



REPORT OF THE DIRECTORS

GROUP ACTIVITIES AND RESULTS

The Group is a provider of air passenger, air cargo and airline-related services. The results of the Group for the year ended December 31, 2004 and the financial positions of the Company and the Group as of the same date are set out in the financial statements on pages 44 to 126 herein.

DIVIDEND

As disclosed in the prospectus issued under the initial public offering of the Company, the Company has taken into consideration the future development, shareholders' interests, operating results and cash flows in determining the distribution of dividend. The Company confirmed that in accordance with the PRC GAAP, the appropriation rates to the statutory common reserve fund, the statutory common welfare fund and the discretionary common reserve fund for the year ended December 31, 2004 were 10%, 5% and 5% respectively.

The Board of Directors of the Company does not recommend the declaration of final dividend for the year ended December 31, 2004. Such retained profit shall be carried forward to the next year and in the distribution ratio currently expected to be between 15% to 30% of the profit after the recovery of losses (if any) and the appropriations of statutory common reserve fund, the statutory common welfare fund and the discretionary common reserve fund.

BANK AND OTHER LOANS

Details of the bank and other loans of the Company and the Group are set out in note 34 to the financial statements.

CAPITALIZATION OF INTERESTS

Details of the capitalization of interests of the Group for the year ended December 31, 2004 are set out in note 8 to the financial statements.

PROPERTY, PLANT AND EQUIPMENT

Movements in the property, plant and equipment of the Company and the Group for the year ended December 31, 2004 are set out in note 16 to the financial statements.

RESERVES

The reserves of the Company available for distribution to shareholders as at December 31, 2004 are set out in note 40 to the financial statements.

Movements in the reserves of the Company during the year are set out in note 38 to the financial statements.

Movements in the reserves of the Group during the year are set out in the consolidated statement of changes in equity on page 47 of the annual report.

DONATIONS

For the year ended December 31, 2004, the Group made donations for charitable purposes and other purposes amounting to RMB40.5 million.



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EMPLOYEE PENSION COST

Details of the employee pension cost and employee benefits are set out in note 11 to the financial statements.

USE OF PROCEEDS FROM INITIAL PUBLIC OFFERING

In the year of 2004, the Company conducted its initial public offering and 2,550,618,182 H Shares were issued (excluding 255,061,818 H Shares sold by selling shareholders) for net proceeds of RMB7,601 million. The proceeds are being used in accordance with the purposes disclosed in the prospectus of the Company dated December 3, 2004.

SHARE CAPITAL

As at December 31, 2004, before the exercise of over-allotment option under initial public offering, the Company's total share capital was RMB9,050,618,182, divided into 9,050,618,182 shares with a nominal value of RMB1.00 each. That over-allotment option was exercised on January 7, 2005 and as at April 12, 2005 being the date of this report the Company's total share capital is RMB9,433,210,909, divided into 9,433,210,909 shares with a nominal value of RMB1.00 each. The share capital structure of the Company is as follows:

Type of Shares	As at December 31, 2004		As at April 12, 2005	
	Number of Shares	% of Total Issued Share Capital	Number of Shares	% of Total Issued Share Capital
Domestic Shares	4,855,945,675	53.65%	4,826,195,989	51.16%
Non-H Foreign Shares	1,388,992,507	15.35%	1,380,482,920	14.64%
H Shares	2,805,680,000	31.00%	3,226,532,000	34.20%
Total	9,050,618,182	100%	9,433,210,909	100%

ULTIMATE HOLDING COMPANY

CNAHC, which is incorporated in the PRC, is regarded by the Directors of the Company as being the Company's ultimate holding company.



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SIGNIFICANT INTERESTS AND SHORT POSITIONS IN SHARES AND UNDERLYING SHARES

As at December 31, 2004, the interests and short positions of the following persons (other than the Company’s Directors, Supervisors or chief executive) in the shares and underlying shares of the Company as recorded in the register of the Company required to be kept under Section 336 of the Securities and Futures Ordinance of Hong Kong (the “SFO”) were as follows:

Name of Shareholder	Type of Shareholding	Type of Shares	Number of Shares Held	% of the Total Issued Share Capital of the Company	% of the Total Issued H Shares of the Company	% of the Total Issued Domestic Shares of the Company	% of the Total Issued Non-H Foreign Shares of the Company	Short Position
CNAHC	Direct holding	Domestic shares	4,855,945,675	53.65%	—	100%	—	—
CNACG	Direct holding	Non-H Foreign shares	1,388,992,507	15.35%	—	—	100%	—
Cathay Pacific	Direct holding ⁽¹⁾	H Shares	905,061,819	10.00%	32.26%	—	—	—
Swire Pacific Limited ⁽²⁾	Indirect holding	H Shares	905,061,819	10.00%	32.26%	—	—	—
John Swire & Sons (H.K.) Limited ⁽²⁾	Indirect holding	H Shares	905,061,819	10.00%	32.26%	—	—	—
John Swire & Sons Limited ⁽²⁾	Indirect holding	H Shares	905,061,819	10.00%	32.26%	—	—	—
Merrill Lynch International	—	H Shares	382,592,728	4.23%	13.64%	—	—	Yes ⁽⁴⁾
Merrill Lynch & Co., Inc ⁽³⁾	—	H Shares	382,592,728	4.23%	13.64%	—	—	Yes ⁽⁴⁾
Merrill Lynch International Incorporated ⁽³⁾	—	H Shares	382,592,728	4.23%	13.64%	—	—	Yes ⁽⁴⁾
Merrill Lynch International Holdings Inc ⁽³⁾	—	H Shares	382,592,728	4.23%	13.64%	—	—	Yes ⁽⁴⁾
Merrill Lynch Europe PLC ⁽³⁾	—	H Shares	382,592,728	4.23%	13.64%	—	—	Yes ⁽⁴⁾
Merrill Lynch Europe Intermediate Holdings ⁽³⁾	—	H Shares	382,592,728	4.23%	13.64%	—	—	Yes ⁽⁴⁾
Merrill Lynch Holdings Limited ⁽³⁾	—	H Shares	382,592,728	4.23%	13.64%	—	—	Yes ⁽⁴⁾
ML UK Capital Holdings ⁽³⁾	—	H Shares	382,592,728	4.23%	13.64%	—	—	Yes ⁽⁴⁾
Merrill Lynch Far East Limited ⁽⁵⁾	Over-allotment option ⁽⁶⁾	H Shares	420,852,000	4.65%	15%	—	—	—
China International Capital Corporation Limited ⁽⁷⁾	Over-allotment option ⁽⁸⁾	H Shares	420,852,000	4.65%	15%	—	—	—
HKSCC ⁽⁹⁾	Direct holding	H Shares	2,181,620,909	24.10%	77.76%	—	—	—



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Notes:

- (1) Among the 905,061,819 H shares, Cathay Pacific has security interest in 382,592,728 H shares arising from a share lending agreement pursuant to which Cathay Pacific lent 382,592,728 H shares of the Company to Merrill Lynch International.
- (2) Swire Pacific Limited, John Swire & Sons (H.K.) Limited and John Swire & Sons Limited have duplication of Cathay Pacific's interests in the H shares of the Company as they are direct or indirect (as the case may be) controlling shareholder of Cathay Pacific.
- (3) Merrill Lynch & Co., Inc., Merrill Lynch International Incorporated, Merrill Lynch International Holdings Inc., Merrill Lynch Europe PLC, Merrill Lynch Europe Intermediate Holdings, Merrill Lynch Holdings Limited, and ML UK Capital Holdings have duplication of Merrill Lynch International's interests in the H shares of the Company as they are direct or indirect (as the case may be) controlling shareholder of Merrill Lynch International.
- (4) A short position in 382,592,728 H shares of the Company arising from a share lending agreement pursuant to which Merrill Lynch International borrowed 382,592,728 H shares of the Company from Cathay Pacific.
- (5) Merrill Lynch & Co., Inc., Merrill Lynch International Incorporated, Merrill Lynch International Holdings Inc., and Merrill Lynch (Asia Pacific) Limited have duplication of Merrill Lynch Far East Limited's interests in the H shares of the Company as they are direct or indirect (as the case may be) controlling shareholder of Merrill Lynch Far East Limited.
- (6) Interests held jointly with China International Capital Corporation Limited pursuant to an over-allotment option as disclosed in the section headed "Structure of the Global Offering — The Global Offering" in the prospectus dated December 3, 2004 issued by the Company.
- (7) China Jiayin Investment Limited and Central Huijin Investment Company Limited have duplication of China International Capital Corporation Limited's interest in the H shares of the Company as they are direct or indirect (as the case may be) controlling shareholder of China International Capital Corporation Limited.
- (8) Interests held jointly with Merrill Lynch Far East Limited pursuant to an over-allotment option as disclosed in the section headed "Structure of the Global Offering — The Global Offering" in the prospectus dated December 3, 2004 issued by the Company.
- (9) To the knowledge of the Company, among the 2,181,620,909 H shares held by HKSCC Nominees Limited,
 - (i) Wellington Management Company, LLP had an interest in 153,112,100 H shares of the Company (representing approximately 5.45% of its then total issued H shares);
 - (ii) Temasek Holdings (Private) Limited had an interest in 399,950,000 H shares of the Company (representing approximately 14.25% of its then issued H shares), out of which the interest in 292,000,000 H shares were held through Aranda Investment (Mauritius) Pte Ltd. and the interest in the remaining 107,950,000 H shares were held through Dahlia Investments Ptd Ltd, FPL Alpha Investment Pte Ltd and Fullerton (Private) Limited, respectively.



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As at December 31, 2004, the interests and short positions of the following persons in the shares and underlying shares of CNAC, as recorded in the register of CNAC, required to be kept under Section 336 of the SFO were as follows:

Name of Interests Holder	Type of Interests	Number of Ordinary Shares of CNAC Concerned	% of the Total Issued Share Capital of CNAC
CNAHC	Attributable Interest	2,264,628,000 ⁽¹⁾	68.4%
Air China Limited	Beneficial owner	2,264,628,000 ⁽²⁾	68.4%
Best Strikes Limited	Beneficial owner	187,656,000	5.6%
On Ling Investments Limited	Attributable Interest	322,856,000 ⁽³⁾	9.7%
Novel Investments Holdings Limited	Attributable Interest	322,856,000 ⁽³⁾	9.7%
Novel Enterprises (BVI) Limited	Attributable Interest	322,856,000 ⁽³⁾	9.7%
Novel Credit Limited	Attributable Interest	322,856,000 ⁽³⁾	9.7%
Novel Holdings (BVI) Limited	Attributable Interest	322,856,000 ⁽³⁾	9.7%
Westleigh Limited	Attributable Interest	322,856,000 ⁽³⁾	9.7%
J.P. Morgan Chase & Co.	Investment manager Custodian corporation/ approved lending agent	197,894,000 24,538,000	5.97% 0.74%
J.P. Morgan Chase Bank N.A.	Attributable Interest	24,538,000 ⁽⁴⁾	0.74%
J.P. Morgan Fleming Asset Management Holdings Inc.	Attributable Interest	173,356,000 ⁽⁵⁾	5.23%
J.P. Morgan Fleming Asset Management (Asia) Inc.	Attributable Interest	173,356,000 ⁽⁵⁾	5.23%
J.P. Morgan Asset Management Limited	Attributable Interest	169,692,000 ⁽⁵⁾	5.12%



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Notes:

- (1) CNAHC's interests in CNAC duplicate with those interest of our Company.
- (2) Our Company's interests in CNAC duplicate with those interests of CNAHC.
- (3) 5.6% of the interest held by each of these companies in CNAC duplicates with Best Strikes Limited's interest in CNAC. The interests of these companies in CNAC also duplicate each other.
- (4) The interest held by it in CNAC duplicates with J.P. Morgan Chase & Co.'s interest in CNAC held by it as custodian corporation/approved lending agent.
- (5) The interests held by each of these companies in CNAC duplicate with J.P. Morgan Chase & Co.'s interest in CNAC held by it as investment manager. The interests of these companies in CNAC also duplicate each other.

SHARE APPRECIATION RIGHTS

The details of the Share Appreciation Rights Scheme provided by the Company are set out in note 39 to the financial statements.

The Company did not grant any Share Appreciation Rights in 2004. The Company is expected to formulate the specific implementation plan for Share Appreciation Rights Scheme in 2005.

PRE-EMPTIVE RIGHTS

There is no provision for pre-emptive rights under the Company's Articles of Association which would oblige the Company to offer new shares on a pro-rata basis to existing shareholders.

PURCHASE, SALE OR REDEMPTION OF SHARES

During the year ended December 31, 2004, neither the Company nor any of its subsidiaries had purchased, sold or redeemed any of its securities. For this purpose, the term "securities" shall have the meaning ascribed to it in the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the "Listing Rules").

SUBSIDIARIES, JOINT VENTURES AND ASSOCIATES

As at December 31, 2004, the details of the subsidiaries of the Company and the joint ventures and associates of the Group are set out in the note 17, note 18 and note 19, respectively to the financial statements.

MAJOR CUSTOMERS AND SUPPLIERS

For the year ended December 31, 2004, the Group's purchases from the largest equipment supplier and the five largest equipment suppliers accounted for 15% and 36% of the Group's total purchases respectively. None of the Directors or Supervisors of the Company, their associates, nor any shareholders, which to the best knowledge of the Directors own 5% or above of the Company's share capital, had any interest in the Group's five largest equipment suppliers.

For the year ended December 31, 2004, the aggregate sales attributable to the Group's five largest customers were less than 30% of the Group's total sales.



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DIRECTORS AND SUPERVISORS OF THE COMPANY

Information on the Directors and Supervisors of the Company during the year of 2004 (since its incorporation on September 30, 2004) and up to the date of this report is as follows:

Directors

Name	Age	Position	Date of Appointment
Li Jiayang	55	Chairman and Non-executive Director	September 30, 2004
Kong Dong	56	Vice Chairman and Non-executive Director	September 30, 2004
Wang Shixiang	55	Vice Chairman and Non-executive Director	September 30, 2004
Yao Weiting	57	Non-executive Director	September 30, 2004
Ma Xulun	40	Executive Director and President	September 30, 2004
Cai Jianjiang	41	Executive Director and Vice President	September 30, 2004
Fan Cheng	49	Executive Director and Chief Financial Officer	October 18, 2004
Hu Hung Lick, Henry	85	Independent Non-executive Director	November 22, 2004
Wu Zhipan	48	Independent Non-executive Director	September 30, 2004
Zhang Ke	51	Independent Non-executive Director	September 30, 2004

Supervisors

Name	Age	Position	Date of Appointment
Zhang Xianlin	51	Chairman of Supervisory Committee	September 30, 2004
Liao Wei	40	Supervisor	October 18, 2004
Zhang Huilan	44	Supervisor	September 30, 2004
Liu Feng	46	Supervisor	September 30, 2004

Ms. Chan Ching Har, Eliza was appointed as a Director of the Company on September 30, 2004 and later resigned on November 12, 2004.



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INDEPENDENCE OF THE INDEPENDENT NON-EXECUTIVE DIRECTORS

The Company has confirmed its receipt of, from each of the Independent Non-executive Directors of the Company, a confirmation of his independence pursuant to Rule 3.13 of the Listing Rules. The Company considers all of the Independent Non-executive Directors are of independence.

DIRECTORS' AND SUPERVISORS' INTERESTS AND SHORT POSITIONS IN THE SHARES, UNDERLYING SHARES AND DEBENTURE OF THE COMPANY

As at December 31, 2004, Mr. Zhang Xianlin, a Supervisor of the Company, had interests in 33,126,000 shares, which represents 1% of the share capital of CNAC, a subsidiary of the Company.

Save as the above mentioned, none of our Directors, Supervisors and chief executive has any interests or short positions in the shares, underlying shares or debentures of the Company or its any associated corporations (within the meaning of Part XV of the SFO, as recorded in the register required to be kept under section 352 of the SFO or as notified to the Company and the Hong Kong Stock Exchange pursuant to the Model Code for Securities Transactions by Directors of Listed Companies.

INTERESTS OF THE DIRECTORS AND SUPERVISORS IN CONTRACTS AND SERVICE CONTRACTS

Each of the Directors and Supervisors of the Company has entered into a service contract with the Company for a term of three years. None of those service contracts with the Company is not determinable by the Company within one year without payment of compensation (other than statutory compensation).

None of the Directors and Supervisors of the Company was materially interested, whether directly or indirectly, in any contract of significance (within the meaning of the Listing Rules) subsisting during or at the end of year 2004 with the Company or the Company's subsidiary or holding company or a subsidiary of the Company's holding company.

EMPLOYEES

As at December 31, 2004, the Group has 29,133 employees (including total head count of the equity invested entities). The following table sets forth the number of employees fallen into different departments:

	As of December 31, 2004
Flight Crew	
Pilots (<i>Note 1</i>)	2,446
Flight Attendants	2,968
Ground personnel	
Ground services	2,517
Maintenance	3,188
Others	2,132
Marketing and sales	2,184
Management	3,152
Total	18,587
Employees of the equity invested entities other than the Company (<i>Note 2</i>)	10,546
Total	29,133

Note 1: The number of pilots in Air China Cargo is not included.

Note 2: The number of pilots employed by Air China Cargo is included.



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COMPENSATION POLICY

Our employees receive cash remuneration consisting of salary and other cash subsidies. In general, employee salaries are determined based on the employee's qualification, position, seniority and performance. Cash subsidies may include living subsidies, but subject to changes. The Group also provides various non-cash benefits, including medical insurance, unemployment insurance, early retirement and other social welfare benefits to employees in the PRC. In addition, all of our full-time employees in the PRC are covered by a defined contribution retirement scheme operated by the PRC government, to which the Group is required to make annual contributions at rates ranging from 15% to 20% of our employees' basic salaries.

In order to retain the captain team and give them incentives, the Company worked out and implemented a captain incentive scheme in October, 2004, whereby their bonuses are linked with the hours flown, safety indicators and efficiency of the Company. Under this scheme, the annual bonuses will be awarded based on a standard of RMB110,000 for each captain of B747, B777 and A340, RMB105,000 for each captain of B767 and B757, RMB100,000 for each captain of B737, A320 and A319.

The details of the remuneration of Directors and Supervisors were set out in note 10 to the financial statements.

TAXATION ON DIVIDENDS

Dividends paid by a PRC company are normally subject to a PRC withholding tax levied at flat rate of 20%. Pursuant to a rule of the taxation authority of the PRC, however, dividends paid by a PRC company to its shareholders with respect to shares listed on an overseas stock exchange, such as H Shares, are not subject to above mentioned PRC withholding tax.

MATERIAL LEGAL PROCEEDINGS

As of December 31, 2004, other than as disclosed in note 41 to the financial statements, the Group was not involved in any significant litigation or arbitration. To our knowledge, there was no litigation or claims of material importance pending or proposed to be made or having been made against the Group.

COMPLIANCE WITH THE CODE OF BEST PRACTICE

The Company set up a well-functioning corporate governance structure upon listing. As of December 31, 2004, the Company had altogether held five Board meetings. Our Company has been abiding by all the rules and regulations, which has efficiently protected the interests of the Company and its shareholders.

The Board of Directors of the Company consists of:

The Strategy & Investment Committee, the current members of which are Mr. Kong Dong, Mr. Wang Shixiang, Mr. Ma Xulun and Mr. Cai Jianjiang, with Mr. Ma Xulun acting as the chairman of the Committee.

The Audit & Risk Control Committee, which currently comprises two Independent Non-executive Directors, Mr. Wu Zhipan and Mr. Zhang Ke, and one Non-executive Director, Mr. Yao Weiting, with Mr. Zhang Ke acting as the chairman of the Committee.

The Nominations & Remuneration Committee, the current members of which are Mr. Li Jiexiang, Mr. Kong Dong, Dr. Hu Hung Lick, Henry, Mr. Zhang Ke and Mr. Wu Zhipan, with Mr. Wu Zhipan acting as the chairman of the Committee.



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The Directors of the Company are in the opinion that the Company has from its listing date, namely December 15, 2004, to December 31, 2004 complied with the Code of Best Practice as set out in Appendix 14 to the Listing Rules before its amendment which came into effect on January 1, 2005.

In 2005, the Company started to revise its internal corporate governance structure based on the requirements of "Code on Corporate Governance Practices" as set out in Appendix 14 to the Listing Rules as revised.

CONTRACT OF SIGNIFICANCE

The Company entered into a Restructuring Agreement on November 20, 2004 with CNAHC and CNACG, pursuant to which CNAHC and CNACG transferred to the Company certain businesses, assets, liabilities and investments.

Details of the Restructuring Agreement were set out in the Company's prospectus dated December 3, 2004.

ASSETS VALUATION

The Company's prospectus dated December 3, 2004 in relation to its initial public offering contained the valuation of the Group's properties, aircraft and equipment (the "Assets") as at September 30, 2004 of a total amount of approximately RMB44,092 million (the "Valuation"), details of which are set out in Appendices IV and V to that prospectus. The Assets are not stated at the Valuation in the Group's financial statements for the year ended December 31, 2004. Should the Assets be stated at values based upon the Valuation, additional depreciation of approximately RMB117 million would be charged to the Group's consolidated income statement for the year of 2004.

CONNECTED TRANSACTIONS

Our Group has entered into a number of transactions on a continuing basis with CNAHC and its associates (as defined under the Listing Rules) and other connected persons of our Group. Details of those connected transactions conducted during the year of 2004, which are not exempt under Rule 14A.33 of the Listing Rules, are as follows:

I. CONTINUING CONNECTED TRANSACTIONS BETWEEN OUR GROUP AND CNAHC GROUP

Construction Project Management Services

We entered into a construction project management agreement (the "Construction Project Management Agreement") with China National Aviation Construction and Development Company (the "CNACD"), a wholly owned subsidiary of CNAHC on November 1, 2004.

Pursuant to this agreement:

- CNACD will provide us with project management services on projects involving the construction of any property or industrial plant/facility with budgeted costs equal to or exceeding RMB20 million;
- In return for its project management services, we will pay CNACD a fee of up to 2% of the construction budget if the budget is equal to or exceeds RMB1 billion, and up to 2.5% if the budget is below RMB1 billion;
- If CNACD is able to manage the construction projects such that the final cost falls below the amount we have budgeted, we will pay CNACD a bonus fee, which will be decided by both parties through arm's length negotiation but shall not exceed



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40% of the management fee calculated based on the budgeted amount of the project;

- If the final cost of the project managed by CNACD is higher than the budgeted amount, CNACD will pay us the difference between the final cost and the budgeted amount unless the difference is caused by (i) a change of government policies; (ii) factors attributed to us; or (iii) force majeure; and
- If CNACD acquires land relating to a project on our behalf, we will pay CNACD an agency fee of up to 2% of all the fees and expenses in relation to the land acquisition (including, among other things, land acquisition fee, formality fee, labour expenses, travel expenses, but excluding the land premium).

The Construction Project Management Agreement will expire on December 31, 2006 subject to renewal.

Properties Leasing

We entered into a properties leasing framework agreement (the "Properties Leasing Framework Agreement") with CNAHC on November 1, 2004.

Pursuant to this agreement, we will lease from the CNAHC group a total of 14 properties covering an aggregate gross floor area of approximately 53,087 square metres for various uses including as business premises, offices and storage facilities. We will also lease to CNAHC group a total of 7 properties covering an aggregate gross floor area of approximately 8,262 square metres. The rents payable under the Properties Leasing Framework Agreement are and will continue to be determined in accordance with market rates.

The Properties Leasing Framework Agreement will expire on December 31, 2006 subject to renewal.

Media and Advertising Services

We entered into a media and advertising services framework agreement (the "Advertising Services Framework Agreement") on November 1, 2004 with China National Aviation Media and Advertisement Co., Ltd. ("CNAMC"), a wholly owned subsidiary of CNAHC.

Pursuant to this agreement, CNAMC will have the right to procure advertisements and will be entitled to retain all the advertising revenues generated from these advertisements that appear:

- in the in-flight magazines, in-flight entertainment programmes, boarding passes and certain other items specified in the Advertising Services Framework Agreement (the "Specified Items"); and
- on the potential items that may be developed from time to time (the "Potential Items").

As the consideration, CNAMC will pay us an annual concession fee for the Specified Items and 20% of the total revenues generated from advertisements which appear on the Potential Items. CNAMC has also agreed to:

- provide us at no charge with the in-flight items (except for the in-flight entertainment programmes) and the Potential Items (for those not owned by us) on which the advertisements appear or will appear;
- provide us with some in-flight entertainment programmes it produces, the production cost and disbursement of which will be reimbursed by us; and



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- procure the content for our in-flight entertainment programmes from independent third parties on a commission-free basis.

In addition, CNAMC has the right to bid for the provision of advertisement agency and design services to us.

The Advertising Services Framework Agreement will expire on December 31, 2006 subject to renewal.

Tourism Co-operation Services

We entered into a tourism services co-operation agreement (the "Tourism Co-operation Agreement") on November 1, 2004 with China National Aviation Tourism Company ("CNATC").

Pursuant to this agreement, we have agreed to provide the following services to CNATC:

- *Commercial charter flight services:* we will provide charter services to customers procured by CNATC at market rates.
- *Package tours co-operation services:* we and CNATC will sell package tours combining (i) our Company's airline tickets with (ii) accommodation at hotels owned and operated by CNATC. For the airline tickets in such packages sold by CNATC, CNATC will pay us in accordance with the pricing principle in the "Sales Agency Framework Agreement" while we will pay CNATC for the hotel fee portion of the packages.
- *Reciprocal frequent-flyer programme ("FFP") co-operation services:* CNATC will join our FFP programme under which our Companion card members are encouraged to stay at CNATC's hotels by receiving mileage

credits for such stay. As consideration, CNATC will pay us the equivalent value represented by those mileage credits.

Pursuant to the Tourism Co-operation Agreement, CNATC has agreed to provide the following services to us:

- *FFP co-operation services:* Under the FFP programme, if our Companion card members redeem their mileage credits for free, discounted or upgraded stay at CNATC's hotels, we will reimburse CNATC for the redemption at a price similar to our arrangements with other FFP partners.
- *Hotel accommodation services:* CNATC will provide hotel accommodation services to our employees on duty and the passengers affected by our flight delays and cancellations and we will pay CNATC at group rates.

The Tourism Co-operation Agreement will expire on December 31, 2006 subject to renewal.

Comprehensive Services

We entered into a comprehensive services agreement (the "Comprehensive Services Agreement") with CNAHC on November 1, 2004 pursuant to which:

- CNAHC will provide us with various ancillary services, including but not limited to:
 - (i) supply of various items for in-flight services;
 - (ii) manufacturing and repair of airline-related ground equipment and vehicles;



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- (iii) cabin decoration and equipment;
 - (iv) passenger cabin and cargo cabin ancillary parts (including seats);
 - (v) warehousing services;
 - (vi) cabin cleaning services; and
 - (vii) printing of air tickets and other documents.
- We will provide certain welfare-logistics services to the retired employees of CNAHC and its subsidiaries.

The charges payable by us to CNAHC for the comprehensive services above as well as the charges payable by CNAHC to us for the welfare-logistics services provided to retired employees shall be based on prevailing market rates or, if no prevailing market price is available, fair and reasonable prices based on arm's length negotiations.

The Comprehensive Services Agreement will expire on December 31, 2006 subject to renewal.

Line Maintenance and Other Ground Services

We entered into a standard ground handling agreement (the "Standard Ground Handling Agreement") with China Aircraft Services Limited ("CASL"), a 53.3%-owned subsidiary of CNACG, on April 17, 2004, pursuant to which CASL agreed to provide line maintenance and other ground services at Hong Kong International Airport to us. The services are charged at market rates.

Financial Services

We entered into a financial services agreement (the "Financial Services Agreement") with China National Aviation Finance Co., Ltd. ("CNAF") which is 52% owned by CNAHC and 42.5% owned by the Company on November 1, 2004.

Pursuant to this agreement, CNAF has agreed to provide us with a range of financial services including the following:

- deposit services;
- loan and finance leasing services;
- negotiable instrument and letter of credit services;
- trust loan and trust investment services;
- underwriting services for debt issuances;
- intermediary and consulting services;
- guarantee services;
- settlement services;
- internet banking services; and
- any other services provided by CNAF approved by the China Banking Regulatory Commission ("CBRC").

The fees and charges payable by us to CNAF under the Financial Services Agreement are determined by reference to the applicable fees and charges specified by the People's Bank of China (the "PBOC") and the CBRC for the relevant services from time to time, and if neither the PBOC nor the CBRC has specified a fee or charge for a particular service, then the services will be provided by CNAF on terms no less favorable than terms available from commercial banks in China.



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The Financial Services Agreement will expire on December 31, 2006 subject to renewal.

Subcontracting of Charter Flight Services

We entered into a charter flight service framework agreement (the "Charter Flight Service Framework Agreement") on November 1, 2004 with CNAHC.

Pursuant to this agreement, CNAHC will subcontract to us their obligation of government charter flight that they undertake from the PRC government. Our hourly rate of the charter flight service fee will, subject to periodical adjustment, be calculated on the basis of the following formula which includes total cost and reasonable margins:

Hourly rate = Total cost per flight hour x (1 + 6.5%)

The total cost includes all direct cost and indirect cost.

The Charter Flight Service Framework Agreement will expire on December 31, 2006 subject to renewal.

Sales Agency Services for Airline Tickets and Cargo Space

We entered into a sales agency framework agreement with CNAHC (the "Sales Agency Services Framework Agreement") on November 1, 2004.

Pursuant to this agreement, certain associates of CNAHC acting as our sales agents will

- purchase our air tickets and cargo space at wholesale prices and on-sell such air tickets and cargo space to end-purchasers; or
- procure purchasers for our air tickets and cargo space on a commission basis.

We will pay the relevant agents commissions based on relevant PRC regulations or, where regulations do not provide for a specific commission, based on market rates. Currently, the commissions prescribed for sales of air tickets are:

- for domestic routes, 3% of the ticket price;
- for Hong Kong and Macau routes, 7% of the ticket price; and
- for international routes, 9% of the ticket price.

In accordance with industry practice, and subject to applicable regulations, the Company may also offer incentives to sales agents for reaching certain ticket sale targets.

The Sales Agency Services Framework Agreement will expire on December 31, 2006 subject to renewal.

II. CONTINUING CONNECTED TRANSACTIONS BETWEEN OUR GROUP AND THE LUFTHANSA GROUP

Lufthansa holds a 40% equity interest in and is a substantial shareholder of Aircraft Maintenance and Engineering Corporation ("Ameco"), a subsidiary of us, and is therefore a connected person of us under the Listing Rules.

We have entered into various transactions with Lufthansa and its associates (collectively, the "Lufthansa Group") in the ordinary course of our business, including, among others:

- Aircraft maintenance, repair and overhaul services ("MRO") provided by us to the Lufthansa Group;
- mutual provision of catering services;



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- mutual provision of ground handling services in China and Germany;
- mutual provision of ticket sales agency services;
- airline codeshare arrangement under which the actual carrier's flights can be marketed under the airline designator code of the partner carrier and revenues earned from these arrangements are allocated between the parties based on negotiated terms according to airline industry standards;
- special prorate arrangement under which a carrier agrees to accept passengers from another carrier and receive payment directly from that carrier; and
- other airline co-operation arrangements between the Lufthansa Group and us.

The above transactions have been entered into on normal commercial terms based on arm's length negotiations.

III. CONTINUING CONNECTED TRANSACTIONS BETWEEN OUR GROUP AND THE BEIJING CAPITAL AIRPORTS GROUP

Capital Airports Holding Company holds a 24% equity interest in and is a substantial shareholder of Air China Cargo, and therefore is a connected person of us under the Listing Rules. We have entered into various transactions with Capital Airports Holding Company and its associates (collectively, the "Beijing Capital Airports Group") in the ordinary course of our business, including, among others:

- provision of taking-off/landing/parking services of our aircraft at airports owned by the Beijing Capital Airports Group;

- provision of passengers' waiting lounge, check-in counters and office buildings to us by airports owned by the Beijing Capital Airports Group;
- provision of utilities (including water, gas and electricity) to us at Beijing Capital International Airport by the Beijing Capital Airports Group; and
- provision of ground handling services to us by the Beijing Capital Airports Group.

Most of the services provided by the Beijing Capital Airports Group to us are charged on the pricing terms which are prescribed, approved or suggested by PRC governmental authorities.

IV. CONTINUING CONNECTED TRANSACTIONS BETWEEN OUR GROUP AND THE CATHAY PACIFIC GROUP

Cathay Pacific holds 10% of the total issued share capital of the Company and therefore is a connected person of us under the Listing Rules. We have entered into various transactions with Cathay Pacific and its associates (collectively, the "Cathay Pacific Group") in the ordinary course of our business. Such transactions, the nature of which is part of the necessary daily operation of an airline business, include, among others:

- provision of ground handling services by the Cathay Pacific Group to us;
- provision of MRO services by us to the Cathay Pacific Group;



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- provision of catering services by us to the Cathay Pacific Group; and
- mutual provision of ticket sales agency services.

The above transactions have been entered into on normal commercial terms based on arm's length negotiations.

V. CONTINUING CONNECTED TRANSACTIONS BETWEEN THE CNAC GROUP AND OTHER CONNECTED PERSONS OF THE GROUP

CNAC is a non-wholly owned subsidiary of our Company. Therefore, the continuing connected transactions entered into between CNAC and its subsidiaries (collectively, the "CNAC Group") as one party and connected persons as the other party, will also constitute continuing connected transactions for us under the Listing Rules. Details of those continuing connected transactions conducted during the year of 2004, which are not exempt under Rule 14A.33 of the Hong Kong Listing Rules from the Company's perspective, are as follows:

Provision of In-flight Catering Services by Macau Catering Services Company Limited

Macau Catering Services Company Limited ("MCS") is an associate of a substantial shareholder of Air Macau. MCS provides in-flight meals in Macau to Air Macau based on normal commercial terms determined on an arm's length basis, and at prices no less favourable than those Air Macau would be able to obtain from independent third-party providers of comparable services. The in-flight catering services expenses paid by Air Macau to MCS in 2004 was approximately HK\$41.2 million, the percentage ratio test under the Listing Rules of which is less than 2.5%

but more than 0.1%, therefore such transactions are exempt, from the Company's perspective, from the independent shareholders' approval requirement but are subject to the announcement requirement for connected transactions under the Listing Rules. CNAC has obtained a waiver from the Hong Kong Stock Exchange from strict compliance with the announcement and/or independent shareholders' approval requirements relating to above continuing connected transactions under the Listing Rules

Payment of Airport Charges and Airport Fees

In the ordinary course of business of Air Macau, airport charges and airport fee are invoiced and collected by Administration of Airports Limited, an indirect subsidiary of CNACG, on behalf of Macau International Airport Company ("MIAC"), an associate company of a substantial shareholder of Air Macau. As a result, the payment of airport charges and airport fees constitutes continuing connected transactions under the Listing Rules. The total airport charges and airport fees paid by Air Macau to ADA in 2004 was approximately HK\$69.3 million, the percentage ratio test under the Listing Rules of which is less than 2.5% but more than 0.1%, therefore such transactions are exempt, from the Company's perspective, from the independent shareholders' approval requirement but are subject to the announcement requirement for connected transactions. CNAC has obtained a waiver from the Hong Kong Stock Exchange from strict compliance with the announcement and/or independent shareholders' approval requirements relating to above continuing connected transactions under the Listing Rules.



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VI. WAIVER FROM STRICT COMPLIANCE OF THE LISTING RULES

The Company has obtained a waiver from the Hong Kong Stock Exchange expiring on December 31, 2006 from strict compliance with the announcement and/or independent shareholders' approval requirements relating to above continuing connected transactions (except for

transactions set out under above section V) under the Listing Rules. The maximum aggregate annual value (cap) permitted by the Hong Kong Stock Exchange and the aggregate annual value actually occurred for each category of above continuing connected transactions for the year ended December 31, 2004 are set out below:

Transactions	Aggregate Amount of Transactions for the Year Ended December 31, 2004	
	Cap RMB (in millions)	Actual Amount RMB (in millions)
Transactions with the CNAHC Group		
Construction project management services	40.0	0
Properties leasing	47.6	17.0
Media and advertising services	23.0	4.3
Tourism services co-operation	30.8	6.7
Comprehensive services	100.0	92.8
Line maintenance and other ground services	40.0	23.7
Financial services:		
Payment of fees and charges	40.0	0
Maximum daily outstanding deposits with CNAF	5,000.0	1,196.3
Maximum daily outstanding loans from CNAF	3,000.0	523.9
Subcontracting of charter flights	600.0	0
Sales agency service:		
Aggregate sales of airline tickets and cargo space to the CNAHC group for on-sale to end-purchasers	420.0	218.4
Aggregate ticket and cargo agency commission and amount of incentives to be paid by us to CNAHC group	29.0	25.9
Transactions with the Lufthansa Group		
Total amount to be paid by us to Lufthansa Group	630.0	435.0
Total amount to be paid by Lufthansa Group to us	500.0	409.3
Transactions with the Beijing Capital Airports Group		
Total amount to be paid by us to Beijing Capital Airports Group	730.0	653.4
Transactions with the Cathay Pacific Group		
Aggregate amount to be paid by us to the Cathay Pacific Group	35.0	10.9



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VII. INDEPENDENT NON-EXECUTIVE DIRECTORS' CONFIRMATION

The Independent Non-executive Directors of the Company have confirmed that all connected transactions in the year ended December 31, 2004 to which our Company was a party have been entered into:

1. in the ordinary and usual course of business of the Company;
2. either:
 - (i) on normal commercial terms; or
 - (ii) where there was no sufficient comparable transactions to judge whether they are on normal commercial terms, on terms no less favourable to the Company than terms available to or from independent third parties, where applicable; and
3. in accordance with the relevant agreement governing them on terms that are fair and reasonable and in the interests of the shareholders of the Company as a whole.

VIII. AUDITORS' CONFIRMATION

Messrs. Ernst & Young, the auditors of the Company, has provided a letter to the board of directors of the Company, confirming that above connected transactions:

1. have received the approval of the Company's board of directors;
2. are in accordance with the pricing policies as stated in the relevant agreements;
3. have been entered into in accordance with the relevant agreement governing the transactions; and
4. have not exceeded the cap disclosed in the prospectus of the Company.

AUDITORS

The Company has appointed Ernst & Young and Ernst & Young Hua Ming as its international auditors and domestic auditors respectively for the year ended December 31, 2004. Ernst & Young has audited the attached financial statements prepared in compliance with International Financial Reporting Standards. The Company has retained Ernst & Young and Ernst & Young Hua Ming since the date of its listing. The resolution concerning retention of Ernst & Young and Ernst & Young Hua Ming as its international auditors and domestic auditors for the year ending December 31, 2005 will be proposed at the Annual General Meeting of the Company to be held on May 30, 2005.



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PROPERTY OWNERSHIP CERTIFICATE

As disclosed in the prospectus of the Company dated December 3, 2004, CNAHC agreed to contribute the properties the Company then occupied to the Company pursuant to the Restructuring Agreement. All these properties had been registered under the name of Air China International Corporation, the Company's predecessor. The Company and CNAHC are actively applying to relevant property authorities for the transmission and renaming of property certificates. The Company expected this process to be completed within six months since its incorporation. As of December 31, 2004, the transmission and renaming of these property certificates was not completed. The Company will notify its shareholders in the interim or annual report immediately following the completion of these processes.

In our opinion, the fact that the above processes have not been completed would not affect the normal use of these properties, and this fact would not have any material adverse effect to the Company's business operation. Once the above processes are completed, the Company shall have the legal title of relevant properties and right to mortgage, sub-let and dispose of these properties.

By Order of the Board

Li Jiaxiang
Chairman

Beijing, PRC
April 12, 2005