



## 1 GROUP REORGANISATION AND PRINCIPAL ACTIVITIES

The Company was established in the People's Republic of China ("PRC") on 30th April 2003 as a joint stock company with limited liability under the PRC laws as a result of a group reorganisation (the "Reorganisation") of China Aviation Industry Corporation II ("AVIC II" or "Holding Company") in the preparation for the listing of the Company's shares on the Main Board of The Stock Exchange of Hong Kong Limited.

In accordance with the reorganisation agreement entered into among the Company, AVIC II, 中國華融資產管理公司 ("China Hua Rong Asset Management Corporation" or "Hua Rong"), 中國信達資產管理公司 ("China Cinda Asset Management Corporation" or "Cinda") and 中國東方資產管理公司 ("China Orient Asset Management Corporation" or "Orient") (the "Reorganisation Agreement") effective as of 30th April 2003 (the "date of Reorganisation"), the Company issued 2,981,388,500 shares of RMB1.00 per share to AVIC II in exchange for various assets and liabilities relating to the manufacture, assembly, sales and servicing of automobiles, helicopters, jet trainers and aircraft, transferred to the Company by AVIC II. In addition, 104,620,000 shares, 15,470,000 shares and 15,040,000 shares, all of RMB 1.00 each, were issued to Hua Rong, Cinda and Orient (collectively the "Asset Management Companies") respectively for the transfer of their equity interests of 14.61%, 2.16% and 2.1% in Harbin Aviation Industry Group, Ltd ("Hafei Industry Company"). The aggregate number of shares issued in this connection amounting to 3,116,518,500 shares were the initial registered capital of the Company with a par value of RMB1.00 per share (collectively the "Domestic Shares").

Pursuant to the Reorganisation, AVIC II transferred to the Company certain of its assets, liabilities and interests in the PRC related to (i) the development, manufacture and sales of mini-sized vehicles, economy sedan, and auto motors engines, (ii) the development, manufacture, sales and modification of civilian aircraft, helicopters and related aviation products, (iii) a helicopter research institute, and (iv) an electrical aviation products development company (collectively the "Transferred Businesses").

AVIC II retained assets, liabilities and interests related to the (i) design, research and development, manufacture and sales of non-civilian aircraft (ii) manufacture and sales of motor parts, (iii) ownership of certain assets and liabilities including staff quarters, certain office buildings, bank balances, investments in securities, borrowings and tax liabilities, and (iv) provision of social welfare and the operations that provided ancillary support services.

In October 2003, the Company completed its initial public offering and placing of 1,679,800,500 H Shares (the "Offering") which comprised 1,527,090,000 new shares issued by the Company and 152,710,500 shares offered by AVIC II and the Asset Management Companies (collectively the "Promoters"). As a result, the issued share capital of the Company increased from 3,116,518,500 shares to 4,643,608,500 shares, comprising 2,963,808,000 Domestic Shares and 1,679,800,500 H Shares, representing 63.83% and 36.17% of the issued capital respectively.



## 2 BASIS OF PREPARATION

As AVIC II controlled the Transferred Businesses before the Reorganisation and continues to control the Company after the Reorganisation, the consolidated financial statements of the Group for the year ended 31st December 2003 have been prepared as a reorganisation of business under common control in a manner similar to a uniting of interests. Accordingly, the assets and liabilities transferred to the Company have been stated at historical amounts.

The consolidated financial statements of the Group for the year ended 31st December 2003 present the consolidated results of the Group as if the Group had been in existence throughout the period and as if the Transferred Businesses were transferred to the Company by AVIC II at 1st January 2003 or when such businesses were acquired by AVIC II, whichever is later. The Company's directors are of the opinion that the consolidated financial statements prepared on this basis present fairly the consolidated financial position, consolidated results and consolidated cash flows of the Group as a whole. Therefore, the net profit for the year ended 31st December 2003 includes the consolidated results before the Reorganisation.

As set out in Note 1 to the financial statements, the Group increased its interests in the assets and liabilities in Hafei Industry Company previously owned by the Asset Management Companies from 81.13% to 100% with effect from 30th April 2003. Accordingly, the minority interests in Hafei Industry Company have been recognised in the consolidated profit and loss account and consolidated cash flow statements up to 30th April 2003.

The financial statements include the historical costs of operations relating to the Transferred Businesses. Expenses that could be specifically identified include the following:

- purchases of goods and services;
- staff costs (excluding those attributable directly to administration staff);
- depreciation (excluding those attributable directly to property, plant and equipment used for general and administrative functions);
- selling and distribution expenses;
- research and development costs;
- taxes other than income taxes; and
- finance costs

Costs for which a specific identification method was not practical include only general and administrative expenses, which are allocated to the Group by AVIC II based on the average of the percentages of the respective historical number of employees, assets and turnover of the Transferred Businesses to the respective historical total number of employees, assets and turnover of AVIC II up to the date of Reorganisation.



## 2 BASIS OF PREPARATION (continued)

The preparation of financial statements in accordance with International Financial Reporting Standards ("IFRS") requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the year. Actual results could differ from these estimates.

The financial statements have been prepared in accordance with IFRS promulgated by the International Accounting Standards Board ("IASB") under the historical cost convention except that non-current investments and trading investments are shown at fair value as disclosed in Note 3(g) of the accounting policies below.

IASB has issued a number of new and revised IFRS which are effective for accounting periods beginning on or after 1st January 2005. The Group has not early adopted these new IFRS in these financial statements for the year ended 31st December 2004. The Group has already commenced an assessment of the impact of these new IFRS but is not yet in a position to state whether these new IFRS would have a significant impact on its results of operations and financial position.

## 3 PRINCIPAL ACCOUNTING POLICIES

### (a) Group accounting

#### (i) Basis of consolidation

The financial statements include the financial statements of the Company, its subsidiaries and associates as set out in Note 43. The results of operations of subsidiaries are included in the consolidated profit and loss account, and the share attributable to minority interests is deducted from the consolidated net profits.

#### (ii) Subsidiaries

Subsidiaries are those entities in which the Group has an interest of more than one half of the voting rights or otherwise has power to exercise control over the operations and are consolidated. Subsidiaries are included from the date on which control is transferred to the Group and are excluded from the date that control ceases. All intercompany transactions, balances and unrealised gains on transactions between group companies are eliminated; unrealised losses, if any, are also eliminated unless cost cannot be recovered. Where necessary, accounting policies for subsidiaries have been changed to ensure consistency with the policies adopted by the Group.

The gain or loss on the disposal of a subsidiary represents the difference between the proceeds of the sale and the Group's share of its net assets together with any unamortised goodwill or negative goodwill or goodwill/negative goodwill taken to reserves and which was not previously charged or recognised in the consolidated profit and loss account and any related accumulated foreign currency translation reserve.



### 3 PRINCIPAL ACCOUNTING POLICIES (continued)

#### (a) Group accounting (continued)

##### (ii) Subsidiaries (continued)

Investments in subsidiaries are accounted for using the equity method in the Company's financial statements. Equity accounting involves recognising in the profit and loss account the Company's share of the subsidiaries' profit or loss for the year. The Company's interests in the subsidiaries are carried in the balance sheet at amounts that reflect its share of the net assets of the subsidiaries.

##### (iii) Associates

Associates are entities, not being subsidiaries, over which the Group generally has between 20% and 50% of the voting rights, or over which the Group has significant influence, but which it does not control.

Investments in associates are accounted for by the equity method of accounting. Equity accounting involves recognising in the consolidated profit and loss account the Group's share of the profit or loss of the associates for the year; and the consolidated balance sheet includes the Group's share of the net assets of the associates. Unrealised gains on transactions between the Group and its associates are eliminated to the extent of the Group's interest in the associates; unrealised losses, if any, are also eliminated unless the transaction provides evidence of an impairment of the asset transferred.

Equity accounting is discontinued when the carrying amount of the investment in an associate reaches zero, unless the Group has incurred obligations or guaranteed obligations in respect of the associate.

#### (b) Property, plant and equipment

Property, plant and equipment are stated at cost less accumulated depreciation and accumulated impairment losses. Cost includes the purchase price of the asset and any directly attributable costs of bringing the asset to its working condition and location for its intended use.

Depreciation is calculated on a straight-line basis to write off the cost less accumulated impairment losses of each asset to their residual values over their estimated useful lives as follows:

Buildings	12 - 45 years
Plant and equipment	5 - 18 years
Furniture and fixtures, other equipment and motor vehicles	4 - 10 years

Expenditure incurred after the property, plant and equipment have been put into operation, such as repairs and maintenance and overhead costs, is normally charged to the consolidated profit and loss account in the period in which it is incurred. In situations where it can be clearly demonstrated that the expenditure has resulted in an increase in the future economic benefits expected to be obtained from the use of the property, plant and equipment, the expenditure is capitalised as an additional cost of the assets.



### 3 PRINCIPAL ACCOUNTING POLICIES (continued)

#### (b) Property, plant and equipment (continued)

Property, plant and equipment are reviewed periodically for impairment losses whenever events or changes in circumstances indicate that the carrying amount may not be recoverable.

Where the carrying amount of an asset is greater than its estimated recoverable amount, it is written down immediately to its recoverable amount. Estimated recoverable amount is determined based on estimated discounted future cash flows of the cash-generating unit at the lowest level to which the asset belongs. The recoverable amount is the higher of value in use or net selling price.

Gains and losses on disposals are determined by comparing proceeds with carrying amount and are included in the consolidated profit and loss account.

#### (c) Construction-in-progress

Construction-in-progress represents buildings, plant and machinery under construction and pending installation and is stated at cost. Cost includes the costs of construction of buildings, the costs of plant and machinery, and interest charges arising from borrowings used to finance these assets during the period of construction or installation and testing. All other borrowing costs are expensed. No provision for depreciation is made on construction-in-progress until such time as the relevant assets are completed and ready for intended use. When the assets concerned are brought into use, the costs are transferred to property, plant and equipment and depreciated in accordance with the policy as stated in Note 3(b) to the financial statements.

#### (d) Land use rights

Land use rights are stated at cost less accumulated amortisation. Cost represents consideration paid for the rights to use the land on which various plants and buildings are situated for periods varying from 30 to 50 years. Amortisation of land use right is calculated on a straight-line basis over the period of the land use right.



### 3 PRINCIPAL ACCOUNTING POLICIES (continued)

#### (e) Intangible assets

##### (i) Research and development

Research expenditure is recognised as an expense as incurred. Costs incurred on development projects (relating to the design and testing of new or improved products) are recognised as intangible assets when it is probable that the project will be a success considering its commercial and technical feasibility and only if the cost can be measured reliably. Other development expenditures are recognised as an expense as incurred. Development costs previously recognised as an expense are not recognised as an asset in a subsequent period. Development costs that have been capitalised are amortised from the commencement of the commercial production of the product on a straight-line basis over the period of its expected benefit. The amortisation periods adopted do not exceed five years.

Where the research phase and the development phase of an internal project cannot be clearly distinguished, all expenditure incurred on the project is charged to the consolidated profit and loss account.

##### (ii) Electricity use rights

Expenditure on acquired electricity use rights is capitalised and amortised using the straight-line method over the period of electricity use rights of 30 years.

#### (f) Impairment of assets

Assets that have an indefinite useful life are not subject to amortisation and are tested annually for impairment. Assets that are subject to amortisation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units).

#### (g) Investments

The Group classified its investments into the following categories: held-to-maturity, available-for-sale and trading.

Investments with a fixed maturity that management has the intent and ability to hold to maturity are classified as held-to-maturity and are included in non-current assets. During the year, the Group did not hold any investment in this category.



## 3 PRINCIPAL ACCOUNTING POLICIES (continued)

### (g) Investments (continued)

Investments intended to be held for an indefinite period of time, which may be sold in response to needs for liquidity or changes in interest rates, are categorised as available-for-sale investments and are classified as non-current investments; these are included in non-current assets unless management has the express intention of holding the investment for less than twelve months from the balance sheet date or unless they will need to be sold to raise operating capital, in which case they are included in current assets. Management determines the appropriate classification of its investments at the time of the purchase and re-evaluates such designation on a regular basis.

Investments that are acquired principally for the purpose of generating a profit from short-term fluctuations in price are classified as trading investments and included in current assets.

All purchases and sales of investments are recognised on the trade date, which is the date that the Group commits to purchase or sell the asset. Cost of purchase includes transaction costs. Trading and non-current investments are subsequently carried at fair value.

Non-current investments where an active market exist, are measured at their fair values. Those that do not have a quoted market price in an active market and whose fair value cannot be reliably measured are measured at amortised cost using the effective interest rate method if they have a fixed maturity, or are measured at cost if they do not have a fixed maturity. Impairment of the investments is assessed at each balance sheet date. Unrealised gains and losses arising from changes in the fair value of non-current investments are recognised in equity. Where non-current investments are sold or impaired, the accumulated fair value adjustments are included in the profit and loss account as gains and losses from investments.

Realised and unrealised gains and losses arising from changes in the fair value of trading investments are included in the consolidated profit and loss account in the period in which they arise.

### (h) Inventories

Inventories are stated at the lower of cost and net realisable value. Cost is determined by the weighted average method. The cost of finished goods and work in progress comprises raw materials, direct labor, other direct costs and related production overheads (based on normal operating capacity) but excludes borrowing costs. Net realisable value is the estimated selling price in the ordinary course of business, less the estimated costs of completion and the estimated costs necessary to make the sale.





### 3 PRINCIPAL ACCOUNTING POLICIES (continued)

#### (i) Contracts in progress

Contracts in progress in connection with the manufacturing of aircraft are accounted for under construction contracts.

When the outcome of a construction contract cannot be estimated reliably, contract revenue is recognised only to the extent of contract costs incurred and that it is probable to be recoverable; and contract costs are recognised when incurred.

When the outcome of a construction contract can be estimated reliably, contract revenue and contract costs are recognised over the period of the contract, respectively, as revenue and expenses. The Group uses the percentage of completion method with reference to stage of completion to determine the appropriate amount of revenue and costs to recognise in a given period. When it is probable that total contract costs will exceed total contract revenue, the expected loss is recognised as an expense immediately.

In determining costs incurred up to the balance sheet date, any costs relating to future activity on a contract are excluded and shown as a contract work in progress. The aggregate of the costs incurred and the profit and loss recognised on each contract is compared against the progress billings up to the balance sheet dates.

Where costs incurred and recognised profits (less recognised losses) exceed progress billings, the balance is shown as due from customers on construction contract under accounts receivable. Where progress billings exceed costs incurred plus recognised profits (less recognised losses), the balance is shown as due to customers on construction contract, under other payables.

#### (j) Accounts receivable

Accounts receivable are carried at original invoice amounts less provision made for impairment of these receivables. Such provision for impairment of accounts receivable is established if there is objective evidence that the Group will not be able to collect all amounts due according to the original term of receivables. The amount of the provision is the difference between the carrying amount and the recoverable amount, being the present value of expected cash flows, discounted at the market rate of interest for similar borrowers.

#### (k) Cash and cash equivalents

Cash and cash equivalents includes cash in hand and deposits held at call with banks.

#### (l) Borrowings

Borrowings are recognised initially at the proceeds received, net of transaction costs incurred. In subsequent periods, borrowings are stated at amortised cost using the effective yield method; any difference between proceeds (net of transaction costs) and the redemption value is recognised in the consolidated profit and loss account over the period of the borrowings.





## 3 PRINCIPAL ACCOUNTING POLICIES (continued)

### (m) Borrowings costs

Interest costs on borrowings to finance the construction of property, plant and equipment are capitalised, during the period of time that is required to complete and prepare the asset for its intended use. All other borrowing costs are expensed as incurred.

### (n) Deferred income tax

Deferred income tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements for financial reporting purposes. The principal temporary differences arise from provision for impairment of receivables and inventories, provision for impairment of property, plant and equipment, provision for tax value of losses carried forward and capitalisation of development costs. Tax rates enacted or substantively enacted by the balance sheet date are used to determine deferred income tax.

Deferred tax assets are recognised to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised.

Deferred income tax is provided on temporary differences arising on investments in subsidiaries and associates, except where the timing of the reversal of the temporary difference can be controlled and it is probable that the temporary difference will not reverse in the foreseeable future.

### (o) Employee benefits

#### (i) Pension obligations

The Group contributes on a monthly basis to various defined contribution retirement benefit plans organised by relevant municipal and provincial governments in the PRC. The municipal and provincial governments undertake to assume the retirement benefit obligations payable to all existing and future retired employees under these plans and the Group has no further obligation for post-retirement benefits beyond the contributions made. Contributions to these plans are expensed as incurred.

#### (ii) Early retirement benefits

Early retirement benefits are recognised as expense in the period the Group reaches agreements with the relevant employees for the early retirement.



### 3 PRINCIPAL ACCOUNTING POLICIES (continued)

#### (o) Employee benefits (continued)

##### (iii) Housing benefits

The Group sold staff quarters to its employees, subject to a number of eligibility requirements, at preferential prices. When staff quarters are identified as being subject to sale under these arrangements, the carrying value of the staff quarters is written down to the net recoverable amount. Upon sale, any difference between sales proceeds and the carrying amount of the staff quarters is charged to the consolidated profit and loss account.

The above discounted quarters allocation plans were phased out in accordance with the policies of the PRC government. In 1998, the State Council of the PRC issued a circular which stipulated that the sale of quarters to employees at preferential prices should be withdrawn. In 2000, the State Council further issued a circular stating that cash subsidies should be made to the employees following the withdrawal of allocation of staff quarters. However, the specific timetable and procedures of implementation of these policies are to be determined by individual provincial or municipal government based on the particular situation of the province or municipality.

Based on the relevant detailed local government regulations promulgated, certain entities within the Group have adopted cash housing subsidy plans. In accordance with these plans, for those eligible employees who have not been allocated with quarters at all or who have not been allocated with quarters up to the prescribed standards before the discounted quarters sale plans were terminated, the Group is required to pay them one-off cash housing subsidies based on their years of service, positions and other criteria. These cash housing subsidies are charged to the consolidated profit and loss account in the year in which it was determined that the payment of such subsidies is probable and the amounts can be reasonably estimated. Based on the available information and its best estimate, the Group estimated the required provision for these cash housing subsidies which was charged to the consolidated profit and loss account in the year ended 31st December 2000 when the State Council circular in respect of cash subsidies was issued.

Pursuant to the Reorganisation, AVIC II would bear any further one-off cash housing subsidies in excess of the amount provided for in the consolidated balance sheets of the Group. Employees joining the Group after the incorporation of the Company would not be entitled to any one-off cash housing subsidies.

In addition, all full-time employees of the Group are entitled to participate in various government-sponsored housing funds. The Group contributes on a monthly basis to these funds based on certain percentages of the salaries of the employees. The Group's liability in respect of these funds is limited to the contributions payable in each period.



## 3 PRINCIPAL ACCOUNTING POLICIES (continued)

### (p) Provisions

Provisions are recognised when the Group has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources will be required to settle the obligation, and a reliable estimate of the amount can be made. Where the Group expects a provision to be reimbursed, the reimbursement is recognised as a separate asset but only when the reimbursement is virtually certain.

The costs of the warranty obligation are accrued at the time the sales are recognised, based on the estimated costs of fulfilling the total obligations, including handling and transportation costs. The assumptions used to estimate warranty expenses are evaluated periodically and based on historical experience.

### (q) Operating leases

Leases where a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments made under operating leases are charged to the consolidated profit and loss account on a straight-line basis over the period of the lease.

Assets leased out under operating leases are included in property, plant and equipment in the consolidated balance sheet. They are depreciated over their expected useful lives on a basis consistent with similar owned property, plant and equipment. Rental income is recognised on a straight-line basis over the lease term.

### (r) Foreign currency translation

The Group maintains its books and records in Renminbi ("RMB"). Transactions in other currencies are translated into RMB at the applicable rates of exchange stipulated by the People's Bank of China ("PBOC") prevailing at the dates of the transactions. Monetary assets and liabilities denominated in other currencies are translated into RMB at the applicable PBOC rates prevailing at the balance sheet date. Gains and losses resulting from the settlement of such transactions and from the translation of monetary assets and liabilities denominated in foreign currencies are recognised in the consolidated profit and loss account.

### (s) Contingent liabilities

A contingent liability is a possible obligation that arises from past events and whose existence will only be confirmed by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the Group. It can also be a present obligation arising from past events that is not recognised because it is not probable that outflow of economic resources will be required or the amount of obligation cannot be measured reliably.

A contingent liability is not recognised but is disclosed in the notes to the financial statements, if any. When a change in the probability of an outflow occurs so that outflow is probable, it will then be recognised as a provision.



### 3 PRINCIPAL ACCOUNTING POLICIES (continued)

#### (t) Revenue recognition

Turnover represents revenues recognised on sales of automobiles and aviation products, net of VAT, if any.

Sales are recognised upon delivery of products and customer acceptance, if any, or on the performance of services. Sales are shown net of sales taxes and discounts, and after eliminating sales within the Group. Revenues are recognised only when the Group has transferred to the customers the significant risks and rewards of ownership of the goods, and when the amount of revenue and the costs incurred or to be incurred in respect of the transaction can be measured reliably.

Recognition policy of revenue relating to long-term construction contracts is disclosed in Note 3(j) above.

Dividend income and income from investments are recognised when the right to receive payment is established.

Revenue from the provision of technical consultancy services is recognised when the services are rendered.

Rental income under operating leases is recognised on a straight-line basis over the lease periods.

Interest income from bank deposits is recognised on a time proportion basis, taking into account the principal amounts outstanding and the interest rates applicable.

#### (u) Government grants

Grants from the government are recognised at their fair value where there is a reasonable assurance that the grant will be received and the Group will comply with all attached conditions.

Government grants relating to costs are deferred and recognised in the consolidated profit and loss account over the period necessary to match them with the costs they are intended to compensate.

Government grants related to the purchase of property, plant and equipment are included in non-current liabilities as deferred income from government grants and are credited to the consolidated profit and loss account on a straight line basis over the expected lives of the related assets.

#### (v) Financial instruments

Financial instruments carried on the consolidated balance sheet include cash and bank balances, deposits in approved financial institutions, investments, accounts receivable and other receivables, trade payables, borrowings and other payables. The accounting policies on recognition and measurement of these items are disclosed in the respective accounting policies.

Disclosures about financial instruments of the Group are provided in Note 40 to the financial statements.



### 3 PRINCIPAL ACCOUNTING POLICIES (continued)

#### (w) Dividends/Profit distributions

Dividends/profit distributions proposed or declared after the balance sheet date are disclosed as a post balance sheet event and are not recognised as a liability at the balance sheet date.

#### (x) Segment reporting

A segment is a distinguishable component of the Group that is engaged either in providing products or services (business segment), or in providing products or services with a particular economic environment (geographical segment), which is subject to risks and rewards that are different from those of other segments.

Operating expenses of a functional unit are allocated to the relevant segment which is the predominant user of the services provided by the unit. Operating expenses of other shared services which cannot be allocated to a specific segment are included as unallocated costs. Unallocated costs mainly represent corporate expenses.

Segment assets consist primarily of property, plant and equipment, land use rights, intangible assets, inventories, operating receivables and cash and cash equivalents, and mainly exclude deferred tax assets, investments in associates and corporate assets. Segment liabilities comprise operating liabilities and exclude items such as employee benefits, current and deferred tax liabilities, and corporate liabilities. Capital expenditures mainly comprise additions to property, plant and equipment, land use rights and intangible assets.

#### (y) Related parties

Related parties are those parties which have the ability, directly or indirectly, to control the other party or exercise significant influence over the other party in making financial and operating decisions. Parties are also considered to be related if they are subject to common control or common significant influence.

The Group is a large group of companies under AVIC II and has significant transactions and relationships with other entities under AVIC II. Because of these relationships, it is possible that the terms of these transactions are not the same as those that would result from transactions among wholly unrelated parties.

AVIC II itself is owned by the PRC Government. There are also other enterprises directly or indirectly owned or controlled by the PRC Government ("state-owned enterprises"). As the Group will carry out its business activities in the ordinary course of business in the PRC with the PRC Government or state-owned enterprises both directly through their numerous authorities and indirectly through their numerous affiliates and other organisations, the Group considers that these sales are activities in the ordinary course of business in the PRC. Accordingly, transactions with the PRC Government or state-owned enterprises whose relationship with the Group were merely by virtue of common control or significant influence by the PRC Government are not disclosed as related party transactions.



## 4 SEGMENT INFORMATION

The Group is principally engaged in the manufacturing, assembly, sales and servicing of automobiles and civilian aircraft.

### Primary reporting format – business segments

The Group is organised into two main business segments:

- Automobiles – manufacturing, assembly, sales and servicing of automobiles.
- Aviation – manufacturing, assembly, sales and servicing of helicopters, trainers and aircraft.

### Secondary reporting format – geographical segments

All assets and operations of the Group for the year were located in the PRC, which is considered as one geographical location in an economic environment with similar risk and returns.

No geographical segments analysis is presented as less than 10% of the Group's turnover and contribution to operating profit is attributable to markets outside the PRC.





# Notes to the Financial Statements

## 4 SEGMENT INFORMATION (continued)

### Primary reporting format — business segments

	2004		
	Aviation RMB'000	Automobiles RMB'000	Total RMB'000
<b>Operating results</b>			
Turnover	2,608,152	10,269,300	12,877,452
Segment results	271,646	160,343	431,989
Other unallocated revenues			9,724
Unallocated costs			(54,716)
Operating profit			386,997
Finance costs, net			(170,804)
Share of results of associates before taxation	15,683	(1,496)	14,187
Profit before taxation			230,380
Taxation			(92,514)
			137,866
Minority interests			(66,427)
Profit for the year			71,439
<b>Assets</b>			
Segment assets	5,109,652	12,618,794	17,728,446
Investments in associates	116,133	108,059	224,192
Unallocated assets			1,863,324
Total assets			19,815,962
<b>Liabilities</b>			
Segment liabilities	1,495,482	9,602,574	11,098,056
Unallocated liabilities			680,167
Total liabilities			11,778,223
<b>Other segment items</b>			
Capital expenditure	190,836	1,463,367	1,654,203
Depreciation	84,473	613,557	698,030
Amortisation	165	88,749	88,914
Other non-cash expenses	9,925	65,452	75,377





#### 4 SEGMENT INFORMATION (continued)

##### Primary reporting format — business segments (continued)

	2003		Total RMB'000
	Aviation RMB'000	Automobiles RMB'000	
<b>Operating results</b>			
Turnover	2,585,125	12,480,817	15,065,942
Segment results	287,349	656,928	944,277
Other unallocated revenues			18,935
Other operating income			31,901
Unallocated costs			(6,697)
Operating profit			988,416
Finance costs, net			(209,873)
Share of results of associates before taxation	(6,888)	(6,923)	(13,811)
Profit before taxation			764,732
Taxation			(60,830)
			703,902
Minority interests			(251,828)
Profit for the year			452,074
<b>Assets</b>			
Segment assets	4,428,125	14,019,552	18,447,677
Investments in associates	78,878	87,181	166,059
Unallocated assets			2,187,501
Total assets			20,801,237
<b>Liabilities</b>			
Segment liabilities	1,882,351	9,924,907	11,807,258
Unallocated liabilities			974,813
Total liabilities			12,782,071
<b>Other segment items</b>			
Capital expenditure	283,951	1,390,689	1,674,640
Depreciation	93,563	569,032	662,595
Amortisation	176	38,448	38,624
Other non-cash expenses	34,618	80,974	115,592



## Notes to the Financial Statements

### 5 OTHER REVENUES

	<b>2004</b>	2003
	<b>RMB'000</b>	RMB'000
Sales of scrap materials	<b>19,542</b>	19,173
Income from investments and designated deposits	<b>9,724</b>	18,935
Amortisation of government grants	<b>15,046</b>	15,046
Discretionary value-added tax and real estate tax refund (note)	<b>9,279</b>	14,287
Technical consultancy services	<b>—</b>	14,266
Rental income from plant and equipment	<b>3,041</b>	3,770
	<hr/> <b>56,632</b> <hr/>	<hr/> 85,477 <hr/>

Note:

Pursuant to relevant tax laws and regulations, certain subsidiaries of the Group are entitled to refunds of certain real estate tax and value-added tax for sales of aircraft.



## 6 OPERATING PROFIT

Operating profit is stated after charging/(crediting) the following:

	2004 RMB'000	2003 RMB'000
Auditors' remuneration	6,816	5,615
Amortisation of land use rights (included in "Administrative expenses") (Note 15)	4,295	4,307
Amortisation of intangible assets (Note 16)		
— development costs (included in "Administrative expenses")	83,360	33,058
— electricity use rights (included in "Administrative expenses")	1,259	1,259
Costs of inventories recognised as expenses included in cost of sales (note)	10,947,908	12,414,260
Depreciation on property, plant and equipment (Note 14)	698,030	662,595
Fair value losses on trading investments	11,582	—
Loss on disposal of property, plant and equipment	2,052	7,920
Loss on sales of trading investments	3,066	—
Operating lease rentals in respect of		
— land and buildings	50,642	57,035
— plant and machinery	23	1,967
Provision for impairment of a non-current investment (Note 19)	25,000	—
Provision for impairment of receivables	45,959	75,920
Repairs and maintenance expense on property, plant and equipment	8,964	15,140
Research and development expense	168,081	63,225
Staff costs (including directors' emoluments) (Note 13)	873,941	903,410
Warranty expense (Note 32)	26,498	104,527
Write-down of inventories to net realisable value	29,418	39,672
Gain on disposal of subsidiaries	—	(31,901)
	<u>                    </u>	<u>                    </u>

Note:

Costs of inventories recognised as expenses include purchases, direct employee compensation costs and the relevant depreciation.



## Notes to the Financial Statements

### 7 FINANCE COSTS, NET

	2004 RMB'000	2003 RMB'000
Interest expense on bank loans		
— wholly repayable within 5 years	<b>242,282</b>	245,961
Interest expense on other loans		
— wholly repayable within 5 years	<b>669</b>	782
— not wholly repayable within 5 years	<b>121</b>	121
Less: amount capitalised in property, plant and equipment (note (a))	<b>(34,697)</b>	(33,477)
Less: government interest subsidies (note (b))	<b>(4,849)</b>	(23,618)
	<b>203,526</b>	189,769
Interest income on bank balances and deposits	<b>(65,701)</b>	(41,382)
Exchange losses, net	<b>29,714</b>	54,722
Bank charges	<b>3,265</b>	6,764
	<b>170,804</b>	209,873

Note:

- (a) Amounts capitalised are borrowing costs related to funds borrowed specifically for the purpose of obtaining a qualifying asset. Interest rates on such capitalised borrowings are as follows:

	2004	2003
Interest rates per annum at which finance costs were capitalised	<b>4.00% to 6.63%</b>	3.69% to 6.63%

- (b) Interest subsidies have been granted by local governments to certain subsidiaries of the Group as an encouragement to technical innovation and improvements.



## 8 TAXATION

	2004 RMB'000	2003 RMB'000
PRC current income tax	37,988	64,761
Deferred income tax	48,354	(4,735)
Share of tax of associates	6,172	804
	<u>92,514</u>	<u>60,830</u>

The provision for PRC current income tax is calculated based on the statutory income tax rate of 33% of the assessable income of the Group as determined in accordance with the relevant PRC income tax rules and regulations for the year (2003: 33%), except for certain subsidiaries and associates which are taxed at preferential rates ranging from 0% to 30% (2003: 0% to 30%) based on the relevant PRC tax rules and regulations.

- (a) The reconciliation between the Group's actual tax charge and the amount which is calculated based on the statutory tax rate of 33% in the PRC is as follows:

	2004 RMB'000	2003 RMB'000
Profit before taxation	<u>230,380</u>	<u>764,732</u>
Tax calculated at the statutory tax rate of 33% (2003: 33%)	76,025	252,362
Preferential tax rates on the income of certain subsidiaries and associates	(64,393)	(101,624)
Non-taxable income	(29,562)	(123,883)
Expenses not deductible for tax purposes	37,568	12,852
Tax losses for which no deferred income tax asset was recognised (note)	82,852	40,741
Utilisation of previously unrecognised tax losses	(8,758)	(18,652)
Others	(1,218)	(966)
Tax charge	<u>92,514</u>	<u>60,830</u>

Note:

Tax losses for which no deferred income tax asset was recognised are expiring within 5 years.



## 9 PROFIT ATTRIBUTABLE TO SHAREHOLDERS

The profit attributable to shareholders is dealt with in the accounts of the Company to the extent of RMB71,439,000 (2003: RMB354,535,000).

## 10 DIVIDENDS/PROFIT DISTRIBUTIONS

	<b>2004</b>	2003
	<b>RMB'000</b>	RMB'000
Profit distributions (note (i))	—	67,697
Special dividend (note (ii))	—	7,125
Final dividend, proposed, of RMB Nil (2003: RMB0.0105) per share (note (iii))	—	48,758
	<hr/>	<hr/>
	—	123,580
	<hr/> <hr/>	<hr/> <hr/>

Note:

- (i) The profit distributions disclosed for the year ended 31st December 2003 represent profit distributions and dividends declared by the relevant subsidiaries of the Group to their then owners or shareholders prior to the completion of the Reorganisation of the Group, after setting aside a required percentage of their net profits to the relevant statutory reserves in accordance with the rules and regulations applicable in the PRC and the Articles of Association of the relevant subsidiaries.

The rates of dividend and the number of shares ranking for dividends are not presented for those profit distributions as such information is not meaningful.

- (ii) Pursuant to the Reorganisation, the Company agreed to distribute a special dividend to AVIC II immediately after its establishment, which represents the undistributed profit of the Group for the period from 1st July 2002 to 30th April 2003, as determined in accordance with the PRC GAAP, amounting to approximately RMB7,125,000 (see also Note 36(c)).
- (iii) For the year ended 31st December 2004, the directors do not recommend the payment of a final dividend (2003: RMB0.0105 per share).



## 11 DIRECTORS', SUPERVISORS' AND SENIOR MANAGEMENT'S EMOLUMENTS

### (a) Directors' emoluments

Details of emoluments paid and payable to the directors of the Company during the year are as follows:

	2004 RMB'000	2003 RMB'000
Fees to independent non-executive directors	217	91
Other emoluments		
Basic salaries, housing allowances, other allowances and benefits in kind	1,180	1,380
Contributions to retirement schemes	—	42
	<u>1,397</u>	<u>1,513</u>

No director of the Company waived any emoluments during the years ended 31st December 2003 and 2004.

The emoluments of the directors are within the following band:

	Number of directors	
	2004	2003
Nil – RMB1,060,000 (equivalent to Hong Kong Dollar 1,000,000)	<u>14</u>	<u>13</u>

### (b) Supervisors' emoluments

	2004 RMB'000	2003 RMB'000
Basic salaries, housing allowances, other allowances and benefits in kind	740	731
Contributions to retirement schemes	—	21
	<u>740</u>	<u>752</u>

The emoluments of the supervisors are within the following band:

	Number of supervisors	
	2004	2003
Nil – RMB1,060,000 (equivalent to Hong Kong Dollar 1,000,000)	<u>9</u>	<u>9</u>





## 11 DIRECTORS', SUPERVISORS' AND SENIOR MANAGEMENT'S EMOLUMENTS (continued)

### (c) Five highest paid individuals

The five individuals whose emoluments were the highest in the Group for the year are as follows:

	Number of individuals	
	2004	2003
In the capacity as:		
Directors	2	2
Supervisor	1	1
Senior management	2	2
	<u>5</u>	<u>5</u>

The five individuals whose emoluments were highest in the Group for the year included two (2003: two) directors and one supervisor (2003: one) whose emoluments are reflected in the analyses presented above. The emoluments payable to the remaining two (2003: two) individuals during the year are as follows:

	2004	2003
	RMB'000	RMB'000
Basic salaries, housing allowances, other allowances and benefits in kind	395	303
Contributions to retirement schemes	—	8
	<u>395</u>	<u>311</u>

The emoluments fell within the following band:

	Number of individuals	
	2004	2003
Nil – RMB1,060,000 (equivalent to Hong Kong Dollar 1,000,000)	<u>2</u>	<u>2</u>

(d) During the year, no emoluments have been paid by the Group to the directors or any of the five highest paid individuals as an inducement to join or upon joining the Group or as compensation for loss of office.



## 12 EARNINGS PER SHARE

The calculation of basic earnings per share is based on the Group's profit attributable to shareholders of RMB71,439,000 (2003: RMB 452,074,000) and based on the weighted average number of 4,643,608,500 (2003: 3,377,707,623) shares in issue during the year.

There was no dilution effect on the basic earnings per share for the years ended 31st December 2003 and 2004 as there were no dilutive shares outstanding during the years ended 31st December 2003 and 2004.

## 13 STAFF COSTS (INCLUDING DIRECTORS' EMOLUMENTS)

	Notes	2004 RMB'000	2003 RMB'000
Wages, salaries and bonuses		636,550	665,705
Housing benefits	(a)	44,025	38,731
Contributions to pension plans	(b)	107,487	123,142
Welfare and other expenses		85,879	75,832
		<b>873,941</b>	<b>903,410</b>

(a) These mainly include the Group's contributions to government sponsored housing funds for employees at rates ranging from 5% to 30% (2003: 5% to 30%) of the employees' basic salary during the year (See also Note 3(o)(iii)).

(b) The employees of the Group participate in various pension plans organised by the relevant municipal and provincial governments under which the Group is required to make monthly defined contributions to these plans at rates ranging from 20% to 22% (2003: 20% to 22%), dependent upon the applicable local regulations, of the employees' basic salary.

The Group has no other obligations for the payment of pension and other post-retirement benefits of employees or retirees other than the payments mentioned above. As at 31st December 2004, the Group had approximately employees 32,122. (2003: 33,293).



14 PROPERTY, PLANT AND EQUIPMENT

Group

(a) Movement

	Construction in progress RMB'000	Buildings RMB'000	Plant and equipment RMB'000	Furniture and fixtures, other equipment and motor vehicles RMB'000	Total RMB'000
Cost					
As at 1st January 2004	1,073,501	1,479,472	6,180,724	442,146	9,175,843
Additions	1,340,311	13,519	115,476	46,404	1,515,710
Transfer upon completion	(790,144)	194,266	565,481	30,397	—
Disposals	—	(12,395)	(127,351)	(42,707)	(182,453)
As at 31st December 2004	<u>1,623,668</u>	<u>1,674,862</u>	<u>6,734,330</u>	<u>476,240</u>	<u>10,509,100</u>
Accumulated depreciation and impairment					
As at 1st January 2004	—	415,287	1,906,884	209,241	2,531,412
Charge for the year	—	73,786	567,247	56,997	698,030
Disposals	—	(4,441)	(79,265)	(23,273)	(106,979)
As at 31st December 2004	<u>—</u>	<u>484,632</u>	<u>2,394,866</u>	<u>242,965</u>	<u>3,122,463</u>
Net book value					
As at 31st December 2004	<u>1,623,668</u>	<u>1,190,230</u>	<u>4,339,464</u>	<u>233,275</u>	<u>7,386,637</u>



## 14 PROPERTY, PLANT AND EQUIPMENT (continued)

Group (continued)

(a) Movement (continued)

	<b>Construction in progress</b>	<b>Buildings</b>	<b>Plant and equipment</b>	<b>Furniture and fixtures, other equipment and motor vehicles</b>	<b>Total</b>
	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000
Cost					
As at 1st January 2003	1,092,897	1,536,725	5,270,969	390,009	8,290,600
Additions	1,178,721	33,098	152,618	52,723	1,417,160
Transfer upon completion	(1,099,597)	106,096	943,157	50,344	—
Disposal of subsidiaries	(98,520)	(69,365)	(109,351)	(6,240)	(283,476)
Disposals	—	(127,082)	(76,669)	(44,690)	(248,441)
As at 31st December 2003	<u>1,073,501</u>	<u>1,479,472</u>	<u>6,180,724</u>	<u>442,146</u>	<u>9,175,843</u>
Accumulated depreciation and impairment					
As at 1st January 2003	252	416,230	1,469,623	187,083	2,073,188
Charge for the year	—	92,458	516,182	53,955	662,595
Transfer upon completion	(252)	—	252	—	—
Disposal of subsidiaries	—	(34,940)	(16,189)	(3,105)	(54,234)
Disposals	—	(58,461)	(62,984)	(28,692)	(150,137)
As at 31st December 2003	<u>—</u>	<u>415,287</u>	<u>1,906,884</u>	<u>209,241</u>	<u>2,531,412</u>
Net book value					
As at 31st December 2003	<u>1,073,501</u>	<u>1,064,185</u>	<u>4,273,840</u>	<u>232,905</u>	<u>6,644,431</u>

- (b) Certain of the Group's property, plant and equipment with carrying value of approximately RMB870,469,000 at 31st December 2004 (2003: RMB740,617,000) were situated on leasehold land in the PRC which are granted by AVIC II for the Group's use at no cost or have been leased from certain fellow subsidiaries under long-term leases. The remaining period of the Group's rights on those leasehold land at 31st December 2004 range from 18 to 45 years (2003: 19 to 46 years).



## Notes to the Financial Statements

### 14 PROPERTY, PLANT AND EQUIPMENT (continued)

Group (continued)

(c) Property, plant and equipment pledged as securities for bank loans were as follows:

	<b>2004</b>	2003
	<b>RMB'000</b>	RMB'000
Net book value of property, plant and equipment pledged (Note 33(d))	<b>423,926</b>	401,246
Company		
	<b>Plant and equipment</b>	<b>Furniture and fixtures, other equipment and motor vehicles</b>
	<b>RMB'000</b>	<b>RMB'000</b>
		<b>Total</b>
		<b>RMB'000</b>
Cost		
As at 1st January 2004	6,637	7,546
Additions	—	315
As at 31st December 2004	<u>6,637</u>	<u>7,861</u>
Accumulated depreciation and impairment		
As at 1st January 2004	2,557	1,935
Charge for the year	333	427
As at 31st December 2004	<u>2,890</u>	<u>2,362</u>
Net book value		
As at 31st December 2004	<u><u>3,747</u></u>	<u><u>5,499</u></u>



## 14 PROPERTY, PLANT AND EQUIPMENT (continued)

Company (continued)

	<b>Plant and equipment</b>	<b>Furniture and fixtures, other equipment and motor vehicles</b>	<b>Total</b>
	RMB'000	RMB'000	RMB'000
Cost			
Transferred from AVIC II upon establishment	6,550	7,546	14,096
Additions	87	—	87
As at 31st December 2003	<u>6,637</u>	<u>7,546</u>	<u>14,183</u>
Accumulated depreciation and impairment			
Transferred from AVIC II upon establishment	2,224	1,558	3,782
Charge for the year	333	377	710
As at 31st December 2003	<u>2,557</u>	<u>1,935</u>	<u>4,492</u>
Net book value			
As at 31st December 2003	<u><u>4,080</u></u>	<u><u>5,611</u></u>	<u><u>9,691</u></u>



## 15 LAND USE RIGHTS

	Group	
	2004	2003
	RMB'000	RMB'000
Cost		
At 1st January	107,857	107,857
Additions	3,609	—
At 31st December	<u>111,466</u>	<u>107,857</u>
Accumulated amortisation		
At 1st January	16,773	12,466
Amortisation for the year	4,295	4,307
At 31st December	<u>21,068</u>	<u>16,773</u>
Net book amount		
At 31st December	<u><u>90,398</u></u>	<u><u>91,084</u></u>





## 16 INTANGIBLE ASSETS

	Development costs RMB'000	Group Electricity use rights RMB'000	Total RMB'000
Cost			
As at 1st January 2004	553,940	37,760	591,700
Additions	134,884	—	134,884
As at 31st December 2004	<u>688,824</u>	<u>37,760</u>	<u>726,584</u>
Accumulated amortisation and impairment			
As at 1st January 2004	68,663	6,256	74,919
Amortisation for the year	83,360	1,259	84,619
As at 31st December 2004	<u>152,023</u>	<u>7,515</u>	<u>159,538</u>
Net book amount			
As at 31st December 2004	<u>536,801</u>	<u>30,245</u>	<u>567,046</u>
Cost			
As at 1st January 2003	296,460	37,760	334,220
Additions	257,480	—	257,480
As at 31st December 2003	<u>553,940</u>	<u>37,760</u>	<u>591,700</u>
Accumulated amortisation and impairment			
As at 1st January 2003	35,605	4,997	40,602
Amortisation for the year	33,058	1,259	34,317
As at 31st December 2003	<u>68,663</u>	<u>6,256</u>	<u>74,919</u>
Net book amount			
As at 31st December 2003	<u>485,277</u>	<u>31,504</u>	<u>516,781</u>



## 17 INTERESTS IN SUBSIDIARIES

	Company	
	2004 RMB'000	2003 RMB'000
Investments, at cost		
Shares listed in the PRC	1,044,117	1,044,117
Unlisted equity investments	2,411,254	2,411,254
	<b>3,455,371</b>	3,455,371
Share of undistributed post-acquisition profits, net	367,827	362,259
Reserve arising from the issuance of additional shares by a subsidiary	76,971	76,971
	<b>3,900,169</b>	3,894,601
Amounts due from subsidiaries (note)	662,313	—
	<b>4,562,482</b>	3,894,601
Market value of listed shares	1,235,778	1,953,953

Particulars of the principal subsidiaries of the Group are set out in Note 43.

Note:

Amounts due from subsidiaries are unsecured, non-interest bearing and are not repayable in the next twelve months.

## 18 INVESTMENTS IN ASSOCIATES

	Group	
	2004 RMB'000	2003 RMB'000
Share of net assets, unlisted	224,192	166,059

Particulars of the principal associates of the Group are set out in Note 43.



## 19 NON-CURRENT INVESTMENTS

	Group	
	2004	2003
	RMB'000	RMB'000
Investments in shares of companies listed outside Hong Kong, at cost	<b>73,221</b>	73,221
Unlisted investments, at cost	<b>76,641</b>	59,647
Less: Provision for impairment	<b>(25,000)</b>	—
	<b>51,641</b>	59,647
	<b>124,862</b>	132,868

The Group's non-current investments represent investments in promoters' shares of certain companies listed in the PRC, which are transferable subject to approval from relevant local authorities, and interests in certain unlisted companies, which do not have a quoted market price in an active market and for which other methods of reasonably estimating fair value are clearly unworkable. Accordingly, these investments are carried at cost less accumulated impairment losses.

## 20 DEFERRED INCOME TAXES

Deferred income taxes are calculated in respect of temporary differences under the liability method using the tax rates enacted or substantively enacted by the balance sheet date.

The movement on the deferred income tax accounts is as follows:

Deferred tax assets:

	Group	
	2004	2003
	RMB'000	RMB'000
At 1st January	<b>99,918</b>	68,927
(Charged)/credited to consolidated profit and loss account	<b>(61,205)</b>	30,991
At 31st December	<b>38,713</b>	99,918



# Notes to the Financial Statements

## 20 DEFERRED INCOME TAXES (continued)

Deferred tax liabilities:

	Group	
	2004	2003
	RMB'000	RMB'000
At 1st January	63,961	37,705
(Credited)/charged to consolidated profit and loss account	(12,851)	26,256
At 31st December	<u>51,110</u>	<u>63,961</u>

The deferred income taxes are provided, prior to offsetting of balances within the same tax jurisdiction, in respect of:

	Group	
	2004	2003
	RMB'000	RMB'000
Deferred tax assets:		
Provision for impairment of receivables	49,638	47,534
Provision for impairment of inventories	16,719	14,666
Provision for impairment of investments	1,737	2,231
Provision for impairment of property, plant and equipment	3,556	6,143
Provision for warranty expense	7,734	5,888
Tax value of unused tax losses/tax credits carried forward	—	26,410
Other temporary differences	8,912	5,437
	<u>88,296</u>	<u>108,309</u>
Deferred tax liabilities:		
Interest income	1,483	1,317
Development costs	99,210	69,153
Other temporary differences	—	1,882
	<u>100,693</u>	<u>72,352</u>
Total deferred tax assets less total deferred tax liabilities	<u>(12,397)</u>	<u>35,957</u>



## 20 DEFERRED INCOME TAXES (continued)

Deferred income tax assets and liabilities are offset when there is a legally enforceable right to set off current tax assets against current tax liabilities and when the deferred income taxes related to the same fiscal authority. The following amounts, determined after appropriate offsetting, are shown in the consolidated balance sheet:

	Group	
	2004	2003
	RMB'000	RMB'000
Representing:		
Deferred tax assets	38,713	99,918
Deferred tax liabilities	(51,110)	(63,961)
	<hr/>	<hr/>
Total deferred tax assets less total deferred tax liabilities	<b>(12,397)</b>	35,957
	<hr/> <hr/>	<hr/> <hr/>

As at 31st December 2004, deferred tax assets in respect of tax losses of certain subsidiaries and associates amounting to RMB82,852,000 (2003: RMB40,741,000) have not been recognised as it is uncertain that these subsidiaries and associates have sufficient future taxable profits to utilise these tax losses before their expiries.





## 21 ACCOUNTS RECEIVABLE

	Group	
	2004	2003
	RMB'000	RMB'000
Trade receivables, net (note (a))	457,206	332,077
Notes receivable (note (b))	582,457	1,579,706
Due from related parties (note (c))	856,833	894,499
	<u>1,896,496</u>	<u>2,806,282</u>

(a) Trade receivables, net

	Group	
	2004	2003
	RMB'000	RMB'000
Gross trade receivables	651,113	477,309
Less: provision for impairment of receivables	(193,907)	(145,232)
	<u>457,206</u>	<u>332,077</u>

No specific credit period is granted by the Group to its customers. Certain of the Group's sales were on advance payment or documents against payment, and sales to small, new or short-term customers are normally expected to be settled shortly after delivery. A credit period, which may be extended for up to six months, may be granted, subject to negotiation, in respect of sales to large or long-established customers. Ageing analysis of trade receivables is as follows:

	Group	
	2004	2003
	RMB'000	RMB'000
Current to 6 months	286,760	162,802
6 months to 1 year	161,762	124,788
1 year to 2 years	22,510	30,803
2 years to 3 years	29,380	73,363
Over 3 years	150,701	85,553
	<u>651,113</u>	<u>477,309</u>

(b) Notes receivable are bills of exchange with average maturity period of within six months.



## 21 ACCOUNTS RECEIVABLE (continued)

### (c) Due from related parties

The amounts due from related parties, which are trade in nature, can be analysed as follows:

	Group	
	2004	2003
	RMB'000	RMB'000
Trade receivables		
— Fellow subsidiaries (note (i))	545,568	776,566
— Other related parties (note (i))	210,380	97,279
	<u>755,948</u>	<u>873,845</u>
Less: provision for impairment of receivables	(46,065)	(41,922)
	<u>709,883</u>	831,923
Notes receivable		
— Fellow subsidiaries (note (ii))	146,950	62,576
	<u>856,833</u>	<u>894,499</u>

Trade and notes receivable from related parties are unsecured and non-interest bearing. The credit period granted to related parties are similar to that of the period granted by the Group to its third-party customers.

Note:

(i) The ageing of the amounts due from related parties, which are trade in nature, is summarised as follows:

	Group	
	2004	2003
	RMB'000	RMB'000
Current to 1 year	679,992	762,766
1 year to 2 years	52,340	85,495
2 years to 3 years	428	1,846
Over 3 years	23,188	23,738
	<u>755,948</u>	<u>873,845</u>

(ii) Notes receivable are bills of exchange with average maturity period of within six months.



## 22 OTHER RECEIVABLES, PREPAYMENTS AND OTHER CURRENT ASSETS

	Group		Company	
	2004 RMB'000	2003 RMB'000	2004 RMB'000	2003 RMB'000
Advances to suppliers	332,636	257,122	—	—
Advances for purchase of property, plant and equipment	31,523	22,223	—	—
Due from related parties (note)	538,519	525,489	40,946	—
Other receivables	25,892	177,148	—	—
Prepayments and deposits	96,711	69,657	—	—
Value-added tax recoverable	32,539	—	—	—
Other current assets	25,880	9,302	—	—
	<b>1,083,700</b>	<b>1,060,941</b>	<b>40,946</b>	<b>—</b>

Notes:

The amounts due from related parties can be analysed as follows:

	Group		Company	
	2004 RMB'000	2003 RMB'000	2004 RMB'000	2003 RMB'000
Holding company:				
— Other temporary advances (note (iv))	95,156	—	40,946	—
Fellow subsidiaries:				
— Advances for purchase of goods and raw materials (note (ii))	288,454	340,181	—	—
— Loan to a fellow subsidiary (note (iii))	—	60,000	—	—
— Other temporary advances (note (iv))	36,688	13,803	—	—
	<b>325,142</b>	<b>413,984</b>	<b>—</b>	<b>—</b>
Other related parties:				
— Advances for purchase of goods and raw materials (note (ii))	118,221	111,505	—	—
	<b>538,519</b>	<b>525,489</b>	<b>40,946</b>	<b>—</b>

(i) Amounts due from related parties are unsecured and non-interest bearing.

(ii) Advances for purchase of goods and raw materials are recurrent in nature and have no fixed terms of repayment.

(iii) The loan to a fellow subsidiary was repaid during 2004.

(iv) Other temporary advances mainly represent current account balances with the respective companies and will be fully settled in 2005.





## 23 INVENTORIES

	Group	
	2004	2003
	RMB'000	RMB'000
Raw materials	1,639,809	1,627,577
Work in progress	506,714	658,055
Finished goods	1,615,955	1,496,206
Consumables	104,892	98,991
	<hr/>	<hr/>
	3,867,370	3,880,829
Less: provision for impairment losses	(86,907)	(71,999)
	<hr/>	<hr/>
	<b>3,780,463</b>	<b>3,808,830</b>
	<hr/> <hr/>	<hr/> <hr/>

As at 31st December 2004, inventories stated at net realisable value amounted to approximately RMB212,463,936 (2003: RMB67,749,000).

## 24 CONTRACTS IN PROGRESS

	Group	
	2004	2003
	RMB'000	RMB'000
At 1st January	21,994	88,812
Contract costs incurred in the year	1,073,401	719,290
Contract expenses recognised in the year	(926,286)	(786,108)
	<hr/>	<hr/>
At 31st December	<b>169,109</b>	21,994
	<hr/> <hr/>	<hr/> <hr/>
Contract costs incurred and recognised profits to date	<b>1,260,732</b>	958,271
	<hr/> <hr/>	<hr/> <hr/>
Advances received on construction contracts	—	25,918
	<hr/> <hr/>	<hr/> <hr/>



## 25 DESIGNATED DEPOSITS — GROUP

The deposits placed with a trust investment company approved by the relevant PRC authorities to conduct trust investment business in the PRC, for investment purposes, had been uplifted during 2004.

## 26 TRADING INVESTMENTS — GROUP

Trading investments represent stocks and government bonds listed in the PRC and are stated at fair value at the close of business at year end date. Fair value is estimated by reference to the quoted bid prices.

## 27 PLEDGED DEPOSITS

	Group	
	2004	2003
	RMB'000	RMB'000
Deposits have been placed in certain banks as securities against certain trade finance facilities granted by the banks as follows:		
Deposits pledged	<u>434,795</u>	<u>153,763</u>
Corresponding trade finance facilities utilised	<u>512,324</u>	<u>154,607</u>

The corresponding trade finance facilities utilised mainly represent notes payable to suppliers.

## 28 TERM DEPOSITS WITH INITIAL TERM OF OVER THREE MONTHS

### Group

- (i) As at 31st December 2004, approximately RMB682,900,000 (2003: RMB852,894,000) of the Group's term deposits with initial term of over three months were denominated in RMB and deposited with banks in the PRC. The conversion of these RMB denominated balances into foreign currencies is subject to the rules and regulations of foreign exchange control promulgated by the PRC Government.
- (ii) As at 31st December 2004, approximately RMB531,850,000 (HK\$500,000,000) (2003: RMB1,562,361,000 (HK\$1,466,042,000)) of the Group's term deposits with initial term of over three months were denominated in the Hong Kong Dollar.
- (iii) The weighted average effective interest rate on term deposits with initial term of over three months was 2.23% for the year (2003: 0.90%).



## 28 TERM DEPOSITS WITH INITIAL TERM OF OVER THREE MONTHS (continued)

### Company

- (i) As at 31st December 2004, approximately RMB400,000,000 (2003: RMB200,000,000) of the Company's term deposits with initial term of over three months were denominated in RMB and deposited with banks in the PRC. The conversion of these RMB denominated balances into foreign currencies is subject to the rules and regulations of foreign exchange control promulgated by the PRC Government.
- (ii) As at 31st December 2004, approximately RMB531,850,000 (HK\$ 500,000,000) (2003: RMB1,562,361,000 (HK\$1,466,042,000)) of the Company's term deposits with initial term of over three months were denominated in the Hong Kong Dollar.
- (iii) The weighted average effective interest rate on term deposits with initial term of over three months was 2.35% (2003: 0.50%) for the year.

## 29 TRADE PAYABLES

	Group	
	2004	2003
	RMB'000	RMB'000
Trade payables (note (a))	2,681,222	3,019,916
Notes payable (note (b))	664,997	719,758
Due to related parties (note (c))	617,840	847,235
	3,964,059	4,586,909
	3,964,059	4,586,909

### (a) Trade payables

The normal credit period for trade payables generally ranges from 0 to 6 months. Ageing analysis of trade payables at 31st December 2004 is as follows:

	Group	
	2004	2003
	RMB'000	RMB'000
Current to 1 year	2,612,318	2,947,455
1 year to 2 years	34,123	29,806
2 years to 3 years	9,009	17,964
Over 3 years	25,772	24,691
	2,681,222	3,019,916
	2,681,222	3,019,916



# Notes to the Financial Statements

## 29 TRADE PAYABLES (continued)

(b) Notes payable are bills of exchange with average maturity period of within six months.

(c) Due to related parties

The amounts due to related parties, which are trading in nature, can be analysed as follows:

	Group	
	2004	2003
	RMB'000	RMB'000
Trade payables:		
— Fellow subsidiaries (note (i))	327,552	667,737
— Other related parties (note (i))	93,957	61,070
	421,509	728,807
Notes payable:		
— Fellow subsidiaries (note (ii))	194,353	89,484
— Other related parties (note (ii))	1,978	28,944
	196,331	118,428
	617,840	847,235

Note:

(i) Trade payables to related parties are unsecured and non-interest bearing. The credit period granted by related parties are similar to that of the period granted to the Group by its third-party suppliers. The ageing of the amounts due to related parties, which are trade in nature, is summarised as follows:

	Group	
	2004	2003
	RMB'000	RMB'000
Current to 1 year	332,662	656,824
1 year to 2 years	44,725	70,862
2 years to 3 years	43,604	1,029
Over 3 years	518	92
	421,509	728,807
	421,509	728,807

(ii) Notes payable are bills of exchange with average maturity period of within six months.



### 30 OTHER PAYABLES, ACCRUALS AND OTHER CURRENT LIABILITIES

	Group		Company	
	2004 RMB'000	2003 RMB'000	2004 RMB'000	2003 RMB'000
Other payables and accruals (note (a))	1,117,164	1,447,711	4,210	16,894
Due to related parties (note (b))	538,288	495,603	19,063	287,667
	<u>1,655,452</u>	<u>1,943,314</u>	<u>23,273</u>	<u>304,561</u>

(a) Other payables and accruals

	Group		Company	
	2004 RMB'000	2003 RMB'000	2004 RMB'000	2003 RMB'000
Customer deposits	347,629	380,638	—	—
Payable for property, plant and equipment	158,694	289,723	—	—
Wages, salaries and bonuses payables	162,516	178,200	—	—
Welfare payables	133,869	183,788	—	—
Accrued expenses	157,353	166,210	4,210	16,894
Deferred income from government grants	22,417	33,269	—	—
Consumption tax, business tax and other taxes payable	25,291	75,124	—	—
Value-added tax payable	—	50,595	—	—
Other current liabilities	109,395	90,164	—	—
	<u>1,117,164</u>	<u>1,447,711</u>	<u>4,210</u>	<u>16,894</u>



## 30 OTHER PAYABLES, ACCRUALS AND OTHER CURRENT LIABILITIES (continued)

(b) Due to related parties

The amounts due to related parties can be analysed as follows:

	Group		Company	
	2004 RMB'000	2003 RMB'000	2004 RMB'000	2003 RMB'000
Holding company:				
— Special dividend (Note 10 (ii))	7,125	7,125	7,125	7,125
— Other temporary advances (note (iii))	6,280	260,636	1,860	272,643
	<u>13,405</u>	<u>267,761</u>	<u>8,985</u>	<u>279,768</u>
Fellow subsidiaries:				
— Deposits for sales of aircraft and automobiles (note (ii))	1,600	20,504	—	—
— Payable for property, plant and equipment (note (ii))	385	13,776	—	—
— Other temporary advances (note (iii))	399,010	177,190	10,078	7,899
	<u>400,995</u>	<u>211,470</u>	<u>10,078</u>	<u>7,899</u>
Other related parties:				
— Deposits for sales of aircraft and automobiles (note (ii))	—	2,508	—	—
— Other temporary advances (note (iii))	123,888	13,864	—	—
	<u>123,888</u>	<u>16,372</u>	<u>—</u>	<u>—</u>
	<u>538,288</u>	<u>495,603</u>	<u>19,063</u>	<u>287,667</u>

- (i) Amounts due to related parties are unsecured and non-interest bearing.
- (ii) Deposits for sales of aircraft and automobiles, and payable for property, plant and equipment are recurrent in nature and have no fixed terms of repayment.
- (iii) Other temporary advances mainly represent current account balances with the respective companies and will be fully settled in 2005.



### 31 LONG-TERM PAYABLE TO ULTIMATE HOLDING COMPANY

	Group and Company	
	2004	2003
	RMB'000	RMB'000
At 1st January	<b>573,244</b>	—
Transfer from provisions (Note 32)	—	614,190
	<hr/>	<hr/>
At 31st December	<b>573,244</b>	614,190
Less: current portion repayable within one year	<b>(40,946)</b>	(40,946)
	<hr/>	<hr/>
	<b>532,298</b>	573,244
	<hr/> <hr/>	<hr/> <hr/>



32 PROVISIONS

	Supplementary pension subsidiaries RMB'000 (note (a))	Early retirement RMB'000 (note (a))	Group One-off cash housing subsidiaries RMB'000 (note (b))	Warranty RMB'000 (note (c))	Total RMB'000
At 1st January 2004	—	—	56,226	90,536	146,762
Additional provisions	—	—	—	26,498	26,498
Utilised during the year	—	—	—	(48,132)	(48,132)
At 31st December 2004	—	—	56,226	68,902	125,128
Analysis of total provisions:					
Non-current	—	—	56,226	—	56,226
Current	—	—	—	68,902	68,902
	—	—	56,226	68,902	125,128
At 1st January 2003	553,710	60,480	56,226	60,157	730,573
Additional provisions	—	—	—	104,527	104,527
Utilised during the year	—	—	—	(74,148)	(74,148)
Transfer to long-term payable to ultimate holding company (Note 31)	(553,710)	(60,480)	—	—	(614,190)
At 31st December 2003	—	—	56,226	90,536	146,762
Analysis of total provisions:					
Non-current	—	—	56,226	—	56,226
Current	—	—	—	90,536	90,536
	—	—	56,226	90,536	146,762





## 32 PROVISIONS (continued)

### (a) Supplementary pension subsidies and early retirement obligations

Prior to the Reorganisation, the Group paid supplementary pension subsidies to its retired employees who retired prior to the Reorganisation. In addition, the Group was committed to make periodic benefits payments to certain former employees who were asked to retire early in accordance with various rationalisation programmes adopted by the Group prior to the Reorganisation. Pursuant to the Reorganisation, the Group and AVIC II agreed that, upon establishment of the Company, the Group's obligations to make these supplementary pension benefits and early retirement payments as at 30th June 2002 were assumed by AVIC II and the actual payments of these obligations will be made by AVIC II. The Group is not obliged to any further liabilities in respect of these supplementary pension benefits and early retirement payments to these former employees after 30th June 2002. The Company is however obliged to settle such amount assumed by AVIC II in 15 equal annual instalments from 2003. Accordingly, an amount due to AVIC II in the amount of approximately RMB614,190,000, which is unsecured and non-interest bearing, was recorded by the Company and the Group as at 31st December 2003. The above obligations were actuarially determined by a PRC insurance company using the projected unit credit method.

### (b) One-off cash housing subsidies

This represents the Group's provision for one-off housing subsidies. As set out in Note 3 (o)(iii) to the financial statements, certain provincial governments have not yet promulgated the detailed local regulations in relation to the reformed housing subsidy policies and certain entities within the Group have not yet adopted any formal cash housing subsidy plans. In respect of certain entities which have not adopted any cash housing subsidy plans, based on the available information and best estimates, the Group estimated a provision of approximately RMB56,226,000 which was charged to the consolidated profit and loss account in the year ended 31st December 2000 when the State Council issued a circular regarding the cash housing subsidies in the PRC. However, because of the significant uncertainties involved in view of the absence of detailed local government regulations and formal cash housing subsidy plans for these entities, this estimate is subject to a high degree of measurement uncertainty. Actual cash housing subsidies eventually to be paid out may differ significantly from this estimate. AVIC II has, however, agreed to bear any further one-off cash housing subsidies in excess of the amount provided above.

### (c) Warranty

The Group gives warranties on certain automobile products and undertakes to repair or replace items that fail to perform satisfactorily based on certain pre-determined conditions.

A provision of approximately RMB68,902,000 has been recognised as of 31st December 2004 (2003: RMB90,536,000) in connection with the expected warranty claims based on past experience of the level of repairs and returns.



## 33 BORROWINGS

(a) Borrowings including bank borrowings and other borrowings are analysed as follows:

	Group	
	2004	2003
	RMB'000	RMB'000
Current borrowings:		
Bank borrowings	<b>3,898,425</b>	3,784,091
Current portion of non-current borrowings	<b>515,497</b>	199,725
	<b>4,413,922</b>	3,983,816
Non-current borrowings:		
Bank borrowings	<b>929,870</b>	1,373,875
Other borrowings	<b>12,067</b>	12,067
	<b>941,937</b>	1,385,942
Total borrowings	<b>5,355,859</b>	5,369,758
Representing:		
Unsecured	<b>1,068,855</b>	684,555
Secured	<b>4,287,004</b>	4,685,203
	<b>5,355,859</b>	5,369,758



### 33 BORROWINGS (continued)

(a) Borrowings including bank borrowings and other borrowings are analysed as follows: (continued)

The exposure of the borrowings of the Group to interest rate changes and the effective interest rates is as follows:

	<b>Group</b>	
	<b>2004</b>	2003
	<b>RMB'000</b>	RMB'000
Total borrowings:		
— at fixed rates	<b>4,660,390</b>	4,884,456
— at floating rates	<b>695,469</b>	485,302
	<u><b>5,355,859</b></u>	<u>5,369,758</u>
Weighted average effective interest rates:		
— bank borrowings	<b>4.71%</b>	4.65%
— other borrowings	<b>1.75%</b>	1.85%

The carrying amounts and fair values of non-current borrowings are as follows:

	<b>Group</b>	
	<b>Carrying values</b>	
	<b>2004</b>	2003
	<b>RMB'000</b>	RMB'000
Bank borrowings	<b>929,870</b>	1,373,875
Other borrowings	<b>12,067</b>	12,067
	<u><b>941,937</b></u>	<u>1,385,942</u>



## 33 BORROWINGS (continued)

(a) Borrowings including bank borrowings and other borrowings are analysed as follows: (continued)

	Group	
	Fair values	
	2004	2003
	RMB'000	RMB'000
Bank borrowings	919,427	1,363,870
Other borrowings	8,624	8,428
	<u>928,051</u>	<u>1,372,298</u>

The fair values are based on discounted cash flows using applicable discount rates based upon the prevailing market rates of interest available to the Group for financial instruments with substantially the same terms and characteristic as at the balance sheet dates. Such discount rates ranged from 5.76% to 6.12% as of 31st December 2004 (2003: 5.49% to 5.76%), depending on the type of the debt. The carrying amounts of current borrowings approximate their fair values.

(b) The repayment terms of the non-current borrowings are analysed as follows:

	Group	
	2004	2003
	RMB'000	RMB'000
Bank borrowings:		
Wholly repayable within five years	<u>1,412,184</u>	<u>1,536,959</u>
Other borrowings:		
Wholly repayable within five years	33,183	36,641
Not wholly repayable within five years	<u>12,067</u>	<u>12,067</u>
	<u>45,250</u>	<u>48,708</u>
	<u>1,457,434</u>	<u>1,585,667</u>



### 33 BORROWINGS (continued)

(c) At 31st December 2004, the Group's non-current bank borrowings and other borrowings are repayable as follows:

	Group	
	2004	2003
	RMB'000	RMB'000
Bank borrowings:		
Within one year	482,314	163,084
In the second year	419,200	713,916
In the third to fifth years	510,670	659,959
	<u>1,412,184</u>	<u>1,536,959</u>
Less: current portion	<u>(482,314)</u>	<u>(163,084)</u>
	<u>929,870</u>	<u>1,373,875</u>
Other borrowings:		
Within one year	33,183	36,641
After the fifth year	12,067	12,067
	<u>45,250</u>	<u>48,708</u>
Less: current portion	<u>(33,183)</u>	<u>(36,641)</u>
	<u>12,067</u>	<u>12,067</u>
Total:		
Within one year	515,497	199,725
In the second year	419,200	713,916
In the third to fifth years	510,670	659,959
After the fifth year	12,067	12,067
	<u>1,457,434</u>	<u>1,585,667</u>
Less: current portion	<u>(515,497)</u>	<u>(199,725)</u>
	<u>941,937</u>	<u>1,385,942</u>



## Notes to the Financial Statements

### 33 BORROWINGS (continued)

#### (d) Borrowings facilities

The securities of the Group's borrowings are analysed as follows:

	Group	
	2004	2003
	RMB'000	RMB'000
Net book value of property, plant and equipment pledged (Note 14(c))	423,926	401,246
Guarantees provided by AVIC II and fellow subsidiaries of the Group	945,888	1,369,146
Cross guarantees among subsidiaries of the Group	2,650,366	2,679,057
Guarantees provided by third parties	167,000	227,000
	<u>4,287,004</u>	<u>4,685,203</u>
Corresponding borrowing facilities utilised	<u>4,287,004</u>	<u>4,685,203</u>

All guarantees provided by AVIC II and fellow subsidiaries of the Group should have been released or withdrawn within six months after the listing of the Company's shares. The directors have confirmed that all remaining guarantees will gradually be released or withdrawn.

At 31st December 2004, the Group has the following undrawn committed borrowing facilities:

	Group	
	2004	2003
	RMB'000	RMB'000
Expiring beyond one year at fixed rates	<u>1,369,206</u>	<u>2,643,848</u>

### 34 MINORITY INTERESTS

	Group	
	2004	2003
	RMB'000	RMB'000
Equity interests	2,814,279	2,818,387
Loans from minority shareholders of a subsidiary	127,737	127,737
	<u>2,942,016</u>	<u>2,946,124</u>

The loans from minority shareholders of a subsidiary are unsecured, interest free and have no fixed terms of repayment.



### 35 SHARE CAPITAL

	<b>Company</b> RMB'000
Registered, issued and fully paid:	
Upon establishment of the Company — 3,116,518,500 Domestic Shares of RMB1.00 each	3,116,519
Transfer of 152,710,500 Domestic Shares of RMB1.00 each to 152,710,500 H Shares of RMB1.00 each as part of the Offering	<u>(152,711)</u>
At 31st December 2003 2,963,808,000 Domestic Shares of RMB1.00 each	<u>2,963,808</u>
Offering of H Shares 1,527,090,000 new H Shares of RMB1.00 each	1,527,090
Transfer of 152,710,500 Domestic Shares of RMB1.00 each to 152,710,500 H Shares of RMB1.00 each as part of the Offering	<u>152,711</u>
At 31st December 2003 1,679,800,500 H Shares of RMB1.00 each	<u>1,679,801</u>
At 31st December 2003	<u>4,643,609</u>
At 31st December 2004	<u><b>4,643,609</b></u>



## Notes to the Financial Statements

### 35 SHARE CAPITAL (continued)

The Company was established on 30th April 2003 with an initial registered share capital of RMB3,116,518,500, divided into 3,116,518,500 shares with par value of RMB1.00 each. 2,981,388,500 shares, 104,620,000 shares, 15,470,000 shares and 15,040,000 shares were issued to AVIC II, Hua Rong, Cinda and Orient respectively, all of which were credited as fully paid, in consideration for the transfer of the relevant assets, liabilities and interests to the Company pursuant to the Reorganisation referred to in Note 1. These Domestic Shares rank pari passu in all respects with each other.

During 2003, the Company completed its initial public offering and placing of 1,679,800,500 H Shares with a par value of RMB1.00 each at a price of HK\$1.21 (equivalent to RMB1.28) per H Share in cash for an aggregate consideration of HK\$2,033 million (equivalent to approximately RMB2,167 million), which comprised 1,527,090,000 new H Shares issued by the Company and 152,710,500 shares offered by the Promoters pursuant to an approval from the State Assets Commission to convert such relevant Domestic Shares owned by the Promoters into H Shares as part of the Offering. As a result, the issued share capital of the Company increased to 4,643,608,500 shares, comprising 2,963,808,000 Domestic Shares and 1,679,800,500 H Shares, representing 63.83% and 36.17% of the issued capital respectively.

The H Shares rank pari passu in all respects with the Domestic Shares and rank equally for all dividends or distributions declared, paid or made except that all dividends in respect of H Shares are to be paid by the Company in Hong Kong dollars and H Shares may only be subscribed for by, and traded in Hong Kong dollars between legal or natural persons of Hong Kong, Macau, Taiwan or any other country other than the PRC. The transfer of the Domestic Shares is subject to such restrictions as the PRC laws may impose from time to time.





## 36 RESERVES

### Company

	Capital reserve RMB'000 (Note (b))	Statutory surplus reserve RMB'000 (Note (e))	Statutory public welfare fund RMB'000 (Note (f))	Retained earnings RMB'000 (Note (c))	Total RMB'000
At 1st January 2004	74,898	16,259	8,129	330,147	429,433
Profit for the year	—	—	—	71,439	71,439
Dividend relating to 2003	—	—	—	(48,758)	(48,758)
Transfer to reserves	—	445	222	(667)	—
As at 31st December 2004	<u>74,898</u>	<u>16,704</u>	<u>8,351</u>	<u>352,161</u>	<u>452,114</u>
Representing:					
Other reserves	<u>74,898</u>	<u>16,704</u>	<u>8,351</u>	<u>352,161</u>	<u>452,114</u>
Upon establishment	(345,725)	—	—	7,125	(338,600)
Premium on issue of shares	442,827	—	—	—	442,827
Share issuance costs	(99,175)	—	—	—	(99,175)
Reserve arising from the issuance of additional shares by a subsidiary	76,971	—	—	—	76,971
Profit for the year	—	—	—	354,535	354,535
Special dividend (Note 10 (ii))	—	—	—	(7,125)	(7,125)
Transfer to reserves	—	16,259	8,129	(24,388)	—
As at 31st December 2003	<u>74,898</u>	<u>16,259</u>	<u>8,129</u>	<u>330,147</u>	<u>429,433</u>
Representing:					
Proposed final dividend	—	—	—	48,758	48,758
Other reserves	74,898	16,259	8,129	281,389	380,675
	<u>74,898</u>	<u>16,259</u>	<u>8,129</u>	<u>330,147</u>	<u>429,433</u>



### 36 RESERVES (continued)

Note:

- (a) Movements in the reserves of the Group are set out in the consolidated statement of changes in shareholders' equity.
- (b) The Company was established on 30th April 2003 to take over the assets, liabilities and interests relating to the Group's existing business. The amount of capital reserve upon establishment represented the difference between the amount of share capital issued and the historical net value of the assets, liabilities and interests transferred to the Company as at 30th June 2002.
- (c) Retained profit of the Group and the Company upon establishment of the Company represents the undistributed profits of the Group, as determined in accordance with the PRC GAAP, for the period from 1st July 2002 to 30th April 2003. Pursuant to the Reorganisation, such undistributed profits of the Group for the above period are attributable to AVIC II and the Company has agreed to distribute such amount to AVIC II by way of a special dividend (See also Note 10 (ii)). Therefore the amount was not capitalised by the Group and the Company upon establishment of the Company.
- (d) In accordance with the relevant PRC regulations and Articles of Association of the Company, retained profits available for distribution by the Company will be deemed to be the lower of the amounts determined in accordance with the PRC GAAP and the amount determined in accordance with IFRS. As at 31st December 2004, the amount of retained earnings available for distribution was approximately RMB90,994,000 being the amount determined in accordance with the PRC GAAP.
- (e) Statutory surplus reserve

In accordance with the relevant PRC laws and financial regulations, every year the Company is required to transfer 10% of the profit after taxation prepared in accordance PRC accounting standards to the statutory surplus reserve until the balance reaches 50% of the paid-up share capital. Such reserve can be used to reduce any losses incurred and to increase share capital. Except for the reduction of losses incurred, any other usage should not result in this reserve balance falling below 25% of the registered capital.

- (f) Statutory public welfare fund

In accordance with the relevant PRC laws and financial regulations, every year the Company is required to transfer between 5% to 10% of the profits after taxation prepared in accordance with PRC accounting standards to the statutory public welfare fund. The use of this fund is restricted to capital expenditure for employees' collective welfare facilities, the ownership in respect of which belongs to the Group. The statutory public welfare fund is not available for distribution to shareholders except under liquidation. Once the capital expenditure on staff welfare facilities has been made, an equivalent amount must be transferred from statutory public welfare fund to the discretionary surplus reserve, a reserve which can be used to reduce any losses incurred or to increase share capital. The Company decided to make a 5% transfer as statutory public welfare fund for the year ended 31st December 2004.



### 37 CONSOLIDATED CASH FLOW STATEMENT

#### (a) Reconciliation of profit for the year to net cash generated from operations

	2004	2003
	RMB'000	RMB'000
Profit for the year	71,439	452,074
Adjustments for:		
Minority interests	66,427	251,828
Taxation	92,514	60,830
Share of results of associates	(14,187)	13,811
Gain on disposal of subsidiaries	—	(31,901)
Amortisation of land use rights and intangible assets	88,914	38,624
Depreciation on property, plant and equipment	698,030	662,595
Loss on disposal of property, plant and equipment	2,052	7,920
Amortisation of government grants received	(15,046)	(15,046)
Provision for impairment of receivables	45,959	75,920
Write-down of inventories to net realisable value	29,418	39,672
Provision for impairment of a non-current investment	25,000	—
Fair value losses of trading investments	11,582	—
Loss on sales of trading investments	3,066	—
Interest income	(65,701)	(41,382)
Interest expense	203,526	189,769
	<b>1,242,993</b>	<b>1,704,714</b>
Changes in working capital:		
— decrease/(increase) in accounts receivable	849,487	(885,604)
— increase in other receivables, prepayments and other current assets	(30,501)	(127,340)
— increase in inventories	(1,051)	(834,292)
— (increase)/decrease in contracts in progress	(147,115)	66,818
— increase in trading investments	(42,437)	(219,012)
— (decrease)/increase in trade payables	(622,850)	809,476
— (decrease)/increase in other payables, accruals and other current liabilities	(422,209)	107,089
— decrease in provisions	(21,634)	(583,811)
— (decrease)/increase in long-term payable to ultimate holding company	(40,946)	614,190
— increase in deferred income from government grants	9,145	16,039
Net cash generated from operations	<b>772,882</b>	<b>668,267</b>



## 37 CONSOLIDATED CASH FLOW STATEMENT (continued)

### (a) Reconciliation of profit for the year to net cash generated from operations (continued)

In the cash flow statement, proceeds from sale of property, plant and equipment comprise:

	<b>2004</b>	2003
	<b>RMB'000</b>	RMB'000
Net book amount (Note 14(a))	<b>75,474</b>	98,304
Loss on disposal of property, plant and equipment	<b>(2,052)</b>	(7,920)
Injection of property, plant and equipment into certain associates	—	(51,758)
Receivables from sale of property, plant and equipment	<b>(16,914)</b>	(18,356)
	<hr/>	<hr/>
Proceeds from sale of property, plant and equipment	<b>56,508</b>	20,270
	<hr/> <hr/>	<hr/> <hr/>

### (b) Analysis of changes in financing during the year:

#### (i) Borrowings

	<b>2004</b>	2003
	<b>RMB'000</b>	RMB'000
At 1st January	<b>5,369,758</b>	4,642,978
Proceeds from borrowings	<b>4,610,160</b>	4,778,677
Disposal of subsidiaries	—	(228,450)
Repayments of borrowings	<b>(4,624,059)</b>	(3,823,447)
	<hr/>	<hr/>
At 31st December	<b>5,355,859</b>	5,369,758
	<hr/> <hr/>	<hr/> <hr/>



### 37 CONSOLIDATED CASH FLOW STATEMENT (continued)

#### (b) Analysis of changes in financing during the year: (continued)

##### (ii) Minority interests

	<b>2004</b>	2003
	<b>RMB'000</b>	RMB'000
At 1st January	<b>2,946,124</b>	2,744,924
Share of profit for the year	<b>66,427</b>	251,828
Contributions from minority shareholders of subsidiaries	<b>1,565</b>	207,940
Repayment of loans from minority shareholders of a subsidiary	—	(500)
Transfer to owner's equity	—	(119,282)
Profit distributions to minority shareholders of subsidiaries	<b>(53,048)</b>	(106,396)
Disposal of subsidiaries	<b>(19,052)</b>	(32,390)
	<hr/>	<hr/>
At 31st December	<b>2,942,016</b>	2,946,124
	<hr/> <hr/>	<hr/> <hr/>



## 37 CONSOLIDATED CASH FLOW STATEMENT (continued)

### (c) Disposal of subsidiaries

	<b>2004</b>	2003
	<b>RMB'000</b>	RMB'000
Property, plant and equipment	—	229,242
Other non-current assets	—	14,624
	<u>—</u>	<u>243,866</u>
Current assets	<b>43,476</b>	500,491
Total assets	<b>43,476</b>	744,357
Borrowings	—	(228,450)
Other current and non-current liabilities	<b>(779)</b>	(367,166)
Total liabilities	<b>(779)</b>	(595,616)
Minority interests	<b>(19,052)</b>	(32,390)
Net assets at the date of disposal	<b>23,645</b>	116,351
Less: amount retained as investment in associates	<b>(22,866)</b>	—
Net assets sold	<b>779</b>	116,351
Proceeds receivable from sales	—	118,252
Proceeds received from sales	<b>779</b>	30,000
Total consideration	<b>779</b>	148,252
Gains on disposal of subsidiaries	—	31,901
The net cash outflow from sale is determined as follows:		
Proceeds received from sales	<b>779</b>	30,000
Less: cash and cash equivalents in subsidiaries sold	<b>(43,476)</b>	(36,203)
Net cash disposed of from sale of subsidiaries	<b>(42,697)</b>	(6,203)



### 37 CONSOLIDATED CASH FLOW STATEMENT (continued)

#### (d) Cash and cash equivalents

##### Group

	<b>2004</b>	2003
	<b>RMB'000</b>	RMB'000
Cash and bank balances	<b>2,273,752</b>	2,140,879
Term deposits with initial term of less than three months	<b>284,248</b>	443,140
	<b>2,558,000</b>	2,584,019

- (i) As at 31st December 2004, approximately RMB2,383,846,000 of the Group's cash and cash equivalents were denominated in RMB and deposited with banks in the PRC (2003: RMB2,299,286,000). The conversion of these RMB denominated balances into foreign currencies is subject to the rules and regulations of foreign exchange control promulgated by the PRC Government.
- (ii) The weighted average effective interest rates on deposits with banks as set out in note (i) above is 0.72% at 31st December 2004 (2003: 0.72%).

##### Company

	<b>2004</b>	2003
	<b>RMB'000</b>	RMB'000
Cash and bank balances	<b>63,468</b>	112,000
Term deposits with initial term of less than three months	<b>84,248</b>	213,140
	<b>147,716</b>	325,140

- (i) As at 31st December 2004, approximately RMB84,154,000 of the Company's cash and cash equivalents were denominated in RMB and deposited with banks in the PRC (2003: RMB71,551,000). The conversion of these RMB denominated balances into foreign currencies is subject to the rules and regulations of foreign exchange control promulgated by the PRC Government.
- (ii) The weighted average effective interest rates on deposits with banks as set out in note (i) above is 0.72% at 31st December 2004 (2003: 0.72%).



## 38 COMMITMENTS

### (a) Capital commitments

The Group has the following capital commitments not provided for at 31st December 2004:

	Group	
	2004	2003
	RMB'000	RMB'000
Acquisition of property, plant and equipment:		
— Authorised but not contracted for	517,856	138,501
— Contracted but not provided for	536,345	300,860
	1,054,201	439,361
Construction commitments:		
— Authorised but not contracted for	100,000	159,675
— Contracted but not provided for	80,238	2,789
	180,238	162,464
Investments in associates:		
— Contracted but not provided for	32,997	12,008
	1,267,436	613,833





### 38 COMMITMENTS (continued)

#### (b) Operating lease commitments

The Group has commitments to make the following future minimum lease payments under non-cancellable operating leases at 31st December 2004:

	Group	
	2004	2003
	RMB'000	RMB'000
Land and buildings:		
Not later than one year	32,413	37,114
Later than one year and not later than five years	101,782	89,977
Later than five years	122,742	132,109
	256,937	259,200
Plant and equipment:		
Not later than one year	23	23
	256,960	259,223

Generally, the Group's operating leases are for terms of 1 to 20 years.

The Company did not have any significant commitment at 31st December 2004.

### 39 SIGNIFICANT RELATED PARTY TRANSACTIONS

During the year, the Group entered into various transactions with related parties including the Holding Company, certain fellow subsidiaries, and other entities, directly or indirectly, controlled or significantly influenced by the Holding Company.



## Notes to the Financial Statements

### 39 SIGNIFICANT RELATED PARTY TRANSACTIONS (continued)

Set out below is a summary of significant related party transactions during the year.

#### Profit and loss items:

The aggregate income and expenses arising from those significant related party transactions are summarised as follows:

	2004 RMB'000	2003 RMB'000
<b>Revenues:</b>		
Sales of goods and materials		
— Fellow subsidiaries	1,814,126	2,153,115
— Other related parties	643,266	591,999
Rendering of service		
— Fellow subsidiaries	163,790	41,633
— Other related parties	8,799	—
Rental income		
— Fellow subsidiaries	933	961
<b>Expenses:</b>		
Purchase of goods and raw materials		
— Fellow subsidiaries	1,578,935	2,130,597
— Other related parties	647,641	808,896
Service fees payable		
— Fellow subsidiaries	1,006,134	678,012
— Other related parties	33,756	5,280
Rental expenses for property, plant and equipment		
— Fellow subsidiaries	50,665	59,811
<b>Others:</b>		
Guarantees obtained from		
— Holding company	230,000	280,400
— Fellow subsidiaries	715,888	1,088,746



### 39 SIGNIFICANT RELATED PARTY TRANSACTIONS (continued)

These transactions are entered into at terms agreed with these related parties in the ordinary course of the Group's business and are continuing in nature except for the guarantees given by AVIC II and certain of its subsidiaries amounted to approximately RMB230,000,000 and approximately RMB715,888,000 respectively as at 31st December 2004, details of which are disclosed in Note 33(d).

In addition, AVIC II granted certain leasehold land for the Group's use at no cost, details of which are disclosed in Note 14(b).

#### Balance sheet items:

The significant balances with related parties at 31st December 2004 are as follows:

	2004 RMB'000	2003 RMB'000
Balances with related parties included in:		
Accounts receivable		
— Fellow subsidiaries	692,518	839,142
— Other related parties	210,380	97,279
Other receivables, prepayments and other current assets		
— Holding company	95,156	—
— Fellow subsidiaries	325,142	413,984
— Other related parties	118,221	111,505
Trade payables		
— Fellow subsidiaries	521,905	757,221
— Other related parties	95,935	90,014
Other payables, accruals and other current liabilities		
— Holding company	13,405	267,761
— Fellow subsidiaries	400,995	211,470
— Other related parties	123,888	16,372
Long-term payable to ultimate holding company	573,244	614,190

For the balance sheet items, other related parties primarily represent those entities, directly or indirectly, controlled or significantly influenced by the Holding Company. Details of the balances with the above related parties are disclosed in Notes 21, 22, 29 and 30.



## 40 FINANCIAL INSTRUMENTS

### (a) Financial risk factors

The Group's activities expose it to a variety of financial risks, including the effects of: changes in debt and equity market prices, foreign currency exchange rates and interest rates.

#### (i) Foreign exchange risk

The Group mainly operates in the PRC with most of the transactions settled in RMB.

The Group's assets and liabilities, and transactions arising from international trade that subject to foreign exchange risk are primarily with respect to the US Dollar, Euro Dollar, Hong Kong Dollar and Japanese Yen. The Group has not used any forward contracts to hedge its exposure. As at 31st December 2004, the Group had US Dollar, Euro Dollar, Hong Kong Dollar and Japanese Yen denominated deposits in banks of approximately RMB110,488,000 (2003: RMB10,303,000), RMB4,000 (2003: RMB10,722,000), RMB63,523,000 (2003: RMB253,589,000) and RMB139,000 (2003: RMB2,369,000) respectively.

As at 31st December 2004, the Group had US Dollar, Euro Dollar and Japanese Yen denominated loans of approximately RMB207,550,000 (2003: RMB275,000,000), RMB366,038,000 (2003: RMB335,995,000) and RMB175,196,000 (2003: RMB327,054,000) respectively.

#### (ii) Interest rate risk

The Group's income and operating cash flows are substantially independent of changes in market interest rates and the Group has no significant interest-bearing assets. The Group's exposure to changes in interest rates is mainly attributable to its non-current borrowings, details of which have been disclosed in Note 33 to the financial statements. The Group enters into debt obligations to support general corporate purposes including capital expenditure and working capital needs. As of 31st December 2004, over 87% (2003: over 90%) of its borrowings were at fixed rates. The Group has not used any interest rate swaps to hedge its exposure to interest rate risk.

#### (iii) Credit risk

The Group has no significant concentrations of credit risk. The carrying amount of trade receivables included in the consolidated balance sheet represent the Group's maximum exposure to credit risk in relation to its financial assets. The Group has policies in place to ensure that sales of products and services are made to customers with an appropriate credit history and the Group performs periodic credit evaluations of its customers. The Group's historical experience in collection of trade and other receivables falls within the recorded allowances and the directors are of the opinion that adequate provision for uncollectible trade receivables has been made in the financial statements.



## 40 FINANCIAL INSTRUMENTS (continued)

### (b) Fair value estimation

The fair value of financial instruments traded in active markets is based on quoted market price at the balance sheet date. The quoted market price used for financial assets held by the Group is the current bid price.

The carrying amounts of the Group's current financial assets including cash and cash equivalents, deposits in approved financial institutions, trade receivables, notes receivable and other receivables; and current financial liabilities including trade payables, borrowings and other payables, approximate their fair values due to their short maturities.

The fair value of non-current borrowings are disclosed in Note 33 to the financial statements.

In assessing the fair value of non-traded financial instruments, the Group uses a variety of methods and makes assumptions that are based on market conditions existing at each balance sheet date. Quoted market prices or dealer quotes for the specific or similar instruments are used for long-term debt. Other techniques, such as estimated discounted value of future cash flows, are used to determine fair value for the remaining financial instruments.

The face values less any estimated credit adjustments for financial assets and liabilities with a maturity of less than one year are assumed to approximate their fair values. The fair value of financial liabilities for disclosure purposes is estimated by discounting the future contractual cash flows at the current market interest rate available to the Group for similar financial instruments.

As detailed in Note 19 to the financial statements, there are no quoted market price in an active market for the Group's non-current investments in the PRC and for which other methods of reasonably estimating fair value are clearly unworkable. Accordingly, a reasonable estimate of fair value could not be made without incurring excessive costs.

## 41 ULTIMATE HOLDING COMPANY

The Company's directors regard AVIC II, a company established in the PRC, as being the ultimate holding company of the Company.

## 42 APPROVAL OF FINANCIAL STATEMENTS

The financial statements were approved by the board of directors on 4th April 2005.



## Notes to the Financial Statements

### 43 PARTICULARS OF SUBSIDIARIES AND ASSOCIATES

At the date of these financial statements, the Company has interests in the following principal subsidiaries and associates, which, in the opinion of the directors, were significant to the results for the year or formed a substantial portion of the Group at the balance sheet date:

Name	Registered and paid up capital	Attributable equity interest	Type of legal entity	Principal activities
<b>Subsidiaries</b>				
Directly held:				
哈爾濱航空工業(集團)有限公司 (Harbin Aviation Industry Group Co., Ltd.)	RMB775,832,000	100%	Limited liability company	Manufacture and sale of general-purpose aeroplane and automobile
江西昌河航空工業有限公司 (Jiangxi Changhe Aviation Industry Company Limited)	RMB1,131,700,000	100%	Limited liability company	Manufacture and sale of general-purpose aeroplane, automobile and automobile parts and components
江西洪都飛機工業有限公司 (Jiangxi Hongdu Aircraft Industry Co., Ltd.)	RMB725,647,000	100%	Limited liability company	Manufacture and sale of general-purpose aeroplane and aeroplane parts and components
哈爾濱東安汽車動力股份有限公司 (Harbin Dongan Auto Engine Co., Ltd.)	RMB462,080,000	70.01%	Joint stock company (listed on the Shanghai Stock Exchange)	Manufacture and sale of automobile engine
北京維思衛爾航空電子技術有限公司 (Beijing WiseWell Avionics Technology Co., Ltd.)	RMB10,000,000	51%	Limited liability company	Development, production and sale of avionics and IT products
Indirectly held:				
哈飛航空工業股份有限公司 (Hafei Aviation Industry Co., Ltd.)	RMB259,500,000	55.8%	Joint stock company (listed on the Shanghai Stock Exchange)	Research, development, design, manufacture and sale of aero products, including parts and components
江西洪都航空工業股份有限公司 (Jiangxi Hongdu Aviation Industry Co., Ltd.)	RMB210,000,000	54.75%	Joint stock company (listed on the Shanghai Stock Exchange)	Design, development, manufacture and sale of basic trainers, general-purpose aeroplane and other aero products, including parts and components
江西昌河汽車股份有限公司 (Jiangxi Changhe Automobile Co., Ltd.)	RMB410,000,000	64.55%	Joint stock company (listed on the Shanghai Stock Exchange)	Design, development, manufacture and sale of mini-sized vehicles



### 43 PARTICULARS OF SUBSIDIARIES AND ASSOCIATES (continued)

Name	Registered and paid up capital	Attributable equity interest	Type of legal entity	Principal activities
<b>Subsidiaries</b>				
Indirectly held:				
哈爾濱哈飛汽車模具製造有限責任公司 (Harbin Hafei Motor Mould Manufacturing Co., Ltd.)	RMB70,370,000	84.6%	Limited liability company	Design, manufacture and sale of press dies
江西昌河鈴木汽車有限責任公司 (Jiangxi Changhe Suzuki Automobile Co., Ltd.)	USD55,300,000	36.47%	Equity joint venture	Manufacture and sale of mini-sized vehicles
九江昌河汽車有限責任公司 (Jiujiang Changhe Automobile Co., Ltd.)	RMB161,250,000	72.89%	Limited liability company	Development, manufacture and sale of parts and components for mini-sized vehicles
哈爾濱東安汽車發動機製造有限公司 (Harbin Dongan Automotive Engine Manufacturing Co., Ltd.)	RMB500,000,000	40.20%	Equity joint venture	Manufacture and assembly of 4G1 series petrol engines
哈飛汽車股份有限公司 (Hafei Motor Co., Ltd.)	RMB1,013,280,000	74.81%	Joint stock company	Manufacture and sale of automobile products
<b>Associates</b>				
北京方正東安稀土新材料有限責任公司 (Beijing Founder & Dong-An Rare Earth Advanced Materials Ltd.)	RMB74,080,000	18.9%	Limited liability company	Mining, concentrating and smelting of rare earth material, processing and sale of rare earth products
哈爾濱勝邦哈飛汽車線束有限公司 (Harbin Shengbang Hafei Motor Harness Co., Ltd.)	RMB20,000,000	31.96%	Limited liability company	Manufacture and after-sale service of automobile wiring harness and electronic products
哈爾濱萬向汽車底盤系統有限責任公司 (Harbin Wanxiang Hafei Motor Chassis System Co., Ltd.)	RMB60,000,000	35%	Limited liability company	Manufacture and sales of motor chassis system
萬都(哈爾濱)汽車底盤系統有限公司 (Wandu (Harbin) Motor Chassis System Co., Ltd.)	USD8,500,000	14.96%	Limited liability company	Development, manufacture and sale of automobile chassis system
哈爾濱安博威飛機工業有限公司 (Harbin Embraer Aircraft Industry Co., Ltd.)	USD25,000,000	38.17%	Limited liability company	Production of regional jets and provision of relevant sales and after-sale services

All the above subsidiaries and associates are established and operating in the PRC.