PRC attracting both domestic and international visitors. In 2004, the number of individual visits reached 14.03 million representing an increase of 13.7% when compared with previous year. Income generated from tourism increased by 18.7%, amounted to RMB11,101 million. In 2004, Hainan Island captured the opportunity and carried out large-scaled promotion campaign so as to actively explore the international market. The annual number of international tourism reached 308,600 persons, kept at a healthy year-on-year growth rate of 5.22%.

The special and natural environment of Hainan Island not only attracted a large number of domestic and overseas tourists, but also attracted a lot of domestic and international conference activities. Various forms of business and academic seminars enhanced the reputation of Hainan's tourism. The hosting of the Annual Bo'ao Forum for Asia (BOA), the 54th Miss World Final, the Hainan Island Festival, International Wedding Festival and Vehicle Enduro have become the new highlights of the Hainan's tourism and further expedite its tourism development. The 55th Miss World Final will be held in Hainan Island again in 2005. We believe that the event will bring a positive influence on Hainan's tourism.

Hainan Provincial Government has already set out natural disasters (such as typhoon and flood, etc.) warning system and reaction policy as preventive measures. A healthy and safe Hainan Island has become an ideal place for tourists. This is also the drive for the increase of traffic volume of Hainan Meilan International Airport.

## Business Review

### Overview of Aeronautical Business

In 2004, the Group has achieved its annual target and reached historical height since its inauguration in 1999.

#### ***The exploitation of International Airline***

Since Hainan Meilan Airport was upgraded as international airport in mid 2003, the Group aggressively discussed with international airlines to open international routes originated from Haikou. As at the end of 2004, there were already 7 local and foreign airlines opened 9 international or regional routes in total which depart from or arrive at Hainan Meilan Airport, reaching Hong Kong, Macau, Seoul, Singapore, Bangkok, Kuala Lumpur, Osaka, Pusan and Fukuoka, etc. 3 other international airlines including, Thailand Phuket Airlines, Malaysia Airlines and Asiana Airlines opened routes to and from Haikou. At the same time, the Group intends to discuss with international airlines, and invite them to carry out field study in Hainan Meilan Airport in order to establish a better foundation for future cooperation.

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In September 2004, the Group successfully got the organisation right of New Routes Asia in 2007. The subsidiary of ASM International Company, Routes Development Organisation Routes, is the organiser of The Asian New Airlines Conference. The headquarters of Routes is located in Manchester, England. Routes is also the organiser of Routes World and Routes Latin America. The New Routes Asia 2003 - 2005 is held in Kuala Lumpur, Malaysia. The New Routes Asia not only provides an opportunity for the city to generate huge income from aeronautical industry, but also increase the international reputation of the city and the airport. It is a valuable opportunity for the Group to promote itself through organising New Routes Asia. The Group will treasure this opportunity to enhance the communication with the international airlines and to open more international routes.

Traffic throughput for 2004 and the previous year are set out below:

	Year 2004	Year 2003	Change (%)
<b>Aircraft movement</b>	<b>68,282</b>	<b>64,136</b>	<b>6.46</b>
In which: Domestic	66,422	62,996	5.44
Hong Kong/Macau	1,317	1,027	28.24
International	543	113	380.53
<b>Passengers Throughput (Ten thousand persons)</b>	<b>747.8</b>	<b>602.9</b>	<b>24.03</b>
In which: Domestic	730.3	592.6	23.24
Hong Kong/Macau	12.5	9.1	37.36
International	5	1.2	316.67
<b>Cargoes Throughput (Tones)</b>	<b>98,482.5</b>	<b>81,401.9</b>	<b>20.98</b>
In which: Domestic	96,179.6	80,065.2	20.13
Hong Kong/Macau	1,489.5	1,138.1	30.88
International	813.4	198.6	309.57

Because of the opening of the third, fourth and fifth aviation rights and the aggressive approach to explore more international routes, the number of international airlines increased substantially. It is estimated that the international routes and international passengers throughput may be the growth momentum of the aeronautical business in 2005.





Benefited from the overall increase in traffic volume in 2004, the Group's revenue from aeronautical business for the year reached RMB 259.75 million, representing an increase of 20.9% when compared with the same period last year.

	Amount (RMB '000)	Change to last year (%)
Passenger charges	101,819	20.3%
Aircraft movement fees and related charges	42,222	10.2%
Airport fee	90,176	25.8%
Ground handling service fees	25,536	26.1%
<b>Total revenue from Aeronautical Business</b>	<b>259,753</b>	<b>20.9%</b>

### Overview of Non-Aeronautical Business

In 2004, the Company introduced the business development experience of Copenhagen Airports A/S and established business development strategies which meet the development requirements of the Company. The development strategies include resources allocation and management method, etc. The Group attained encouraging results in respect of its non-aeronautical business. The revenue from non-aeronautical business amounted to RMB 100.27 million, representing an increase of 7.7% as compared to last year. The sources of revenue are set out as follows:

	Amount (RMB '000)	Change to last year (%)
Leasing of commercial areas in the airport terminal	19,307	21%
Franchise revenue	13,992	-43%
Advertising revenue	8,247	33%
Retail	21,788	90%
Tourism transportation revenue	22,165	0.9%
Car parking fees	5,072	71%
Other revenue	9,701	-3.5%
<b>Total revenue from non-aeronautical business</b>	<b>100,272</b>	<b>7.7%</b>

It is estimated that the leasing of the commercial areas in the airport terminal and car parking fees may be the growth momentum of the non-aeronautical business in 2005.

# Management Discussion and Analysis

## **Commercial Sales**

In 2004, the Group successfully introduced international renowned brands to join the operation of the Group, which included Select Service Partner Hong Kong Limited commenced their businesses and received favourable market response. In October 2004, the Group has entered into an agreement with DFS (the basic charge is decided upon the number of departing passenger, together with a concession fee which is certain percentage of the total turnover), which rented the commercial area of the terminal to them and expect to complete the design and decoration and commence operation in the mid of 2005. The successful introduction of SSP and DFS will enhance the quality of food and beverages and retail services, and encourage the development of other non-aeronautical businesses, which is regarded as a new operation model of the commercial development of the civil aviation airport in the PRC.

In 2004, the Group extended the advertising and VIP services to the area of telecommunications and the sales of vehicles, which can further complete the services of the airport. It can explore income sources and determine suitable business model of the Group, and achieved favourable market response of non-aeronautical business. Turnover amounted at RMB100.27 million.

## **Tourism and Traveling**

Hainan Meilan Airport Traveling Company Limited ("Meilan Traveling") provides a wide range of services such as transportation between Hainan Meilan International Airport and Haikou City, hotel reservation, air ticket sales, travel reception and organises more tour package. The turnover in 2004 amounted RMB 22.17 million.

## **Car Parking**

Car parking charges is another major income source for the Group's non-aeronautical businesses. The turnover in 2004 amounted to RMB 5.07 million.

## **Advertising Business**

The Group also generated revenue by operating and leasing out advertising space at the airport terminal. For the year ended 31 December 2004, income from advertising was RMB 8.25 million, representing an increase of 33% as compared to 2003. As Hainan Meilan International Airport begins accommodating more international flights, the number of domestic and international corporations placing advertisements in the airport terminal will increase and develop more advertising places and ultimately, revenue from advertising business will be further boosted in the future.

## **Retail**

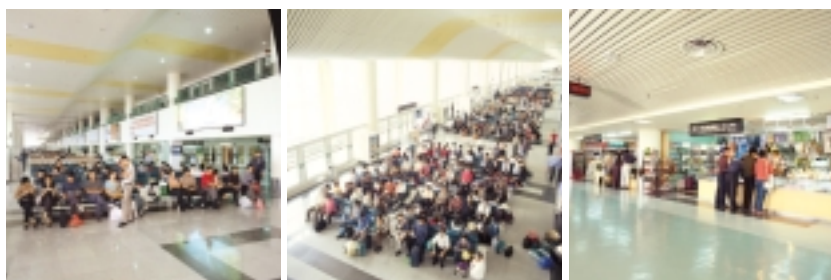
For the year ended at 31 December 2004, the annual revenue from the retail business of the group reached RMB 21.79 million, representing an increase of 90% comparing to last year. The main driving forces for this dramatic increase are: Enormous effort put into the retail market development by the Group, thorough research undertaken on the customer needs, "customer-oriented" operation concept, adjustment to the shop layout and merchandise structure. Moreover, the Group also expanded the retail spaces in the terminal building. In year 2005, the Group is going to enter cooperation with world famous retailer DFS, according to the agreement, the Company will terminate the domestic retail business and outsource them to DFS, the Company will therefore only operate the retail business in the international hall of the terminal building. As a result, it is estimated that the revenue from retail business will drop, but the Company will recognise other income for DFS.

## **Income from Concession**

For the year ended 31 December 2004, revenue from the concession was RMB 13.99 million, representing a decrease of 43% comparing to last year, this is mainly due to the change on the concession fee payment method of the Catering Company and reduction on the outsourcing fee of Cargo Business sine 1 January 2004. As a result, the concession income from the Catering business for 2004 was RMB 2.08 million and the outsourcing income from the Cargo business was RMB 9.9 million, representing decreases of RMB2.3 million and RMB8.1 million respectively comparing to last year.

## **Financial Review** **Structure of assets**

As at 31 December 2004, the total assets of the Group amounted to RMB1,703.95 million, an increase of 5.79% as compared to the previous year. The increase was mainly attributable to the increase of the company reserves brought by the net profit.



### Cost Structure

In 2004, the total operating costs of the Group were RMB106.27 million, representing an increase of 17.6% and RMB15.94 million compared to last year; the administrative expenses were RMB 56.07 million, representing an increase of 5.9% and RMB 3.11 million compared to last year. The increase in expenses was attributable to the followings:

1. The revenue from retails increased by 90% comparing to the previous year, thus the cost of goods sold increased by RMB5.44 million, 92% up comparing with previous year.
2. According to the clauses stated in the General Logistic Service Contract with HNA Group, the logistic expense for 2004 was RMB9.5 million, which increased by RMB3 million or 46% comparing to last year.
3. The staff cost increased by 14% (or RMB4.19 million) comparing with previous year, it is mainly due to the increase in employees as well as the additional expenditure on the Housing Provident Fund.

### Cash flows

In 2004, the Group's net cash flow from operating activities was RMB182.76 million, representing a decrease of 2%, the primary reason for the decrease was the increase in trade receivables. The Group's net cash flow from investing activities was RMB 99.6 million, which was contributed by the phase II expansion of the terminal building.

### Pledge of the Group's Assets

The Company pledged its rights to revenues to secure a long-term bank loan of RMB128 million from China Development Bank.

### Gearing Ratio

As at 31 December 2004, the current assets of the Group was approximately RMB670.22 million, the total assets was approximately RMB1,703.95 million, the current liability was approximately RMB126.22 million and the total liability was approximately RMB240.72 million. The Group's gearing ratio, representing the ratio of the total bank borrowing to the total asset, was 7.5%, a decrease of 0.4% in comparison to that of the previous year. The main reason for the improvement was the increase of the total assets.

### Exposure to Foreign Exchange Risk

Except the purchase of certain equipment, goods and raw materials denominated in US Dollar, the Group's businesses were denominated in RMB. The dividends of H share of the shareholders was published by RMB and paid with HK Dollars. As at 31 December 2004, all of the Group's assets and liabilities are denominated in RMB, only cash and cash equivalents of approximately RMB5.187 million was denominated in HK Dollar and US Dollar. The fluctuation of the exchange rate of RMB to foreign currency may have an impact on the Group's results.

### Financial Instruments

As at 31 December 2004, financial instruments of the Group were mainly comprised bank loans, cash and bank deposits. The purpose of those financial instruments is to finance the operation needs. Besides, the Group has other direct finance instruments in relation to daily operations, such as accounts receivable and accounts payable.

### Contingent Liability

As at 31 December 2004, the Group or the Company did not have any significant contingent liabilities.

### Purchase, Sales or Redemption of Shares

As at 31 December 2004, the Group or the Company has not purchased, sold or redeemed any of the Company's shares.

### Employment, Training and Development

As at 31 December 2004, the Group had a total of 714 employees, representing an increase of 146 employees as compared to that of 2003. Total staff costs accounted for about 9.3% of total turnover, representing an increased of 14% as compared to the previous year. The reason of the increase in cost was mainly contributed by the increase in headcount, higher percentages on the Housing Provident Fund borne by the Company and the increase in the Seniority Payment etc.. Employees are remunerated based on their performance, experience and prevailing industry practices, and the Group will review the remuneration policy and its related combination on a regular basis. Bonuses and commissions may be awarded to employees as incentives based on their performance.

### Retirement pension

The Company and its respective subsidiaries have participated in the employee retirement scheme operated by the relevant local government of the PRC. The relevant local government shall be responsible for the pension of the retired employees. The Group has to make contribution at a rate of 20% of the salary of the employees of permanent residence in the PRC after 1 January 2004 respectively. For the year ended 31 December 2004, the contribution for the pension was amounted to approximately RMB2.78 million (2003: RMB2.72 million).

### Other Information

The Group has no material change in other information in relation to those matters set out in paragraph 32 of Appendix 16 to the Listing Rules in 2004.