

MANAGEMENT DISCUSSION AND ANALYSIS

Having had the consolidation of the PRC aviation transportation market in the first half of 2005, traffic volume of Hainan Meilan International Airport experienced contraction for the first time since its inauguration. Embracing the philosophy of “integrity, performance and innovation”, Meilan Airport proactively adopted measures to broaden sources of income and reduce expenditure. Adhering to a market-oriented approach, the Group steps up its exploration of the aviation market on the basis of dual objectives of revenue growth and cost reduction. On one hand, the Group endeavors to enhance domestic route distribution and expedite international route expansion by capturing opportunities arising from the opening of aviation rights. On the other hand, the Group will speed up the restructuring of internal management processes, while continue to enhance the safety standard of its services and to scale down its cost.

For the six months ended 30 June 2005, the Group’s total revenue amounted to approximately RMB173,949,000, representing a decrease of 7.9% compared to the corresponding period of last year. Net profit attributable to equity holders of the Company decreased by 20.4% from the corresponding period of last year to RMB80,890,000. Earnings per share were RMB17 cents (Corresponding period of last year: earnings per share were RMB21 cents).

The decrease in the Group’s business revenue and net profit attributable to equity holders during the first half of the year was mainly attributable to the airlines’ concentrated efforts in enhancing their primary route network through the focused deployment of resources on three nationwide pivotal airports in Beijing, Shanghai and Guangzhou, which contributed to a drop in the capacity allocated to Hainan Meilan International Airport and resulted in the contraction of its traffic volume and aircraft movements. Besides, the income tax of the Company was changed from full exemption to a 50% reduction since 2005, which is another important reason for the decrease in the net profit attributable to equity holders of the Company.

BUSINESS REVIEW

1. Aeronautical business

For the six months ended 30 June 2005, accumulated passenger throughput was 3,629,000 persons, representing a decrease of 5.8% as compared to the corresponding period of last year. Aircraft movement was 35,254, representing a decrease of 1.2% as compared to the corresponding period of last year; while cargo throughput reached 52,328.8 tons, representing a decrease of 2.8% compared to the corresponding period of last year.

Revenue from the Group’s aeronautical business was RMB128,828,000, representing a decrease of 6% as compared to the corresponding period of last year, which was mainly attributable to the decline in aircraft movement of 5.2% as compared to the corresponding period of last year.

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Major reasons for the contraction of traffic volume and the adoption of corresponding measures

The decrease in traffic volume from the corresponding period of last year was primarily due to the strengthening of the management of airline routes and flights by the Civil Aviation Administration of China ("CAAC"), prompting airlines to enhance their primary route network through the focused deployment of resources on three nationwide pivotal airports in Beijing, Shanghai and Guangzhou. This contributed to a drop in the capacity allocated by major airlines to Haikou and resulted in the contraction of traffic volume at Hainan Meilan International Airport.

In an attempt to enhance the competitiveness of Hainan Meilan International Airport, the Group continued to step up its marketing efforts on domestic routes, establishing close relationships with airline companies to attract more flights to and from Haikou. In addition, the Group proactively expedited its international route expansion, endeavoured to attract more international airlines to develop routes to and from Haikou, with the view of increasing the operation and revenue from international routes. The Group also assisted domestic airlines in applying to the CAAC for the right to operate routes from Haikou so as to provide Hainan Meilan International Airport with more room for development.

Exploration of international routes

In view of the opening of aviation rights and the rapid development of the PRC civil aviation industry in the first half of the year, the Group proactively attracted international airlines to launch routes to and from Haikou. This expedited the development of a business model compatible with that of the international civil aviation industry and established its brand as a quality international airport. All of the above efforts brought fruitful results.

As at 30 June 2005, 14 international airline companies launched routes to and from Haikou. Additional flights launched during the period included charter flights between Haikou and Bangkok (3 flights per week) launched by PB Air of Thailand in February 2005, charter flights between Kuala Lumpur and Haikou launched by Air Asia of Malaysia in March and charter flights between Singapore and Haikou launched by Silk Air of Singapore in May. It is also Air Asia's current plan to launch charter flights between Bangkok and Haikou and between Indonesia and Haikou in the second half of the year. In mid July, daily schedule flights between Hong Kong and Haikou were also launched by CR Airways of Hong Kong, further demonstrating the Group's capability in expanding its international route network.

With the view of proactively establishing new routes, the Group attended New Routes Asia Conference in Kuala Lumpur, Malaysia in March and explored opportunities for cooperation with numerous international airlines, which showed immense interest in developing the Haikou route. In addition, the Group travelled to Japan in June, to negotiate with Japanese airlines such as Japan Airlines and All Nippon Airways on route arrangements. Some airlines have already indicated their initial intention for cooperation.

In addition, representatives from Malaysian Airlines arrived at Hainan Meilan International Airport in June to conduct field studies and carried out studies and researches on the establishment of new routes. Likewise, international airlines in Russia and some Southeast Asian countries are carrying out similar studies and researches. Meanwhile, the Group will continue to forge stronger ties with domestic airlines and discuss the feasibility of introducing extended aviation rights (positioning Haikou as a transit point to other Southeast Asian regions). Shandong Airlines has conducted research on the route between Jinan and Bangkok via Haikou and the route between Jinan and Kuala Lumpur via Haikou.

For the six months ended 30 June 2005, international aircraft movements at Hainan Meilan International Airport reached 529, representing an increase of 86.3% compared to the corresponding period of last year. Passenger throughput of international flights increased by 77.3% compared to the corresponding period of last year to 46,805 persons. While cargo throughput of international flights surged by 400.3% from the corresponding period of last year to 153.1 tons. As at 30 June 2005, Hainan Meilan International Airport had established five international routes with fixed flight schedules and one international route with an unfixd flight schedule.

Construction work of the new passenger terminal building and apron

The core construction work of the passenger terminal building and apron under Phase II expansion plan of Hainan Meilan International Airport was completed with the external wall elevated, boarding bridge installed and commissioned and internal escalators installed. Currently the interior decoration work is underway and the ancillary systems for ebb electricity, air-conditioning, electricity and water drainage are being installed and tested. The core construction work of the apron was completed and successfully passed inspection. The project has proceeded to the closeout stage of runway line drawing, cable installation and asphaltting of roads for service vehicles. The expansion project of the passenger terminal building and apron is at its construction closeout stage pending inspection. The construction work is expected to be completed and inspected within this year. The building and apron may commence operation once the permit is granted by CAAC after inspection. The expansion of Hainan Meilan International Airport laid a solid foundation for the Group to expand its operation scale, enhance efficiency and propel its future development.

2. Non-aeronautical business

For the six months ended 30 June 2005, revenue from the Group's non-aeronautical business amounted to RMB45,121,000, representing a decrease of 12.9% compared to the corresponding period of last year. It was mainly attributable to the decrease in tourism transportation revenue of 23.6% as compared to the corresponding period of last year, together with a decrease of 35% in retail revenue as the operation of the shopping mall was passed to Duty Free Shoppers Hong Kong Limited ("DFS").

The Group has expedited the transformation of its existing management model on the non-aeronautical business and has established close working relationships and devised a win-win business cooperation mechanism with Select Service Partner Hong Kong Limited ("SSP") and DFS, both being internationally renowned companies.

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For the first half of the year, revenue from the Group's advertising company amounted to RMB4,269,000, representing an increase of 3% from the corresponding period of last year.

For the first half of the year, revenue from the Group's travel company accumulated to a total of RMB10,384,000, representing a decrease of 23.6% from the corresponding period of last year. It was mainly attributable to the decline in passenger throughput and the increase in the free tourism.

For the first half of the year, revenue from the Group's carparks amounted to RMB2,840,000, representing an increase of 7.8% from the corresponding period of last year.

For the first half of the year, revenue from the Group's rental and franchise fee amounted to RMB15,858,000, almost the same as the corresponding period last year. DFS commenced its formal operation since 15 March, which is three and a half months before the end of June. During that period, stores were handed over and renovated. The concession fee paid by DFS to the airport is mainly determined by the monthly minimum rate set according to the store operation and the number of tourists (departing tourists) every month. With the commencement of the operation of stores and the growth in the number of tourists, the Company will charge DFS a higher franchise fee.

3. Endeavor to build its brand reputation and enhance safety standard of its services

Hainan Meilan International Airport has obtained awards from the "Passenger Evaluation of Civil Aviation Survey" for three consecutive years. In the first half of 2005, the accreditation served as a new starting point and a new opportunity, for the Company to proactively implement its "Customer Satisfaction Project" and to take initiatives to accommodate changes in customers' demand for more personalized services as opposed to the previous uniform services. The Group will continue to adhere to its service philosophy, provide innovative services and improve services quality, so as to establish Meilan Airport's brand as a quality service provider.

Participants attending the international summit "Annual Bo'ao Forum for Asia" and members of the National People's Congress and National Committee of the Chinese People's Political Consultative Conference of Hainan Province attending conferences held in Beijing in the first half of the year were provided with secure, efficient and quality ancillary services by the Group, while services provided during the Chinese New Year and the "Labour Day" golden week holiday also reached security standard, enabling the Group to win tremendous recognition and high acclaim from all parties.

4. The successful establishment of an international hygienic airport

Besides focusing on brand building for its tourist services, the Group endeavored in enhancing its corporate competitiveness, pursued a sustainable development strategy and strengthened its profile as an international hygienic airport in the first half of 2005. On 1 May 2005, Hainan Meilan International Airport successfully passed the stringent tests of World Health Organisation and became the fourth international hygienic airport in the PRC, after Shenzhen Baoan International Airport, Beijing Capital International Airport and Shanghai Pudong International Airport.

FINANCIAL REVIEW

1. Liquidity and financial resources

As at 30 June 2005, the Group's current assets amounted to RMB604,154,000, comprising cash and cash equivalents of RMB336,670,000, time deposits of RMB102,467,000, net trade receivable of RMB148,543,000, inventories at cost of RMB2,987,000, other receivables and prepayments of RMB9,093,000 and amounts due from related parties of RMB4,394,000.

As at 30 June 2005, the Group's current liabilities amounted to RMB106,887,000, comprising the outstanding principal of the long-term loans granted by China Development Bank of RMB50,000,000, trade and other payables of RMB53,942,000 and current income tax liabilities of RMB2,945,000.

2. Operating costs

For the first half of 2005, the Group's costs of services and sales of goods amounted to RMB47,744,000, representing a decrease of 4.5% as compared to the corresponding period of last year. The decrease was mainly attributable to the decrease in the revenue from duty free products and tourism transportation services, which led to the cost reduction of 32% and 21% respectively.

For the first half of 2005, the Group's administrative expenses amounted to RMB33,738,000, representing an increase of 21% from the corresponding period last year. The increase was mainly attributable to writing off net goodwill of RMB3,485,000 in compliance with new International Financial Reporting Standards.

3. Gearing ratio

As at 30 June 2005, the Group had current assets of RMB604,154,000 and total assets of RMB1,704,881,000, and the Group's current liabilities and total liabilities amounted to RMB106,887,000 and RMB196,270,000 respectively. The Group's gearing ratio (total liabilities/total assets) was 11.5%, representing a decrease of 2.63% compared to that as at 31 December 2004, which was mainly due to the decrease in trade and other payables of RMB47,270,000 or 46.7%.

4. Pledge of the Group's assets

The Group pledged its rights to revenues to secure a long-term bank loan of RMB128,000,000 from China Development Bank.

5. The Group's share capital structure

As at 30 June 2005, the share capital of the Company was RMB473,213,000. The proposed interim dividend is RMB39,750,000.

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6. Performance and prospect of substantial investments held

As at 30 June 2005, The Group or the Company did not have any significant investment.

7. Purchases, Sales or Redemption of Shares

As at 30 June 2005, the Group or the Company had not purchased, sold or redeemed any of the Company's shares.

8. Entrusted deposits and overdue fixed deposits

As at 30 June 2005, the Group or the Company did not have any entrusted deposits and overdue fixed deposits.

9. Contingent liabilities

As at 30 June 2005, the Group or the Company did not have any contingent liabilities.

10. Exposure to foreign exchange risks

Except for the purchase of certain equipment, goods and materials and the payment of consultancy fees which are denominated in US Dollar, the Group's business is mainly denominated in Renminbi ("RMB"). Dividends to equity holders holding H shares are declared in RMB and paid in Hong Kong Dollar. As at 30 June 2005, the Group's other assets and liabilities were denominated in RMB, only cash and cash equivalents of approximately RMB3,639,000 were denominated in HK Dollar or US Dollar. The Directors believe that the Group's business is not subject to any substantial foreign exchange risk. The Group was not materially affected by the appreciation of Renminbi in July.

11. Recognition of incomes and fees related to connected transactions with Southern Airlines, Hainan Airlines and HNA Group

As at the date of this report, the Group was in negotiation with China Southern Airlines Company Limited ("Southern Airlines"), its promoter shareholder (but not the Group's existing equity holder) with respect to an agreement on the leasing of commercial space at the new terminal. The rental fee is RMB3,081,000 for the six months ended 30 June 2005, which has been agreed by the Company and Southern Airlines.

The property leasing contract entered into between the Group and its major shareholder Hainan Airlines Company Limited ("Hainan Airlines") was not approved at the Extraordinary General Meeting on 17 and 18 May 2005. The Group is negotiating a new transaction contract with Hainan Airlines and is taking steps to comply with the reporting, announcement and independent shareholders' approval (if applicable) requirements. For the six months ended 30 June 2005, the Directors consider that it is appropriate to recognise the rental income amounting to RMB3,350,000 and franchise fee amounting to RMB3,000,000, which are determined according to the new agreements with Hainan Airlines.

The comprehensive support service agreement entered into between the Group and its major shareholder HNA Group Co., Ltd. ("HNA Group") and the stipulated annual transaction cap was not approved at the Extraordinary General Meeting on 17 and 18 May 2005. The Group is negotiating a new transaction agreement and an annual transaction cap with HNA Group and is taking steps to comply with the reporting, announcement and independent equity holders' approval requirements. The Directors of the Company believe that a fee of RMB5,362,000 shall be paid to HNA Group for the period ended 30 June 2005.

NO OTHER MATERIAL CHANGE

Other than those discussed in this interim report, there has been no material change in relation to the information disclosed in the Company's 2004 Annual Report in accordance with Rule 32 set out in Appendix 16 to the Listing Rules.

PROSPECTS FOR THE SECOND HALF OF THE YEAR

For the second half of 2005, the Group will continue to enhance its core business development, adjust its sales strategy in a timely manner, establish a wider array of effective communication channels with international airlines, attract more airlines to establish routes to and from Hainan, strengthen its budget management and cost control, enhance the safety standard of its services, promulgate safety rules and regulations, and improve the technology of its equipment with the view of upgrading safety standards. The Group will further apply the funds raised from the issuance of H Shares to gradually implement its stated plans and realize its business development strategy for further enhancement of the Company's value and equity holders' returns.

INTERIM DIVIDEND

The Board has resolved the payment of an interim dividend of RMB8.4 cents per share for the six months ended 30 June 2005 to the equity holders of the Company whose names appear on the Company's Register of Members on Friday, 16 September 2005. In accordance with the Articles of Association of the Company, dividends payable to holders of Domestic Shares will be paid in Renminbi, whereas dividends payable to holders of H Shares will be calculated and declared in Renminbi and paid in Hong Kong Dollars. The exchange rate to be adopted shall be the average closing rates for the five working days preceding the date of dividend declaration as quoted by the People's Bank of China.

CLOSURE OF REGISTER OF MEMBERS

The Register of Members of the Company will be closed from Monday, 19 September 2005 to Friday, 23 September 2005, both days inclusive, during which period no transfer of shares will be registered. In order to qualify for the interim dividend, all instruments of transfers, accompanied by the relevant share certificates, must be lodged with the H Share Registrar of the Company, Computershare Hong Kong Investor Services Limited at Shop 1712-1716, 17th Floor, Hopewell Centre, 183 Queen's Road East, Wanchai, Hong Kong, no later than 4 p.m. on Friday, 16 September 2005. The interim dividend is expected to be payable on or before Friday, 21 October 2005 to shareholders whose names appear on the Register of Members on Friday, 16 September 2005.

MATERIAL LITIGATION AND ARBITRATION

The Company had no material litigation or arbitration from 1 January 2005 to 30 June 2005.