



NOTES TO FINANCIAL STATEMENTS

31 December 2004

17. INTERESTS IN SUBSIDIARIES

	Company 2004 RMB'000
Listed shares in Hong Kong, at cost	579,472
Unlisted investments, at cost	134,647
Due from subsidiaries	22,513
Due to subsidiaries	(559,703)
	176,929
Market value of listed shares	3,161,997

The balances with the subsidiaries are unsecured, interest-free and have no fixed terms of repayment.

Particulars of the principal subsidiaries at 31 December 2004 are as follows:

Company name	Place of incorporation/ establishment and operations	Legal status	Nominal value of paid-up capital (in thousands)	Percentage of equity interests attributable to the Company		Principal activities
				Direct	Indirect	
Subsidiaries						
CNAC (中航興業有限公司)	Hong Kong	Limited liability company	HK\$331,268	69	—	Investment holding
Air Macau Company Limited ("Air Macau")* (澳門航空股份有限公司)	Macau	Limited liability company	MOP400,000	—	35.2	Airline operator
Air China Group Import and Export Trading Co. ("AIE") (國航集團進出口貿易公司)	PRC	Limited liability company	RMB90,000	100	—	Import and export trading
浙江航空服務有限公司 (Zhejiang Air Services Co., Ltd.)**	PRC	Limited liability company	RMB20,000	100	—	Provision of airline catering and shuttle bus services
Beijing Aviation Passenger Service Corporation (北京航空旅客服務公司)	PRC	Limited liability company	RMB3,000	100	—	Provision of passenger transportation services
Air China Shantou Industrial Development Company (中國國際航空汕頭實業發展公司)	PRC	Limited liability company	RMB12,000	51	—	Manufacture and retail of aircraft supplies
China National Aviation Air Passenger and Cargo Services Agency Company (中國民航客貨運輸銷售代理公司)	PRC	Limited liability company	RMB6,980	100	—	Provision of travel agency and freight forwarding services



NOTES TO FINANCIAL STATEMENTS

31 December 2004

17. INTERESTS IN SUBSIDIARIES (continued)

Company name	Place of incorporation/ establishment and operations	Legal status	Nominal value of paid-up capital (in thousands)	Percentage of equity interests attributable to the Company		Principal activities
				Direct	Indirect	
四川西南航空信息服務中心 (Sichuan Southwest Aviation Information Service Centre)**	PRC	Limited liability company	RMB1,000	100	—	Provision of information system consultancy services
Beijing Air China Engineering Technology Development Centre (北京國航工程技術發展中心)	PRC	Limited liability company	RMB1,500	100	—	Provision of engineering consultancy services
Beijing Civil Aviation Blue Sky Air Travel Services Company (北京民航藍天空運服務公司)	PRC	Limited liability company	RMB5,533	100	—	Provision of travel agency services
Sichuan Southwest Air Equipment and Supplies Centre (四川西南航空物資設備供應中心)	PRC	Limited liability company	RMB1,000	100	—	Provision of wholesale and retail services
Air China Development Corporation (Hong Kong) Limited (國航香港發展有限公司)	Hong Kong	Limited liability company	HK\$500	95	—	Provision of air ticketing services
上海國航基地開發中心 (Shanghai Air China Base Development Centre)**	PRC	Limited liability company	RMB2,000	100	—	Provision of ground services, air passenger, cargo and consultancy services

* Air Macau is a 51% subsidiary of CNAC.

** The English names are direct translations of the company's Chinese names.

The above table lists the subsidiaries of the Company which, in the opinion of the Directors, principally affected the results for the year ended 31 December 2004 or formed a substantial portion of the net assets of the Group at 31 December 2004. To give details of other subsidiaries would, in the opinion of the Directors, result in particulars of excessive length.

18. INTERESTS IN JOINT VENTURES

	Company 2004 RMB'000
Unlisted investments, at cost	1,392,388



NOTES TO FINANCIAL STATEMENTS

31 December 2004

18. INTERESTS IN JOINT VENTURES (continued)

Particulars of the joint ventures at 31 December 2004 of the Group are set out below:

Company name	Place of incorporation/ establishment and operations	Legal status	Nominal value of paid-up capital (in thousands)	Percentage of equity interests attributable to the Group		Principal activities
				Direct	Indirect	
Joint ventures						
AMECO (北京飛機維修工程有限公司)	PRC	Limited liability company	US\$102,533	60	—	Provision of aircraft overhaul and maintenance services
Air China Cargo (中國國際貨運航空有限公司) (note)	PRC	Limited liability company	RMB2,200,000	51	—	Provision of cargo carriage services
BACL (北京航空食品有限公司)	PRC	Limited liability company	US\$8,000	—	41.4	Provision of airline catering services
SWACL (西南航空食品有限公司)	PRC	Limited liability company	RMB20,000	—	41.4	Provision of airline catering services

Note: During the year, the Company has reclassified its interest in Air China Cargo from a subsidiary to a joint venture upon the termination of a discussion to acquire additional equity interests in Air China Cargo from another joint venture partner.

As at the balance sheet date and for the two years ended 31 December 2004, the Group's proportionate share of the assets, liabilities, and the Group's proportionate share of the revenues and expenses of the joint ventures are as follows:

	Group	
	2004 RMB'000	2003 RMB'000
Current assets	1,606,903	610,502
Non-current assets	1,706,734	633,369
Total assets	3,313,637	1,243,871
Current liabilities	(1,578,665)	(728,033)
Non-current liabilities	(8,734)	—
Net assets attributable to the Group	1,726,238	515,838
Revenues	3,944,633	959,938
Operating expenses	(3,748,389)	(848,222)
Finance costs	(16,137)	(21,919)
Share of profits less losses from associates	1,006	1,111
Profit before tax	181,113	90,908
Tax	(51,976)	(16,427)
Net profit attributable to the Group	129,137	74,481



NOTES TO FINANCIAL STATEMENTS

31 December 2004

18. INTERESTS IN JOINT VENTURES (continued)

As at the date of approval of these financial statements, the Group is in the process of applying to change the registered shareholder name of certain investees, including Air China Cargo and AMECO. Further details are set out in note 1 to these financial statements.

19. INTERESTS IN ASSOCIATES

	Group		Company
	2004 RMB'000	2003 RMB'000	2004 RMB'000
Unlisted shares, at cost	—	—	845,641
Share of net assets	2,587,304	1,789,948	—
Goodwill	1,404,966	1,205,390	—
Due from associates	106,520	110,981	17,305
Due to associates	(97,269)	(38,473)	(82,109)
	4,001,521	3,067,846	780,837

The balances with the associates are unsecured, interest-free and have no fixed terms of repayment.

Movements of goodwill are as follows:

	Group	
	2004 RMB'000	2003 RMB'000
Goodwill at beginning of the year (note 19 (a))	1,205,390	1,205,390
Additions (note 19 (b))	199,576	—
Goodwill at end of the year	1,404,966	1,205,390
Accumulated impairment	—	—



NOTES TO FINANCIAL STATEMENTS

31 December 2004

19. INTERESTS IN ASSOCIATES (continued)

Notes:

- (a) The goodwill brought forward from 2003 related to the acquisition of shareholding interests of 35.86% and 7.43% in Hong Kong Dragon Airlines Limited ("Dragonair") by CNACG and its then wholly-owned subsidiary, CNAC, in June 1996 and October 1997, respectively. The aggregate goodwill arising from these two acquisitions was approximately RMB2,130 million and subsequently reduced to approximately RMB1,205 million through deemed disposal upon the initial public offering of CNAC and the accumulated amortisation on the straight-line basis over a period of 20 years until 1 January 2001 (the date of adoption of IFRS 3 by the Group).
- (b) The goodwill arose in the current year related to the acquisitions of effective shareholding interests of 48.0% in Shandong Aviation Group Corporation ("Shandong Aviation"), 22.8% in Shandong Airlines Co., Ltd. ("Shandong Airlines") and 13.9% in LSG Lufthansa Service Hong Kong Limited ("LSGHK") by the Group, resulting in an aggregate goodwill amount of approximately RMB200 million.

Impairment testing of goodwill attributable to Dragonair

Goodwill acquired through the business combination in relation to the acquisition of shareholding interest in Dragonair has been allocated to the cash-generating unit, Dragonair, within the airline operations segment.

The recoverable amount of Dragonair has been determined based on a value in use calculation. To calculate this, cash flow projections are based on financial budgets approved by management covering a one-year period. The discount rate applied to the cash flow projections beyond the one-year period is 5.0%. No growth has been projected beyond the one-year period.

Key assumptions used in the value in use calculation of Dragonair

The following describes each key assumption on which management has based its cash flow projections when undertaking the impairment testing of goodwill attributable to Dragonair:

Passenger revenues — the bases used to determine the value assigned to the budgeted passenger revenues are available seat kilometers, passenger traffic, passenger load factor and passenger yield. Values assigned to the key assumptions reflect past experience and are consistent with external information sources.

Operating expenses — the bases used to determine the values assigned are staff headcount, scheduled flight hours, passenger traffic and jet fuel consumption. Values assigned to the key assumptions reflect past experience and are consistent with external information sources.



NOTES TO FINANCIAL STATEMENTS

31 December 2004

19. INTERESTS IN ASSOCIATES (continued)

Summarised financial information of the Group's associates is as follows:

	Group	
	2004 RMB'000	2003 RMB'000
Aggregate of associates' financial positions:		
Total assets	27,767,944	21,918,291
Total liabilities	(20,747,807)	(17,215,202)
Aggregate of associates' results:		
Revenues	16,770,072	9,639,481
Net profit	1,330,066	639,579
Share of profits less losses after tax from associates:		
Dragonair	279,801	43,336
Others	184,243	162,290
	464,044	205,626

Particulars of the associates at 31 December 2004 are as follows:

Name	Business structure	Place of incorporation/ establishment and operations	Percentage of equity interests attributable to the Group	Principal activities
Shenzhen Airlines (深圳航空有限責任公司)	Corporate	PRC	25	Airline operator
Dragonair# (港龍航空有限公司)	Corporate	Hong Kong	29.9	Airline operator
Shandong Aviation (山東航空集團有限公司)	Corporate	PRC	48	Investment holding
Shandong Airlines (山東航空股份有限公司)	Corporate	PRC	22.8	Airline operator



NOTES TO FINANCIAL STATEMENTS

31 December 2004

19. INTERESTS IN ASSOCIATES (continued)

Name	Business structure	Place of incorporation/ establishment and operations	Percentage of equity interests attributable to the Group	Principal activities
Sichuan SNECMA Aeroengine Maintenance Co., Ltd. (四川斯奈克瑪航空發動機維修有限公司)	Corporate	PRC	40.3	Provision of maintenance and repair services for aircraft engines
Chengdu Falcon Aircraft Engineering Service Co., Ltd. (成都富凱飛機工程服務有限公司)	Corporate	PRC	35.6	Provision of maintenance and repair services for aircraft engines
Yunan Airport Aircraft Maintenance Services Co., Ltd. (雲南空港飛機維修服務公司)	Corporate	PRC	40	Provision of maintenance and repair services
Macau Aircraft Repair and Conversion Company Limited [#] (澳門飛機維修工程有限公司)	Corporate	Macau	17.3	Provision of aircraft repair and conversion services
Jardine Airport Services Limited [#] (怡中航空服務有限公司)	Corporate	Hong Kong	34.5	Provision of airport ground handling services
Menzies Macau Airport Services Limited [#] (明捷澳門機場服務有限公司)	Corporate	Macau	23.2	Provision of airport ground handling services
Guangzhou Baiyun International Airport Ground Handling Service Company Limited (廣州白雲國際機場地勤服務有限公司)	Corporate	PRC	21	Provision of airport ground handling services
三亞世貿發展有限公司 (Sanya World Trade Development Company Limited)*	Corporate	PRC	40	Provision of airport ground handling services
CAAC Data Communications Co., Ltd. (民航數據通信有限責任公司)	Corporate	PRC	23.2	Provision of aviation data communication services
CAAC Cares Chongqing Co., Ltd. (重慶民航凱亞信息技術有限公司)	Corporate	PRC	24.5	Provision of airline-related information system services
成都民航西南凱亞有限責任公司 (Chengdu CAAC Southwest Cares Co., Ltd.)*	Corporate	PRC	35	Provision of airline-related information system services
Tradeport Hong Kong Limited [#] (香港商貿港有限公司)	Corporate	Hong Kong	17.3	Provision of services for developing and operating logistics centre
LSGHK [#] (德國漢莎航空膳食服務(香港)有限公司)	Corporate	Hong Kong	13.9	Provision of airline catering services
China National Aviation Finance Co., Ltd. (“CNAF”) (中國航空集團財務有限責任公司)**	Corporate	PRC	40.7	Provision of financial services

[#] Shareholding interests are held indirectly through subsidiaries of the Company.

^{*} The English names are direct translations of the company's Chinese names.

^{**} 30% of the Group's equity interests in CNAF is held directly by the Company, while the remaining 10.7% is held indirectly through subsidiaries of the Company.



NOTES TO FINANCIAL STATEMENTS

31 December 2004

19. INTERESTS IN ASSOCIATES (continued)

As at the date of approval of these financial statements, the Group is in the process of applying to change the registered shareholder name of certain associates, including Shenzhen Airlines. Further details are set out in note 1 to these financial statements.

20. LONG TERM RECEIVABLE FROM CNAHC

On 30 September 2004, the Company entered into an agreement with CNAHC whereby CNAHC agreed to assume the obligation to settle an aggregate amount of approximately RMB757 million, which was recorded by the Group as government grant receivable as at 31 December 2003 of RMB842 million, consisting of long term portion and short term portion of RMB764 million and RMB78 million, respectively. This receivable from CNAHC is unsecured, interest-free and repayable over eight years commencing from 31 December 2004 by 16 semi-annual instalments to be made by 30 June and 31 December each year. Pursuant to the relevant agreement, the first instalment amount of RMB25 million was settled by 31 December 2004 and the final instalment amount of approximately RMB32 million should be settled by 30 June 2012, with the remaining 14 semi-annual instalment amounts of RMB50 million each to be settled by 30 June and 31 December each year between 30 June 2005 and 31 December 2011.

21. OTHER INVESTMENTS

Other investments consist of unlisted equity investments.

22. DEFERRED TAX ASSETS

	Group		Company
	2004 RMB'000	2003 RMB'000	2004 RMB'000
Balance at beginning of year	590,153	624,000	—
Transferred to the Company upon its incorporation (note 1)	—	—	660,349
Charge for the year (note 12)	(607,824)	(33,847)	(2,349)
Credited to equity	793,755	—	—
Balance at end of year	776,084	590,153	658,000



NOTES TO FINANCIAL STATEMENTS

31 December 2004

22. DEFERRED TAX ASSETS (continued)

The principal components of the Group's and the Company's deferred income tax are as follows:

	Group		Company
	2004	2003	2004
	RMB'000	RMB'000	RMB'000
Deferred income tax liabilities:			
Accelerated depreciation for tax purposes	(441,441)	(826,000)	(426,000)
Differences in air traffic revenues recognition	—	(27,000)	—
Other deferred income tax liabilities	(47,000)	(52,000)	(47,000)
Gross deferred income tax liabilities	(488,441)	(905,000)	(473,000)
Deferred income tax assets:			
Additional tax deduction on revaluation surplus arising from the Restructuring	714,000	—	606,000
Provisions and accruals	384,000	675,000	381,000
Losses available for offset against future taxable income	20,525	685,153	—
Other deferred income tax assets	146,000	135,000	144,000
Gross deferred income tax assets	1,264,525	1,495,153	1,131,000
Net deferred income tax assets	776,084	590,153	658,000

There was no material un-provided deferred income tax during the year (2003: Nil).



NOTES TO FINANCIAL STATEMENTS

31 December 2004

23. TRADE RECEIVABLES

The Group normally allows a credit period ranging from 30 days to 90 days to its sales agents and other customers. An aged analysis of the trade receivables, net of provision for doubtful debts, of the Group and the Company is analysed as follows:

	Group		Company
	2004 RMB'000	2003 RMB'000	2004 RMB'000
Within 30 days	1,838,756	1,257,040	2,067,875
31 to 60 days	280,382	465,109	102,938
61 to 90 days	152,548	106,603	14,949
Over 90 days	93,130	126,840	11,531
At end of year	2,364,816	1,955,592	2,197,293

Included in the Group's and the Company's trade receivables was the following amount due from a joint venture:

	Group		Company
	2004 RMB'000	2003 RMB'000	2004 RMB'000
Joint venture	412,539	—	841,916

24. INVENTORIES

Inventories primarily consist of materials and supplies.

Set out below is the breakdown of materials and supplies:

	Group		Company
	2004 RMB'000	2003 RMB'000	2004 RMB'000
Flight equipment spare parts	680,039	577,478	454,220
Work in progress	38,061	104,338	1,621
Catering supplies	25,188	30,635	13,089
	743,288	712,451	468,930



NOTES TO FINANCIAL STATEMENTS

31 December 2004

25. PREPAYMENTS, DEPOSITS AND OTHER RECEIVABLES

Set out below is the breakdown of prepayments, deposits and other receivables:

	Group		Company
	2004 RMB'000	2003 RMB'000	2004 RMB'000
Advance payments for aircraft and related equipment	2,193,458	1,213,380	1,958,515
Advances and others	324,655	191,448	322,047
Manufacturers' credits on aircraft acquisition receivable	74,518	84,935	74,518
Government grant receivable	—	77,338	—
Prepaid aircraft operating lease rentals	95,681	65,790	79,260
Receivables from the sale of staff quarters	24,681	57,962	24,681
Miscellaneous deposits	395,595	286,510	388,531
	3,108,588	1,977,363	2,847,552

26. CASH AND CASH EQUIVALENTS AND PLEDGED DEPOSITS

	Group		Company
	2004 RMB'000	2003 RMB'000	2004 RMB'000
Cash and bank balances	8,635,653	2,147,434	7,888,436
Cash placed with CNAF	261,904	1,457,103	219,655
	8,897,557	3,604,537	8,108,091
Time deposits placed with banks	648,667	261,226	94,287
Time deposits placed with CNAF	305,081	—	300,000
	953,748	261,226	394,287
Less: Pledged deposits against			
Bank loans (<i>note 34</i>)	64,242	1,177,064	64,242
Finance leases (<i>note 33</i>)	16,277	41,500	16,277
Others*	36,712	26,978	—
Pledged deposits	117,231	1,245,542	80,519
Cash and cash equivalents (<i>note 45 (a)</i>)	9,734,074	2,620,221	8,421,859

* Includes deposits pledged against the Group's aircraft operating leases and financial derivatives.



NOTES TO FINANCIAL STATEMENTS

31 December 2004

26. CASH AND CASH EQUIVALENTS AND PLEDGED DEPOSITS (continued)

Cash at banks earns interest at floating rates based on daily bank deposit rates. Time deposits are made for terms of between three days and one year depending on the immediate cash requirements of the Group and the Company.

27. DUE TO SHAREHOLDERS

Set out below is the breakdown of the amounts due to shareholders:

	Group		Company
	2004 RMB'000	2003 RMB'000	2004 RMB'000
Due to CNAHC	2,137,437	2,968	2,121,533
Due to CNACG	118,680	—	118,680
	2,256,117	2,968	2,240,213

The amounts due to shareholders are unsecured, interest-free and have no fixed terms of repayment. The amounts mainly represented distributions payable by the Company as detailed in note 14 to these financial statements.

28. BALANCES WITH OTHER CNAHC GROUP COMPANIES

The balances with other CNAHC group companies are unsecured, interest-free and have no fixed terms of repayment.

29. TRADE PAYABLES

An aged analysis of the trade payables is as follows:

	Group		Company
	2004 RMB'000	2003 RMB'000	2004 RMB'000
Within 30 days	3,108,028	1,157,293	2,740,974
31 to 60 days	805,858	669,970	673,690
61 to 90 days	304,943	497,402	243,448
Over 90 days	224,779	1,890,316	161,241
At end of year	4,443,608	4,214,981	3,819,353



NOTES TO FINANCIAL STATEMENTS

31 December 2004

29. TRADE PAYABLES (continued)

Included in the Group's and the Company's trade payables was the following amount due to a joint venture:

	Group		Company
	2004 RMB'000	2003 RMB'000	2004 RMB'000
Joint venture	179,934	123,581	449,835

30. BILLS PAYABLE

An aged analysis of the bills payable is as follows:

	Group		Company
	2004 RMB'000	2003 RMB'000	2004 RMB'000
Within 30 days	—	256,220	—
31 to 60 days	—	189,931	—
61 to 90 days	—	248,687	—
Over 90 days	362,033	622,382	362,033
At end of year	362,033	1,317,220	362,033

Included in the Group's and the Company's bills payable was the following amount due to CNAF:

	Group		Company
	2004 RMB'000	2003 RMB'000	2004 RMB'000
CNAF	—	692,372	—



NOTES TO FINANCIAL STATEMENTS

31 December 2004

31. OTHER PAYABLES AND ACCRUALS

Set out below is a breakdown of other payables and accruals:

	Group		Company
	2004 RMB'000	2003 RMB'000	2004 RMB'000
Provision for staff housing benefits	469,617	772,874	448,694
Accrued salaries, wages and benefits	692,510	647,561	562,493
Interest expense payable	269,928	315,617	255,977
Accruals for share issuing expenses	208,644	—	208,644
Custom duties and levies payable	742,201	207,098	665,986
Current portion of long-term payables (note 35)	101,802	174,363	101,802
Current portion of deferred income (note 36)	76,943	57,894	76,943
Advances from customers	294,798	348,716	224,321
Accrued operating expenses	716,548	533,399	611,257
Others	347,296	183,023	231,753
	3,920,287	3,240,545	3,387,870

32. PROVISION FOR MAJOR OVERHAULS

	Group		Company
	2004 RMB'000	2003 RMB'000	2004 RMB'000
At beginning of year	404,939	253,453	—
Transferred to the Company upon its incorporation (note 1)	—	—	363,842
Provision for the year	221,543	244,387	61,341
Utilised during the year	(127,654)	(92,901)	(23,811)
At the end of year	498,828	404,939	401,372
Less: Portion classified as current liabilities	(28,130)	(115,346)	(28,130)
Long-term portion	470,698	289,593	373,242



NOTES TO FINANCIAL STATEMENTS

31 December 2004

33. OBLIGATIONS UNDER FINANCE LEASES

The Group and the Company have obligations under finance lease agreements expiring during the years from 2004 to 2011 in respect of aircraft and related equipment. As at the balance sheet date, future minimum lease payments under these finance leases, together with the present value of the net minimum lease payments, which are principally denominated in foreign currencies, are as follows:

	Group and Company		Group	
	Minimum lease payments 2004 RMB'000	Present value of minimum lease payments 2004 RMB'000	Minimum lease payments 2003 RMB'000	Present value of minimum lease payments 2003 RMB'000
Amounts repayable:				
Within one year	2,313,871	1,705,146	2,285,703	1,607,056
In the second year	2,408,481	1,943,630	2,271,725	1,697,597
In the third to fifth years, inclusive	7,784,209	6,722,448	6,721,752	5,583,404
Over five years	2,049,406	1,910,163	5,406,410	4,810,836
Total minimum finance lease payments	14,555,967	12,281,387	16,685,590	13,698,893
Less: Amounts representing finance charges	(2,274,580)		(2,986,697)	
Present value of minimum lease payments	12,281,387		13,698,893	
Less: Portion classified as current liabilities	(1,705,146)		(1,607,056)	
Long-term portion	10,576,241		12,091,837	

Certain lease financing arrangements comprised finance leases between the Company and certain of its subsidiaries, and corresponding borrowings between such subsidiaries and the banks. The Company has guaranteed the subsidiaries' obligations under the bank borrowings and, accordingly, the relevant assets as mentioned aforesaid and obligations are recorded in the balance sheets to reflect the substance of the transactions. The future payments under these leases have therefore been presented by the Company and the Group in amounts that reflect the payments under the bank borrowings between the subsidiaries and the banks.



NOTES TO FINANCIAL STATEMENTS

31 December 2004

33. OBLIGATIONS UNDER FINANCE LEASES (continued)

At 31 December 2004, there were 23 aircraft under finance lease agreements. Under the terms of the leases, the Company has the option to purchase, at the end of or during the lease terms, certain aircraft at fair market value and others at either fair market value or at the price as stipulated in the finance lease agreements. For the current year, the effective borrowing rate ranged from 1.64% to 9.13% (2003: 1.64% to 9.13%).

The Group's and the Company's finance leases were secured by:

- (a) mortgages over certain of the Group's and the Company's aircraft, which had an aggregate carrying value of approximately RMB11,999 million as at 31 December 2004 (2003: RMB13,310 million) (note 16);
- (b) the pledge of certain of the Group's and the Company's bank deposits amounting to approximately RMB16 million as at 31 December 2004 (2003: RMB42 million) (note 26); and
- (c) guarantees by certain commercial banks in an aggregate amount of approximately RMB14,785 million (2003: RMB18,949 million).

As at 31 December 2004, certain PRC state-owned banks have provided counter-guarantees in an aggregate amount of RMB3,074 million (2003: RMB4,753 million) in respect of the commercial bank guarantee arrangements set out in note 33 (c) above. CNAHC and CNAF have, in turn, provided counter-guarantees to certain of these PRC state-owned banks in the amounts of RMB921 million (2003: RMB5,355 million) and RMB3,976 million (2003: RMB4,506 million) (note 46), respectively.



NOTES TO FINANCIAL STATEMENTS

31 December 2004

34. BANK AND OTHER LOANS

	Group		Company
	2004 RMB'000	2003 RMB'000	2004 RMB'000
Bank loans:			
Secured	13,685,002	14,519,345	13,643,002
Unsecured	7,519,047	7,228,169	7,144,917
	21,204,049	21,747,514	20,787,919
Other loans:			
Secured	66,667	81,487	66,667
Unsecured	431,957	227,494	297,731
	21,702,673	22,056,495	21,152,317
Bank loans repayable:			
Within one year	8,359,280	8,994,367	7,943,149
In the second year	3,049,084	1,903,342	3,049,084
In the third to fifth years, inclusive	6,178,222	6,227,447	6,178,222
Over five years	3,617,464	4,622,358	3,617,464
Other loans repayable:			
Within one year	446,771	242,307	312,546
In the second year	14,815	14,813	14,815
In the third to fifth years, inclusive	37,037	51,861	37,037
Total bank and other loans	21,702,673	22,056,495	21,152,317
Less: Portion classified as current liabilities	(8,806,051)	(9,236,674)	(8,255,695)
Long-term portion	12,896,622	12,819,821	12,896,622



NOTES TO FINANCIAL STATEMENTS

31 December 2004

34. BANK AND OTHER LOANS (continued)

Further details of bank and other loans at the balance sheet date are as follows:

Nature	Interest rate and final maturity	Group		Company
		2004 RMB'000	2003 RMB'000	2004 RMB'000
RMB denominated loans:				
Loans for construction projects	Floating interest rates ranging from 5.58% to 5.76% per annum at 31 December 2003 with maturities through 2010	—	80,000	—
Loans for purchases of aircraft and related equipment	Floating interest rates ranging from 4.94% to 5.76% and 4.94% to 6.21% per annum at 31 December 2004 and 2003 with maturities through 2014 and 2013, respectively	5,382,986	6,282,444	5,382,986
Loans for working capital	Floating interest rates ranging from 4.54% to 4.94% and 4.54% to 5.73% per annum at 31 December 2004 and 2003 with maturities through 2007 and 2004, respectively	2,528,869	2,931,230	2,171,800
Loans for purchases of properties	Floating interest rate at 4.94% per annum at 31 December 2003 with maturities through 2004	—	72,000	—
United States dollars denominated loans:				
Loans for purchases of aircraft and related equipment	Fixed interest rates ranging from 5.40% to 10.17% and 4.94% to 10.17% per annum at 31 December 2004 and 2003 with maturities through 2012	7,155,311	8,397,835	7,155,311



NOTES TO FINANCIAL STATEMENTS

31 December 2004

34. BANK AND OTHER LOANS (continued)

Nature	Interest rate and final maturity	Group		Company
		2004 RMB'000	2003 RMB'000	2004 RMB'000
Loans for purchases of aircraft and related equipment	Floating interest rates at six months LIBOR + 0.4% to 0.7% per annum at 31 December 2004 and 2003 with maturities through 2014 and 2009, respectively	1,270,236	81,487	1,270,236
Loans for working capital	Floating interest rates at six months LIBOR + 0.6% to 0.8% and three to ten months LIBOR + 0.3% to 0.9% per annum at 31 December 2004 and 2003 with maturities through 2007 and 2004, respectively	5,365,271	4,072,432	5,171,984
Japanese yen denominated loans:				
Loans for purchases of aircraft and related equipment	Fixed interest rates ranging from 4.84% to 5.30% per annum at 31 December 2003 with maturities through 2004	—	139,067	—
		21,702,673	22,056,495	21,152,317
Less: Loans due within one year classified as current liabilities		(8,806,051)	(9,236,674)	(8,255,695)
Loans due after one year classified as long-term portion		12,896,622	12,819,821	12,896,622

The interest rates of RMB denominated loans are set and subject to change by the People's Bank of China.

The Group's and the Company's bank loans of approximately RMB13,710 million as at 31 December 2004 (2003: RMB14,252 million) were secured by:

- (a) mortgages over certain of the Group's and the Company's aircraft and related equipment, which had an aggregate carrying value of approximately RMB16,586 million as at 31 December 2004 (2003: RMB16,422 million) (note 16);



NOTES TO FINANCIAL STATEMENTS

31 December 2004

34. BANK AND OTHER LOANS (continued)

- (b) the pledges of certain of the Group's and the Company's bank deposits amounting to RMB64 million as at 31 December 2004 (2003: RMB1,177 million) (note 26);
- (c) guarantees by certain commercial banks amounting to RMB8,294 million (2003: RMB10,934 million); and
- (d) guarantees by Air China International Corporation and CNAC (PRC) of Nil (2003: RMB396 million) and Nil (2003: RMB380 million), respectively.

As at 31 December 2004, certain PRC state-owned banks provided counter-guarantees in an aggregate amount of RMB5,943 million (2003: RMB7,244 million) to one of these commercial banks as mentioned in note 34 (c) above. CNAHC and CNAF have, in turn, provided counter-guarantees to certain of these PRC state-owned banks in the amounts of RMB1,455 million (2003: RMB3,198 million) and RMB761 million (2003: RMB907 million) (note 46), respectively.

35. LONG-TERM PAYABLES

Long-term payables mainly represent custom duties and value-added tax payable after one year to the PRC government in respect of the acquisition of aircraft and related equipment under finance leases. The custom duties and value-added tax are payable upon repayment of the corresponding finance lease instalments. Set out below are details of the custom duties and value-added tax payable further analysed into non-current and current portions:

	Group		Company
	2004 RMB'000	2003 RMB'000	2004 RMB'000
Custom duties and value-added tax payable	539,121	975,712	539,121
Others	8,992	—	258
	548,113	975,712	539,379
Less: Portion classified as current liabilities (note 31)	(101,802)	(174,363)	(101,802)
Long-term portion	446,311	801,349	437,577



NOTES TO FINANCIAL STATEMENTS

31 December 2004

36. DEFERRED INCOME

In 2000, the Group acquired an aircraft which was funded by the PRC government, and a further aircraft was injected into the Group by the PRC government during 2004. In accordance with IAS 20 "Accounting for Government Grants and Disclosure of Government Assistance", the Group recorded these aircraft purchased in 2000 and received in 2004 as property, plant and equipment with the corresponding amounts of government grant recorded as deferred income at the respective dates of the delivery of the aircraft. As such, the government subsidies in relation to the aforesaid aircraft purchased in 2000 and the aircraft received in 2004 are recorded in deferred income of the Group in 2000 and 2004, respectively. The deferred income is recognised as income over the expected useful life of the relevant aircraft on the straight-line basis.

The movements of deferred income as stated under current and non-current liabilities are as follows:

	Group		Company
	2004 RMB'000	2003 RMB'000	2004 RMB'000
Deferred income:			
At beginning of year	1,157,880	1,157,880	—
Transferred to the Company upon its incorporation (<i>note 1</i>)	—	—	1,462,667
Addition during the year	304,787	—	—
At end of year	1,462,667	1,157,880	1,462,667
Accumulated income recognised as other operating revenues:			
At beginning of year	212,278	154,384	—
Transferred to the Company upon its incorporation (<i>note 1</i>)	—	—	263,636
Credit during the year (<i>note 5</i>)	70,593	57,894	19,235
At end of year	282,871	212,278	282,871
Net amount	1,179,796	945,602	1,179,796
Less: Portion classified as current liabilities (<i>note 31</i>)	(76,943)	(57,894)	(76,943)
Long-term portion	1,102,853	887,708	1,102,853



NOTES TO FINANCIAL STATEMENTS

31 December 2004

37. SHARE CAPITAL

	Number of shares 2004	Nominal value 2004 RMB'000
Company and Group		
Registered, issued and fully paid		
— State legal person shares of RMB1.00 each	4,855,945,675	4,855,946
— Non-H Foreign Shares of RMB1.00 each	1,388,992,507	1,388,992
— H shares of RMB1.00 each	2,805,680,000	2,805,680
	9,050,618,182	9,050,618

A summary of the movements in the Company's issued share capital for the period from 30 September 2004 (date of incorporation of the Company) to 31 December 2004 was as follows:

	Number of shares 2004	Nominal value 2004 RMB'000
Restructuring (<i>note 37 (a)</i>)	6,500,000,000	6,500,000
State legal person shares converted into H shares (<i>note 37 (b)</i>)	(198,331,240)	(198,331)
Non-H Foreign Shares converted into H shares (<i>note 37 (b)</i>)	(56,730,578)	(56,731)
Share placement and public offer (<i>note 37 (c)</i>)	2,805,680,000	2,805,680
	9,050,618,182	9,050,618

The Company was incorporated on 30 September 2004 with an initial registered share capital of RMB6,500,000,000, divided into 6,500,000,000 shares with par value of RMB1.00 each. 5,054,276,915 State legal person shares and 1,445,723,085 non-H Foreign Shares with a par value of RMB1.00 each were issued to CNAHC and CNACG, respectively, all of which were credited as fully paid, in consideration for the transfer of the Relevant Businesses and interests in the Relevant Companies to the Company pursuant to the Restructuring referred to in note 1 to these financial statements.

Notes:

- (a) As part of the Restructuring in preparation for the listing of the Company's H shares on the Hong Kong Stock Exchange and the London Stock Exchange, CNAHC and through its wholly-owned subsidiaries, transferred the Relevant Businesses and interests in the Relevant Companies to the Company (note 1). In consideration of the above, the Company issued 5,054,276,915 State legal person shares and 1,445,723,085 non-H Foreign Shares with a par value of RMB1.00 each to CNAHC and CNACG, respectively.



NOTES TO FINANCIAL STATEMENTS

31 December 2004

37. SHARE CAPITAL (continued)

Notes: (continued)

- (b) The Company's H shares were listed on the Hong Kong Stock Exchange and the London Stock Exchange on 15 December 2004 and 2,805,680,000 H shares, consisting of 2,550,618,182 new shares, 198,331,240 shares converted from State legal person shares and 56,730,578 shares converted from non-H Foreign Shares, with a par value of RMB1.00 each were issued to the public by way of placement and offer at HK\$2.98 (equivalent to approximately RMB3.17072) each. The proceeds from the sale of the 198,331,240 State legal person shares and 56,730,578 non-H Foreign Shares aggregating approximately RMB759 million, after deducting the portion of share issuing expenses of approximately RMB50 million which were borne by the Social Security Fund in connection with these sales of State legal person shares and non-H Foreign Shares, were remitted to the Social Security Fund.
- (c) As referred to in note 37 (b) above, the Company issued 2,805,680,000 H shares to the public by way of placement and offer. After deducting aggregate net proceeds of approximately RMB759 million from the sale of 198,331,240 H shares converted from State legal person shares and 56,730,578 H shares converted from non-H Foreign Shares which were remitted to the Social Security Fund as referred to in note 37 (b) above and share issuing expenses of approximately RMB536 million (before deducting share issuing expenses of approximately RMB50 million borne by the Social Security Fund as referred to in note 37 (b) above), the Company raised net proceeds of approximately RMB7,601 million, of which paid-up share capital amounted to approximately RMB2,551 million and capital reserve amounted to approximately RMB5,050 million.

The H shares rank *pari passu*, in all material respects, with the State legal person shares and non-H Foreign Shares of the Company.

38. RESERVES

Group

The amounts of the Group's reserves and the movements therein for each of the two years ended 31 December 2004 are presented in the consolidated statement of changes in equity on page 47 of these financial statements.

Company

	Capital reserve	Statutory reserve funds	Retained profits	Total
	RMB'000	RMB'000	RMB'000	RMB'000
Upon incorporation of the Company (note 38 (a))	(627,464)	—	34,813	(592,651)
Profit for the period from 1 October 2004 to 31 December 2004	—	—	1,229,603	1,229,603
Distributions (note 38 (b))	—	—	(377,550)	(377,550)
Transfer to statutory reserve funds (note 14)	—	51,908	(51,908)	—
Issue of new shares upon listing (note 37 (c))	5,536,678	—	—	5,536,678
Share issuing expenses (note 37 (c))	(486,457)	—	—	(486,457)
At 31 December 2004	4,422,757	51,908	834,958	5,309,623



NOTES TO FINANCIAL STATEMENTS

31 December 2004

38. RESERVES (continued)

Company (continued)*Notes:*

- (a) As described in note 1 to these financial statements, the financial statements of the Group for the years ended 31 December 2003 and 2004 have been prepared as if the Group had been in existence throughout the period and as if the Relevant Businesses and the interests in the Relevant Companies were transferred to the Company at 1 January 2003. Upon incorporation of the Company on 30 September 2004, the historical net asset value of the Relevant Businesses and the interests in the Relevant Companies transferred to the Company were converted into the Company's registered capital as described in note 37 (a) to these financial statements with all the then existing reserves eliminated and the resulting difference dealt with in the capital reserve and retained profits. Accordingly, the aggregate of the capital reserve and retained profits amounts, being the difference between the amount of share capital issued and the historical net asset value of the Relevant Businesses and the interests in the Relevant Companies transferred to the Company as at 30 September 2004, were presented in the reserves of both the Group and the Company.

Retained profits of the Company and the Group upon incorporation of the Company represent the amounts set aside for distributions, details of which are set out in note 14 to these financial statements. Therefore, these amounts were not capitalised by the Company and the Group upon the Company's incorporation.

- (b) Details of the distributions are set out in note 14 to these financial statements.

39. LONG-TERM COMPENSATION PLAN

The Company has adopted a long-term compensation plan (the "Plan") which was approved by the shareholders on 18 October 2004 for the purpose of motivating its employees. The Plan provides for the grant of share appreciation rights ("SARs") to eligible participants, including the Company's Directors (excluding independent non-executive Directors), supervisors (excluding independent supervisors), president, vice presidents, heads of key departments in the Company's headquarters, general managers and general deputy managers of principal branches and subsidiaries as well as selected senior professionals and key specialists. In any event, SARs will be granted to no more than 200 individuals. The Plan will remain in force unless otherwise cancelled or amended.

Under the Plan, the holders of SARs are entitled the rights to receive an amount in respect of the appreciation in market value of the Company's H shares from the date of grant of SARs and the date of exercise. No shares will be issued under the Plan and therefore the Company's equity interests will not be diluted as a result of the issuance of SARs. The maximum number of unexercised SARs permitted to be granted under the Plan is, upon their exercise, limited to 2% of the Company's H shares in issue at any time during each year. The maximum number of SARs granted to eligible participants under the Plan within any 12-month period is, upon their exercise, limited to 0.4% of the Company's H shares in issue at any time during each year. The maximum number of SARs granted to any eligible participant is limited to 10% of the total number of unexercised SARs in issue at any time during each year. Any further grant of SARs in excess of the above limits is subject to shareholders' approval in general meetings.

The exercise period of all SARs commences after a vesting period and ends on a date which is not later than five years from the date of grant of the SARs. As of each of the last day of the second, third and fourth anniversary of the date of grant, the total number of SARs exercisable will not exceed 30%, 70% and 100%, respectively, of the total SARs granted to the respective eligible participants.



NOTES TO FINANCIAL STATEMENTS

31 December 2004

39. LONG-TERM COMPENSATION PLAN (continued)

The exercise price of SARs will be equal to the average closing price of the Company's H shares on the Hong Kong Stock Exchange for the five consecutive trading days immediately preceding the date of the grant.

As of 31 December 2004, no SARs had been issued under the Plan.

40. DISTRIBUTABLE RESERVES

As at 31 December 2004, in accordance with the PRC Company Law, an amount of approximately RMB7,703.5 million standing to the credit of the Company's capital reserve account, and an amount of approximately RMB51.9 million standing to the credit of the Company's statutory reserve funds, as determined in accordance with the PRC GAAP, were available for distribution by way of future capitalisation issue. In addition, the Company had retained profits of approximately RMB207.6 million, as determined in accordance with the PRC GAAP and being the lesser amount of the retained profits determined in accordance with the PRC GAAP and IFRS, available for distribution as dividend.

41. CONTINGENT LIABILITIES

Pursuant to the Restructuring, the following legal matters and litigation set out in items (a) to (c) below were transferred to or assumed by the Company upon its incorporation. As of 31 December 2004, the Group had the following contingent liabilities:

- (a) Pursuant to the agreement for the Restructuring entered into by the Company with CNAHC and CNACG, except for liabilities constituting or arising out of or relating to business undertaken by the Company after the Restructuring, no other liabilities were assumed by the Company and the Company is not liable, whether severally, or jointly and severally, for debts and obligations incurred prior to the Restructuring by CNAHC and CNACG. The Company has also undertaken to indemnify CNAHC and CNACG in respect of any damage suffered or incurred by CNAHC and CNACG as a result of any breach by the Company of any provision of the Restructuring Agreement.
- (b) On 15 April 2002, Flight CA129 crashed on approach to Gimhae International Airport, South Korea. There were 129 fatalities including 121 passengers and 8 crew members aboard the crashed aircraft. An investigation was conducted by the Chinese and the Korean civil aviation authorities, but the cause of the accident has yet to be released at the date of these financial statements. Certain injured passengers and families of the deceased passengers have commenced proceedings in Korean courts seeking damages against Air China International Corporation. The Group cannot predict the timing of the courts' judgements or the possible outcome of the lawsuits nor any possible appeal actions. Up to 31 December 2004, the Company, Air China International Corporation and the Company's insurer had paid an aggregate amount of RMB190 million in respect of passenger liability and other auxiliary costs. Included in the RMB190 million is an amount of RMB173 million borne by the Company's insurer. As part of the Restructuring, CNAHC has agreed to indemnify the Group for any liabilities relating to the crash of Flight CA129, excluding the compensation already paid up to 30 September 2004 (being the date of incorporation of the Company). The Directors of the Company believe that there will not be any material adverse impact to the Group's financial position.



NOTES TO FINANCIAL STATEMENTS

31 December 2004

41. CONTINGENT LIABILITIES (continued)

- (c) Air China International Corporation is one of the defendants in a civil litigation in the High Court of Hong Kong (Action No. 515 of 2001) (the "Litigation"). United Aero-Supplies System of China Limited ("UASSC") had entered into an agreement with the defendants for the exclusive purchase of aviation equipment consigned to UASSC for sale and, that as the defendants failed to perform the agreement, UASSC has the right to compensation. Since UASSC is in the course of its winding up proceedings, all the rights and benefits of UASSC in connection with the claim have been transferred to New Link Consultants Limited ("NLC"). Air China International Corporation, as one of the defendants to the Litigation, was claimed by NLC for compensation of HK\$60,000,000 (equivalent to approximately RMB63,600,000) for failing to perform the above agreement. Air China International Corporation has filed an objection in respect of the jurisdiction of the court, and has requested the court to transfer the case to Mainland China for trial. Air China International Corporation received an order in respect of this application on 3 May 2004. The judge granted the application and ordered that the action against Air China International Corporation be dismissed. Subsequent to this order, NLC has filed an appeal. The date of hearing for the appeal has been fixed on 28 July 2005. After considering the aforesaid order granted by the judge and consulting the legal counsel, the Directors of the Company consider that Air China International Corporation has a reasonable chance of success in its defence to the claim. Accordingly, the Directors of the Company consider that a provision for such claim and/or the associated legal costs is not required.
- (d) The Group and the Company have issued guarantees to banks in respect of the bank loans granted to the following parties:

	Group		Company
	2004 RMB'000	2003 RMB'000	2004 RMB'000
Joint ventures	—	18,750	—
Associates	214,002	380,521	26,021
Related party	—	7,500	—
Third parties	—	149,170	—
	214,002	555,941	26,021



NOTES TO FINANCIAL STATEMENTS

31 December 2004

41. CONTINGENT LIABILITIES (continued)

- (e) In addition to the counter-guarantees provided by CNAF in respect of the Group's finance lease obligations and bank loans of RMB4,737 million (2003: RMB5,413 million) as disclosed in note 46 to these financial statements, the Group's associates have issued guarantees to banks in respect of the bank loans granted to the following parties:

	Group	
	2004 RMB'000	2003 RMB'000
Related parties	37,608	40,537
Third parties	160,778	20,722
	198,386	61,259

42. COMMITMENTS

(a) Capital commitments

The Group had the following amounts of contractual commitments for the acquisition and construction of plant, property and equipment:

	Group		Company
	2004 RMB'000	2003 RMB'000	2004 RMB'000
Contracted, but not provided for:			
Aircraft and flight equipment	12,738,066	8,315,908	11,260,840
Buildings	544,855	348,400	211,607
Others	8,426	40,082	8,426
	13,291,347	8,704,390	11,480,873
Authorised, but not contracted for:			
Buildings	2,528,544	2,762,531	2,528,544
Others	—	200,062	—
	2,528,544	2,962,593	2,528,544
Total capital commitments	15,819,891	11,666,983	14,009,417



NOTES TO FINANCIAL STATEMENTS

31 December 2004

42. COMMITMENTS (continued)

(b) Investment commitment

As at 31 December 2004, the Company committed to make a capital contribution of approximately RMB422 million (US\$51 million) (2003: Nil) to its joint venture.

(c) Operating lease commitments

The Group leases certain of its office premises, aircraft and related equipment under operating lease arrangements. Leases for these assets are negotiated for terms ranging from 1 to 20 years.

The Group and the Company had the following future minimum lease payments under non-cancellable operating leases:

	Group		Company
	2004 RMB'000	2003 RMB'000	2004 RMB'000
Within one year	1,140,228	908,204	748,202
In the second to fifth years, inclusive	3,215,879	2,626,283	2,111,282
Over five years	1,000,319	1,317,788	566,585
	5,356,426	4,852,275	3,426,069

43. FINANCIAL INSTRUMENTS

Financial assets of the Group and the Company mainly include cash and cash equivalents, pledged assets, trade receivables, other investments, deposits and other receivables. Financial liabilities of the Group and the Company mainly include bank and other loans, obligations under finance leases, trade payables, other payables, bills payable and air traffic liabilities.

The carrying amounts of the Group's and the Company's financial instruments approximated their fair value as at the balance sheet date. Fair value estimates are made at a specific point in time and based on relevant market information about the financial instruments. These estimates are subjective in nature and involve uncertainties and matters of significant judgement and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates.



NOTES TO FINANCIAL STATEMENTS

31 December 2004

44. CONCENTRATION OF RISK

(a) Financial risk management objectives and policies

The Group operates globally and generates revenues in various currencies. The Group's airline operations are exposed to business risk, liquidity risk, jet fuel price risk, foreign currency risk, interest rate risk and credit risk. The Group's overall risk management approach is to moderate the effects of such volatility on its financial performance.

Financial risk management policies are periodically reviewed and approved by the Board of Directors.

(b) Business risk

The operations of the air transportation industry are substantially influenced by global political and economic development. Factors such as accidents and wars may have a material impact on the Group's operations or the industry as a whole. In addition, the Group primarily conducts its principal operations in the PRC and accordingly is subject to special consideration and significant risks not typically associated with companies in the United States of America and Western Europe. These include risks associated with, among other things, the political, economic and legal environment, competition and influence of the CAAC in the Chinese civil aviation industry.

(c) Liquidity risk

The Group's net current liabilities amounted to approximately RMB6,860 million as at 31 December 2004 (2003: RMB12,384 million). The Group recorded a net cash inflow from operating activities of approximately RMB6,151 million for the year ended 31 December 2004 (2003: RMB5,425 million). For the same period, the Group had a net cash outflow from investing activities of approximately RMB4,974 million (2003: RMB4,360 million). The Group also recorded a net cash inflow from financing activities of approximately RMB5,620 million for the year ended 31 December 2004 and a net cash outflow from financing activities of approximately RMB2,207 million for the year ended 31 December 2003. The Group has recorded an increase in cash and cash equivalents of approximately RMB6,824 million for the year ended 31 December 2004 but a decrease in cash and cash equivalents of approximately RMB1,057 million for the year ended 31 December 2003.

With regards to 2005 and thereafter, the liquidity of the Group is primarily dependent on its ability to maintain adequate cash inflow from operations to meet its debt obligations as they fall due, and on its ability to obtain external financing to meet its committed future capital expenditures. With regards to its future capital commitments and other financing requirements, the Company has already obtained several banking facilities with several PRC banks of up to an amount of RMB71,700 million as at 31 December 2004, of which an amount of approximately RMB40,183 million was utilised.



NOTES TO FINANCIAL STATEMENTS

31 December 2004

44. CONCENTRATION OF RISK (continued)

(c) Liquidity risk (continued)

The Directors of the Company have carried out a detailed review of the cash flow forecast of the Group for the year ending 31 December 2005. Based on such forecast, the Directors have determined that adequate liquidity exists to finance the working capital and capital expenditure requirements of the Group during 2005. In preparing the cash flow forecast, the Directors have considered historical cash requirements of the Group as well as other key factors, including the availability of the above-mentioned loans financing which may impact the operations of the Group prior to the end of 2005. The Directors are of the opinion that the assumptions and sensitivities which are included in the cash flow forecast are reasonable. However, as with all assumptions in regard to future events, these are subject to inherent limitations and uncertainties and some or all of these assumptions may not be realised.

(d) Jet fuel price risk

The Group's strategy for managing the risk on jet fuel price aims to provide the Group with protection against sudden and significant increases in prices. In meeting these objectives, the Group allows for the judicious use of approved derivative instruments such as swaps and collars with approved counter-parties and within approved limits.

Moreover, counter-party credit risk is generally restricted to any gains on changes in fair value from time to time, and not the principal amount of the instrument. Therefore, the possibility of material loss arising in the event of non-performance by a counter-party is considered to be unlikely.

The fair values of derivative instruments of the Group and the Company at the balance sheet date are as follows:

	Group and Company		Group	
	2004 Assets RMB'000	2004 Liabilities RMB'000	2003 Assets RMB'000	2003 Liabilities RMB'000
Swaps and collars expiring:				
Within 6 months	—	—	8,000	(2,400)
Over 6 months to 21 months	—	—	26,000	(3,600)
	—	—	34,000	(6,000)

Fair values of derivative instruments, denominated in United States dollars, are obtained from quoted market prices, dealer price quotations, discounted cash flow models and option pricing models, which consider current market and contractual prices for the underlying instruments, as well as time value of money, yield curve and volatility of the underlying instruments.



NOTES TO FINANCIAL STATEMENTS

31 December 2004

44. CONCENTRATION OF RISK (continued)

(e) Foreign currency risk

The Group's finance lease obligations as well as certain bank and other loans are denominated in United States dollars and Japanese yen, and certain expenses of the Group are denominated in currencies other than RMB. The Group generates foreign currency revenues from ticket sales made in overseas offices and would normally generate sufficient foreign currencies after payment of foreign currency expenses, to meet its foreign currency liabilities repayable within one year. RMB against United States dollars and Hong Kong dollars have been comparatively stable in the past. However, RMB against Japanese yen had experienced a significant level of fluctuation over 2004 which is the major reason for the significant exchange difference recognised by the Group for 2004.

(f) Interest rate risk

The Group's earnings are also affected by changes in interest rates due to the impact of such changes on interest income and expense from short-term deposits and other interest-bearing financial assets and liabilities. A significant portion of the Group's interest-bearing financial liabilities with maturities above one year have predominately fixed rates of interest and are denominated in United States dollars and Japanese yen.

The Group's short-term deposits and other interest-bearing financial assets and liabilities are predominately denominated in RMB, United States dollars and Hong Kong dollars.

(g) Credit risk

The Group's cash and cash equivalents are deposited with PRC banks, overseas banks and an associate. The Group has policies in place to limit the exposure to any one financial institution.

A significant portion of the Group's air tickets are sold by agents participating in the Billing and Settlements Plan ("BSP"), a clearing system between airlines and sales agents organised by the International Air Transportation Association. The balance due from BSP agents amounted to approximately RMB531 million as at 31 December 2004 (2003: RMB342 million).

Except for the above, the Group has no significant concentration of credit risk, with exposure spread over a number of counter-parties.



NOTES TO FINANCIAL STATEMENTS

31 December 2004

45. CONSOLIDATED CASH FLOW STATEMENT

(a) Analysis of balances of cash and cash equivalents is as follows:

	Group	
	2004 RMB'000	2003 RMB'000
Cash and cash equivalents for balance sheet (<i>note 26</i>)	9,734,074	2,620,221
Less: Non-pledged time deposits with original maturity of more than three months when acquired	(320,850)	(30,826)
Cash and cash equivalents for consolidated cash flow statement	9,413,224	2,589,395

(b) Establishment of a joint venture

The establishment of a joint venture has been shown in the consolidated cash flow statement as a single item. The cash flow effect can be analysed as follows:

	2004 RMB'000
Cash and bank balances	561,509
Trade receivables	16,844
Other receivables	2,778
Property, plant and equipment (<i>note 16</i>)	565,840
Inventories	352
Trade payables	(40,018)
Other payables and accruals	(357,517)
Air traffic liabilities	(2,010)
Net assets attributable to the joint venture partners	747,778
Dilution gain on investment (<i>note 9</i>)	330,222
Cash contribution from the joint venture partners	1,078,000
Less: Cash attributable to the joint venture partners	(561,509)
Cash flow on establishment of a joint venture, net of cash attributable to the joint venture partners	516,491



NOTES TO FINANCIAL STATEMENTS

31 December 2004

45. CONSOLIDATED CASH FLOW STATEMENT (continued)

(c) Major non-cash transactions

- (i) During the year, the Group received an aircraft injected by the PRC government amounting to RMB304,787,000 (note 36). This amount has been recorded in property, plant and equipment.
- (ii) Upon incorporation of the Company, CNAHC effected the transfer of certain land use rights in an aggregate amount of approximately RMB885,626,000 to the Company.

46. RELATED PARTY TRANSACTIONS

The Group is part of a larger group of companies under CNAHC and has extensive transactions and relationships with members of CNAHC. As such, it is possible that the terms of these transactions are not the same as those that would result from transactions among wholly unrelated parties. Related parties refer to corporations in which CNAHC is a shareholder and is able to exercise control or significant influence. The transactions were made at prices and terms mutually agreed between the parties.

In addition to the Restructuring, further details of which are set out in note 1 to these financial statements, and transactions and balances detailed elsewhere in these financial statements, the Group had the following significant recurring transactions carried out in the ordinary course of business between the Group and (i) CNAHC, its subsidiaries (other than the Group), joint ventures and associates (collectively known as "CNAHC Group"); (ii) its joint ventures; and (iii) its associates:

	Group	
	2004	2003
	RMB'000	RMB'000
A. Included in air traffic revenues		
Sale of air tickets		
CNAHC Group	17,227	23,477
Associates	2,154	1,363
	19,381	24,840
Sale of cargo space		
CNAHC Group	213,836	282,895



NOTES TO FINANCIAL STATEMENTS

31 December 2004

46. RELATED PARTY TRANSACTIONS (continued)

	Group	
	2004 RMB'000	2003 RMB'000
B. Included in other operating revenues		
Aircraft and related equipment lease income		
CNAHC Group	1,912	9,983
Aircraft engineering income		
Associates	9,876	14,511
Ground services income		
Joint ventures	942	—
Associates	19,849	15,281
	20,791	15,281
Bellyhold income		
Joint ventures	1,384,457	—
Others		
CNAHC Group	5,734	1,100
Joint ventures	14,424	100
Associates	11,484	622
	31,642	1,822
C. Included in finance costs		
Interest income		
Associates	3,409	8,736
Interest expense		
Associates	21,843	21,268



NOTES TO FINANCIAL STATEMENTS

31 December 2004

46. RELATED PARTY TRANSACTIONS (continued)

	Group	
	2004 RMB'000	2003 RMB'000
D. Included in operating expenses		
Airport ground services, take-off, landing and depot expenses		
CNAHC Group	97,183	76,802
Associates	210,103	165,551
	307,286	242,353
Air catering charges		
CNAHC Group	43,241	42,401
Joint ventures	85,874	58,913
Associates	5,123	—
	134,238	101,314
Repair and maintenance costs		
Joint ventures	472,378	324,470
Associates	107,508	45,095
	579,886	369,565
Sale commission expenses		
CNAHC Group	25,913	16,357
Management fees		
CNAHC Group	44,080	36,493
Others		
CNAHC Group	71,729	47,846
Associates	9,050	—
	80,779	47,846



NOTES TO FINANCIAL STATEMENTS

31 December 2004

46. RELATED PARTY TRANSACTIONS (continued)

	Group		Company
	2004 RMB'000	2003 RMB'000	2004 RMB'000
E. Deposits, loans and bills payable			
Deposits placed with an associate	566,985	1,457,103	519,655
Loans from an associate	481,132	297,484	364,400
Bills payable to an associate	—	692,372	—

- (a) In addition to the above, on 18 October 1997, CNAC entered into a licence agreement with CNAC (PRC) pursuant to which CNAC (PRC) had agreed to grant a licence to CNAC, free of royalty, for the right to use certain trademarks in Hong Kong, the Taiwan region and Macau so long as CNAC is a subsidiary of CNACG. No royalty charge was levied in respect for the use of these trademarks during each of the two years ended 31 December 2004.

On 25 August 2004, CNAC (PRC) entered into two assignment agreements with CNACG pursuant to which CNAC (PRC) has agreed to assign, free of royalty, the above-mentioned trademarks to CNACG for use in Hong Kong and Macau, respectively. On 25 August 2004, CNACG entered into two licence agreements with CNAC pursuant to which CNACG has agreed to grant licences to CNAC, free of royalty, for the rights to use those trademarks in Hong Kong and Macau, respectively, so long as CNAC is a direct or indirect subsidiary of CNAHC. These licence agreements supersede the licence agreement entered into between CNAC (PRC) and CNAC on 18 October 1997.



NOTES TO FINANCIAL STATEMENTS

31 December 2004

46. RELATED PARTY TRANSACTIONS (continued)

- (b) Pursuant to certain of the Company's aircraft leasing arrangements and bank loan arrangements, the overseas lessors and lenders require guarantees to be given by some major PRC state-owned banks. In giving such guarantees, the PRC state-owned banks in turn require CNAHC and CNAF to provide counter-guarantees in favour of the banks. As at the balance sheet date, the amounts of such counter-guarantees provided by CNAHC and CNAF were as follows:

	Group	
	2004 RMB'000	2003 RMB'000
CNAHC:		
Finance leases (note 33)	921,000	5,355,000
Operating leases	—	3,891,000
Bank loans (note 34)	1,455,000	3,198,000
	2,376,000	12,444,000
CNAF:		
Finance leases (note 33)	3,976,000	4,506,000
Bank loans (note 34)	761,000	907,000
	4,737,000*	5,413,000
	7,113,000	17,857,000

* Subsequent to 31 December 2004, these counter-guarantees provided by CNAF amounting to RMB4,737 million in favour of the banks have been fully released.

Certain of the Group's bank loans from the PRC banks are guaranteed by Air China International Corporation and other related parties, further details of which are set out in note 34 to these financial statements.

- (c) In connection with the Restructuring, the Company entered into several agreements with CNAHC which govern the use of trademarks granted by the Company to CNAHC, the provision of financial services by CNAF, the provision of construction project management services by China National Aviation Construction and Development Company, the subcontracting of charter-flight services to CNAHC, the leasing of properties from and to CNAHC, the provision of air ticketing and cargo services, media and advertising services arrangement to China National Aviation Media and Advertising Co., Ltd., the tourism services co-operation agreement with CNAHC, the comprehensive services agreement with CNAHC, and the provision of maintenance and other ground services by China Aircraft Services Limited.



NOTES TO FINANCIAL STATEMENTS

31 December 2004

46. RELATED PARTY TRANSACTIONS (continued)

- (d) On 19 August 2004, Fly Top Limited, a wholly-owned subsidiary of CNAC, entered into the following acquisition agreements:
- (i) a sale and purchase agreement with CNACG in relation to the acquisition of approximately 16% of the issued share capital of LSGHK, a company incorporated in Hong Kong with limited liability (“CNACG Agreement”); and
 - (ii) a sale and purchase agreement with Hong Kong International Air Catering Limited (“HKIAC”), a company incorporated in Hong Kong with limited liability and in which Air China International Corporation has a 25% equity interest, in relation to the acquisition of approximately 4.2% of the issued share capital of LSGHK (“HKIAC Agreement”).

The total consideration of the above acquisitions is approximately RMB122 million. Immediately after the completion of the CNACG Agreement and HKIAC Agreement, the Group’s effective shareholding interests in LSGHK is approximately 14%.

- (e) All pension payments relating to the Supplementary Pension Benefits of approximately RMB39 million for the year ended 31 December 2004 (2003: RMB54 million) were borne by CNAHC (note 11).

The Directors of the Company are of the opinion that the above transactions with related parties were conducted in the usual course of business.

47. EVENTS AFTER THE BALANCE SHEET DATE

- (a) On 11 January 2005, upon the exercise of the over-allotment option, the Company issued to the public by way of placement of 420,852,000 H Shares, consisting of 382,592,727 new shares and 29,749,686 State legal person shares and 8,509,587 non-H Foreign Shares, with a par value of RMB1.00 each at HK2.98 (equivalent to approximately RMB3.17072) per share. After deducting net proceeds of approximately RMB117 million received from the sale of these State legal person shares and non-H Foreign Shares, the amount of which should be remitted to the Social Security Fund, and share issue expenses of approximately RMB47 million (before deducting share issue expenses of approximately RMB4 million borne by the Social Security Fund as mentioned above), the Company raised net proceeds of approximately RMB1,170 million, of which paid-up share capital amounted to approximately RMB383 million and capital reserve amounted to approximately RMB787 million. The above H shares rank *pari passu*, in all material respects, with the State legal person shares and non-H Foreign Shares of the Company.



NOTES TO FINANCIAL STATEMENTS

31 December 2004

47. EVENTS AFTER THE BALANCE SHEET DATE (continued)

- (b) On 26 January 2005, the Company and AIE entered into an agreement with Airbus S.A.S. ("Airbus"), pursuant to which the Company has agreed to purchase 20 A330-200 aircraft (the "Airbus Aircraft") from Airbus for an aggregate consideration of approximately US\$2.86 billion (equivalent to approximately RMB23.68 billion). The aggregate consideration for the acquisition of Airbus Aircraft is payable in cash by instalments. The Airbus Aircraft are scheduled to be delivered in stages to the Company from mid-2006 to end of 2008. Pursuant to the relevant Chinese regulations, the acquisition of Airbus Aircraft is conditional upon the PRC government's approval. As of the date of approval of these financial statements, the said government approval has not been obtained by the Company.
- (c) On 28 January 2005, the Company, other contracting Chinese airlines, China Aviation Supplies Import and Export Group Corporation ("CASGC") and Boeing Company entered into an agreement (the "Framework Agreement"), pursuant to which CASGC agreed to purchase (as an agent of the Company and other contracting Chinese airlines) 60 Boeing 7E7 aircraft. The aggregate catalog price of the aircraft is approximately US\$7.3 billion (equivalent to approximately RMB60.42 billion). Pursuant to the Framework Agreement, the Company expects to enter into a specific purchase agreement with CASGC and Boeing Company in respect of the purchase of 15 Boeing 7E7 aircraft (the "Boeing Aircraft"). The aggregate consideration for the acquisition of the Boeing Aircraft is expected to be lower than the catalog price. The delivery of the Boeing Aircraft is expected to take place in stages from mid-2008. The specific purchase agreement has not been finalised as at the date of approval of these financial statements.

48. APPROVAL OF THE FINANCIAL STATEMENTS

The financial statements were approved and authorised for issue by the Board of Directors on 12 April 2005.