



中航興業有限公司

CHINA NATIONAL AVIATION COMPANY LIMITED

(於香港註冊成立之有限公司)

*(incorporated in Hong Kong with limited liability)*

2005

中期報告

**INTERIM REPORT**



## CORPORATE INFORMATION

### Directors

Kong Dong (*Chairman*)  
Chuang Shih Ping  
Zhang Xianlin  
Tsang Hing Kwong, Thomas  
Gu Tiefei  
Zhao Xiaohang  
Lok Kung Nam\*  
Hu Hung Lick, Henry\*  
Ho Tsu Kwok, Charles\*  
Li Kwok Heem, John\*  
Chan Ching Har, Eliza\*

\* *Independent Non-Executive Directors*

### Company Secretary

Li Man Kit

### Registered Office

5th Floor, CNAC House  
12 Tung Fai Road  
Hong Kong International Airport  
Lantau  
Hong Kong

### Principal Bankers

Bank of China (Hong Kong) Limited  
Nanyang Commercial Bank, Ltd.  
Bank of Communications, Hong Kong Branch

### Solicitors

Baker & McKenzie

### Auditors

PricewaterhouseCoopers

### Public Relations

Ketchum Newscan Public Relations Limited

### Share Registrars

Computershare Hong Kong Investor Services Limited  
17th Floor, Hopewell Centre  
183 Queen's Road East  
Wanchai  
Hong Kong

### Financial Calendar

Six months ended 30th June, 2005

Book Close from 20th September, 2005  
to 23rd September, 2005

2005 interim dividend payable 13th October, 2005



The Board of Directors (the “Directors”) of China National Aviation Company Limited (the “Company”) is pleased to present the unaudited condensed consolidated interim financial information (“Interim Financial Information”) of the Company and its subsidiaries (collectively the “Group”) for the six months ended 30th June, 2005. The consolidated income statement, consolidated statement of changes in equity and consolidated cash flow statement for the Group for the six months ended 30th June, 2005, and the consolidated balance sheet as at 30th June, 2005 of the Group, all of which are unaudited and condensed, along with selected explanatory notes, are set out on pages 12 to 38 of this report.

## **MANAGEMENT DISCUSSION AND ANALYSIS**

### **Review of Operations and Prospects**

During the first half of 2005, the Group continued the growth momentum of 2004. However, mounting oil prices inevitably added pressure to the aviation industry. With effective cost control measures and new business drivers, the Group supported a healthy operation in the face of a more difficult operating environment.

The Group has established a strong presence in the airline catering industry, following the successful acquisition of a 60 per cent equity interest in Beijing Air Catering Co., Ltd and Southwest Air Catering Company Limited respectively, and an approximately 20 per cent equity interest in LSG Lufthansa Service Hong Kong Limited in 2004. Contribution from this sector accounted for approximately 9.7 per cent and 12.9 per cent of the total revenue and profit attributable to equity holders of the Company respectively. The management believes that this sector will be significant to enhance the Group’s resilience in dealing with the industry’s fast-changing landscape in the future.

For the six months ended 30th June, 2005, turnover of the Group increased 52 per cent to HK\$1.2 billion. Operating profits of the Group in the period reached HK\$18.8 million compared to last year’s operating loss of HK\$15.8 million. The Group recorded a profit attributable to equity holders of the Company of HK\$122.9 million, up 1.9 per cent compared to last year’s HK\$120.6 million. Basic earnings per share were HK3.71 cents (2004: HK3.64 cents).

### ***Air Macau Company Limited (“Air Macau”)***

The operation of Air Macau in the first half of 2005 was influenced by rising fuel prices and the entry of other low-cost-carriers (“LCC”) in the Macau SAR. To remain profitable in such a competitive environment, Air Macau adopted effective measures such as suspending services that suffered operational losses and reallocating resources to more promising markets. Moreover, Air Macau would further contain operating costs by enhancing its efficiency and productivity with streamlined workflows and procedures.

During the period, Air Macau doubled its daily passenger service to Beijing, making a total of 14 scheduled flights weekly. Air Macau also increased its scheduled flights to Taipei to 76 weekly, Kaohsiung to 28 weekly, Manila and Nanjing to three weekly and Seoul to seven weekly respectively. Meanwhile, services to Bangkok were suspended since May 2005 for commercial reasons. “Privileges”, a new passenger loyalty program, was introduced in February 2005 replacing the former CIP Club. By 30th June, 2005, “Privileges” has successfully recruited over 30,000 members, confirming its position as one of the most attractive airline loyalty programs in Asia. In line with the plan of International Air Transport Association (IATA) to implement e-ticket services for all carriers by 2007, Air Macau set up a division to work on its internet booking and electronic ticketing arrangements in early 2005. Furthermore, Air Macau reinforced its efforts and resources in the cargo business. By the end of the first half of 2005, Air Macau has increased its freighter schedule to 58 weekly; including 33 weekly to Taipei, 11 weekly to Shanghai, ten weekly to Shenzhen and four weekly to Xiamen.



Total operating revenue in the first half of 2005 (MOP 1,112.18 million) increased 37 per cent compared to the same period of 2004 (MOP 811.77 million). Number of flights operated rose 20.1 per cent, from 9,549 flights in the first half of 2004 to 11,466 in the first half of 2005. Air Macau carried 980,535 passengers in the first half of 2005, representing an increase of 24.1 per cent from 790,355 in the same period of 2004. Cargo tonnage increased 72.4 per cent from 37,423.62 tonnes in 2004 to 64,524.44 tonnes in 2005.

Passenger activities in terms of revenue passenger kilometres (“RPK”) increased 21.8 per cent from 943.68 million in 2004 to 1,149.47 million in 2005. Passenger load factor increased from 66.08 per cent in 2004 to 69.12 per cent in 2005. Cargo activities in terms of cargo tonne kilometres (“CTK”) increased 98.01 per cent from 36.20 million in 2004 to 71.68 million in 2005. On the other hand, cargo load factor slightly decreased from 65.17 per cent in 2004 to 65.16 per cent in 2005.

As at 30th June, 2005, Air Macau operated a fleet of 16 aircraft, of which 12 were passenger aircraft (seven Airbus 321s, one A320 and four A319s) and four were freighters (three A300-B4 and one Boeing 727-200). Air Macau is currently operating in a network of 13 cities - Beijing, Chengdu, Haikou, Kunming, Guilin, Nanking, Shanghai, Xiamen, Shenzhen, Taipei, Kaohsiung, Manila and Seoul.

#### ***Hong Kong Dragon Airlines Limited (“Dragonair”)***

Rising fuel prices affected Dragonair significantly as the system-wide fuel price increased substantially by 47.0 per cent over the same period last year. Fuel accounted for 23.0 per cent of total operating costs, an increase of 6.7 percentage points over the same period last year. Apart from the fuel hedging program and fuel surcharge partially offsetting the negative impact caused by soaring fuel prices, Dragonair also adopted stringent cost control measures to cut down other operating costs. Unit cost per available tonne kilometre (excluding fuel) dropped by 7.4 per cent.

Passenger revenue surged significantly by 18.8 per cent over the same period in 2004 to HK\$2,733.5 million, due to increased passenger service capacity to the PRC and a new passenger route to Tokyo since April 2004. Total passenger carried reached 2.4 million, representing a 15.5 per cent increase over the same period last year. Passenger load factor was up by 2.8 percentage points to 64.1 per cent and passenger yield per RPK increased by 2.6 per cent.

Cargo revenue increased by 40.7 per cent compared to the same period in 2004. Cargo demand remained robust with 180,000 tonnes of cargo carried in the first half of 2005, representing a growth of 21.8 per cent. This was contributed by higher tonnage carried by our new passenger and freighter services. However, cargo load factor decreased by 2.5 percentage points to 71.6 per cent. Cargo yield per CTK remained stable as compared to the same period of 2004. In April 2005, Dragonair launched its first trans-Pacific freighter service to New York using a wet-leased B747-400 freighter.

As at 30th June, 2005, Dragonair operated passenger services to 30 destinations in Asia, of which 21 were in China mainland. It also offered freighter services to 11 destinations in Asia, Europe and the USA.



Two A330s under operating lease were delivered in March and May 2005, while one purchased A320 was delivered in April 2005. By the end of June 2005, the Dragonair fleet included 11 A320s, six A321s, 12 A330s, one B747-200 freighter, three B747-300 freighters, one wet leased B747-400 freighter and one wet leased A300B4 freighter. One A330 under operating lease will be delivered in October 2005.

The code-share agreement with Air China Limited (“Air China”) has been extended in 2005 to cover Beijing, Hangzhou and Wuhan, in addition to Chengdu, Chongqing, Dalian and Tianjin, which were opened under the same agreement signed in 2004.

Dragonair celebrated its 20th anniversary in May 2005. Over the past two decades, Dragonair has developed into a full-service passenger carrier dedicated to serving major markets in the world. The airline’s quality service has been recognised with the Award of the “Best Airline – China” for four consecutive years from 2002 to 2005. Despite higher fuel costs, with ongoing fleet expansion plans for both passenger and freighter services and efforts in controlling costs, the management remains optimistic about the future development of the airline.

#### ***Beijing Air Catering Co., Ltd (“BACL”)***

During the first half of 2005, BACL provided in-flight catering services for 48,329 flights, up 13 per cent over the same period last year. The total number of in-flight meals served increased 12 per cent over the same period last year to over 6.4 million, equivalent to daily handling about 35,600 in-flight meals on average. It remains the largest in-flight caterer in Beijing Capital International Airport with an approximately 80 per cent market share.

With the upcoming 2008 Beijing Olympic Games, more flights will be expected in Beijing Capital International Airport in the following years. BACL is well positioned to capture the growing demand of in-flight catering services.

#### ***Southwest Air Catering Company Limited (“SWACL”)***

During the first half of 2005, SWACL provided in-flight catering services for 11,500 flights, an increase of 14 per cent over the same period last year. The total number of in-flight meals served increased to over 1.6 million, equivalent to daily handling of about 9,000 in-flight meals on average. It remains the largest in-flight caterer in Chengdu Shuangliu International Airport with a market share of approximately 70 per cent.

With the new catering building commencing its operation in the second half of 2004, it has the capacity of handling 20,000 in-flight meals per day. This strengthened capability enables SWACL to serve more airline customers. Among the newly secured China mainland and foreign airlines, Dragonair has also started using SWACL’s in-flight catering services from August 2005.



### ***LSG Lufthansa Service Hong Kong Limited (“LLSHK”)***

Compared to the first half of 2004, the number of meals served and the number of flights catered by LLSHK increased 12.3 per cent and 13.1 per cent respectively because of a rising demand in air travel.

Despite higher revenue as a result of frequent air travel, the profit margin in the first half of 2005 maintained at about the same level as the same period last year. This was mainly due to price-cut policies of most airlines. Various lean and cost saving measures are in place to cope with such pressure.

Continual revenue and volume growth will be expected in the second half of 2005 in light of the growing air travel in the summer vacation period.

### ***Jardine Airport Services Limited (“JASL”)***

In the first half of 2005, consolidated turnover of JASL increased 12.7 per cent mainly due to an increase in flight frequencies handled. JASL handled 32,330 aircraft movements, an increase of 16.6 per cent over that of 2004, and maintained approximately 40 per cent share of the third-party ground handling market at Hong Kong International Airport (“HK Airport”). Jardine Air Terminal Services Limited (“JATS”) handled 42,628 aircraft movements, an increase of 9.8 per cent compared to the same period of 2004, representing an approximately 60 per cent share of the third-party ramp handling market at the HK Airport.

Given the strong support and business connections with its shareholders, JASL will continue to explore and secure new business opportunities in the China mainland.

### ***Menzies Macau Airport Services Limited (“Menzies Macau”)***

For the first six months ended 30th June, 2005, Menzies Macau handled 10,389 aircraft turns, representing an increase of 18 per cent over the same period last year. However, Menzies Macau handled 9% less cargo compared to the same period of 2004. The reduction in cargo volume was due to keen competitions from the surrounding airports.

With the commencement of other foreign LCC passenger services to Macau and Air Macau's additional freighter flights, Menzies Macau is expecting a growth in its aircraft and cargo handling services during the second half of 2005.

### ***Tradeport Hong Kong Limited (“Tradeport Hong Kong”)***

Tradeport Hong Kong grew significantly during the first half of 2005. At the end of June 2005, space utilisation of the Logistics Centre was 66 per cent against 48 per cent in June 2004. The major rental agreement for the whole ground floor of the Logistics Centre was concluded during the review period. Revenue from existing customers also rose considerably. Consolidated revenue in the first half of 2005 was HK\$28.5 million, up 96 per cent over the same period last year.



## **Outlook**

With the opening of the Hong Kong Disneyland and the burgeoning entertainment and gaming industry in Macau, tourism in these regions will remain upbeat in the second half of 2005. The frequent air travel in Asia will help open up more business opportunities for the aviation industry as a whole.

However, high fuel costs throughout 2005 may dampen the future of the industry. The Group will alleviate the impact with continuous efforts to achieve a streamlined operation and new business ventures. For instance, the newly acquired catering business will become a pillar of an upward development of the Group. Entry of other airlines may be generally seen as a ground for fierce competition in the aviation industry. However, the Group believes the participation of these new players will translate into a catalyst for tourism in Asia.

With an aim to fully capitalise on the business prospects in Asia, the Group's initiatives in LCC business have been well underway. Despite a more competitive and dynamic operating environment ahead, the Group is confident to achieve business growth in the second half of 2005.

## **Financial Review**

### **Liquidity and Financial Resources**

As at 30th June, 2005, the capital and reserves attributable to the Company's equity holders amounted to HK\$3,062 million, compared to HK\$2,968 million as at 31st December, 2004.

The Group generally financed its operations with cash flows generated internally. As at 30th June, 2005, the Group had cash and bank balances of a total amount of approximately HK\$1,060 million and total assets of approximately HK\$4,089 million, as compared to HK\$814 million and HK\$3,949 million respectively as at 31st December, 2004. The current liabilities of the Group increased from HK\$607 million (restated as at 31st December, 2004) to HK\$643 million as at 30th June, 2005. The Group consistently maintained a strong working capital base that provides a good foundation for the Group's future business development.

The Group's gearing ratio expressed as a percentage of total borrowings to equity attributable to equity holders of the Company as at 30th June, 2005 was 1.7% (31st December, 2004: 2.3%).

### **Share Capital**

There were no options granted or exercised during the period, and 104,378,000 options remained outstanding as at 30th June, 2005.

As at 30th June, 2005, 3,312,680,000 shares were in issue (31st December, 2004: 3,312,680,000 shares).

### **Contingent Liabilities and Commitments**

As of 30th June, 2005, the Group had given a guarantee to a bank for loan facilities granted to an associate totalling HK\$20,000,000 (31st December, 2004: HK\$15,000,000).



As of 30th June, 2005, the Group had given a guarantee to a bank for loan facilities granted to a jointly controlled entity of Renminbi (“RMB”) 115,000,000 (equivalent to approximately HK\$108,184,000). Loans of RMB 58,300,000 (equivalent to approximately HK\$54,845,000) were drawdown by the jointly controlled entity as at 30th June, 2005. The Group’s proportionate share of bank loans of HK\$32,907,000 had been included in the condensed consolidated balance sheet as at 30th June, 2005 (31st December, 2004: Nil).

In February 2001, the Group together with the Tradeport Logistics Centre consortium partners jointly gave a guarantee to the Airport Authority Hong Kong in respect of their obligations to provide sufficient funding for the development of the Tradeport Logistics Centre. On 17th March, 2004, the Airport Authority Hong Kong agreed to reduce the maximum liability limit from approximately HK\$780 million to approximately HK\$312 million. The Directors are of the opinion that, had the Group been required to perform its obligation under the guarantee in the event of default of all of the consortium partners, the maximum amount of the contingent liabilities assumed, including the Group’s estimated share of capital commitments of approximately HK\$78 million, would have been approximately HK\$312 million.

The Group’s proportionate share of capital expenditure of the jointly controlled entities in respect of property, plant and equipment at the balance sheet date but not yet incurred is as follows:

|                                 | <b>30th June,<br/>2005<br/>HK\$’000</b> | 31st December,<br>2004<br>HK\$’000 |
|---------------------------------|---|------------------------------------|
| Contracted but not provided for | <b><u>3,591</u></b>                     | <u>–</u>                           |

**Charge on Assets**

The shares of Tradeport held by the Group were pledged as securities for a banking facility granted to Tradeport.

**Financial Assistance to Affiliated Companies and their Proforma Combined Balance Sheet**

Pursuant to Chapter 13 of the Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong Limited (“Listing Rules”), a proforma combined balance sheet of those affiliated companies with financial assistance from the Group and the Group’s attributable interest in those affiliated companies are presented below.

Affiliated companies comprise the Group’s associated companies and jointly controlled entities. As at 30th June, 2005, the Group had loans to affiliated companies totalling HK\$82,103,000 and has given guarantees of HK\$440,184,000 in respect of facilities granted to and provide sufficient funding for an infrastructure development of affiliated companies, financial assistance totalling HK\$522,287,000. These exceed 8% of the Group’s total assets as at 30th June, 2005.



|                         | <b>As at 30th June, 2005</b>                   |  |
|-------------------------|--|--|
|                         | <b>Proforma<br/>combined<br/>balance sheet</b> | <b>The Group's<br/>attributable<br/>interest</b> |
|                         | <i>HK\$'000</i>                                | <i>HK\$'000</i>                                  |
| Non-current assets      | 558,910  | 204,893  |
| Current assets          | 411,307  | 202,111  |
| Current liabilities     | (336,923)                                      | (175,639)  |
| Non-current liabilities | (277,341)                                      | (70,991)   |
| Minority interests      | (21,474)                                       | (10,737)   |
| Shareholders' advances  | (259,066)                                      | (82,103)   |
|                         | <hr/>  | <hr/>  |
|                         | 75,413   | 67,534   |
|                         | <hr/>  | <hr/>  |

### **Foreign Exchange and Currency Risks**

The Group generates a portion of its revenue from ticket sales in certain foreign jurisdictions giving rise to exposures to fluctuation in foreign exchange rates. The Group continuously monitors its foreign currency positions and does not consider that it has a significant exposure to foreign exchange risk from any currency.

### **Human Resources**

The bulk of human resources of the Company and their remuneration, amongst others, are covered by a management services agreement concluded with the Company's fellow subsidiary, China National Aviation Corporation (Group) Limited ("CNACG"). Likewise, China National Aviation Corporation (Macau) Limited also concluded a management services agreement with CNAC (Macau) Aviation Limited. Both agreements were negotiated under normal commercial terms and conditions.

Air Macau, a 51 per cent held subsidiary, employs about 928 staff (six months ended 30th June, 2004: 740 staff). Employees' remuneration packages are designed and structured based on the foregoing market conditions, relevant laws and regulations, industry practices and standards, work performance, education or professional training background and past working experience.

As at 30th June, 2005, BAACL has 1,089 staff and SWACL has 600 staff.

### **SUBSEQUENT EVENT**

On 7th July, 2005, the Group approved an additional capital contribution in a jointly controlled entity amounted to RMB 30,000,000 (equivalent to approximately HK\$28,222,000).

### **PURCHASE, SALE OR REDEMPTION OF SECURITIES**

The Company has not redeemed any of its shares during the period. Neither the Company nor any of its subsidiaries purchased or sold any of the Company's listed shares during the period.



### **SUFFICIENCY OF PUBLIC FLOAT**

The Company has maintained a sufficient public float throughout the six month period ended 30th June, 2005.

### **DIRECTORS AND CHIEF EXECUTIVE'S INTERESTS AND SHORT POSITIONS IN SHARES, UNDERLYING SHARES AND DEBENTURES**

Apart from the interests of the Directors in the share options of the Company are separately disclosed in the "Share Options" below, as at 30th June, 2005, none of the directors and the chief executive of the Company and/or any of their respective associates had any interest or deemed interest in the long and short position in the shares, underlying shares and debentures of the Company or any of its associated corporation (within the meaning of Part XV of the Securities and Future Ordinance ("SFO")) as recorded in the register required to be kept by the Company under Section 352 of the SFO; or as otherwise notified to the Company and the Stock Exchange of Hong Kong Limited (the "Stock Exchange") pursuant to Part XV of the SFO or the Model Code for Securities Transaction by Directors of Listed Companies.

### **DIRECTORS' INTERESTS IN COMPETING BUSINESS**

Pursuant to paragraph 8.10(2) of the Listing Rules, Mr. Kong Dong disclosed that he is the Deputy General Manager of China National Aviation Holding Company ("CNAH"), the ultimate holding company of the Company, and the Vice Chairman and a non-executive director of Air China. CNAH is a state-owned enterprise established in the People's Republic of China ("PRC"), Air China is a joint stock limited company incorporated in the PRC, shares of which are listed on the Stock Exchange and the London Stock Exchange. Air China is engaged in the business of passenger and cargo air transportation services and airport ground handling services and CNAH is its ultimate holding company. As such the business activities of CNAH and Air China compete, or are likely to compete, either directly or indirectly, with the business of the Group.

Nevertheless Mr. Kong is not directly involved in managing Air China's business. The Group is therefore capable of carrying on such business independently of, and at arm's length from the said competing business.

**SHARE OPTIONS**

A share option scheme (the "Scheme") was adopted by the Company on 29th May, 2002.

Details of the share options outstanding as at 30th June, 2005 under the Scheme are as follows:

| Name of grantee          | Options held at 1st January, 2005 | Options granted during the period | Options exercised during the period | Options held at 30th June, 2005 | Exercise price<br>HK\$ | Grant Date | Exercise period          |
|--------------------------|-----------------------------------|-----------------------------------|-------------------------------------|---------------------------------|------------------------|------------|--------------------------|
| Chuang Shih Ping         | 33,126,000                        | -                                 | -                                   | 33,126,000                      | 1.14                   | 25/07/2003 | 26/10/2003 to 25/10/2009 |
| Zhang Xianlin            | 33,126,000                        | -                                 | -                                   | 33,126,000                      | 1.14                   | 25/07/2003 | 26/10/2003 to 25/10/2009 |
| Tsang Hing Kwong, Thomas | 33,126,000                        | -                                 | -                                   | 33,126,000                      | 1.14                   | 25/07/2003 | 26/10/2003 to 25/10/2009 |
| Gu Tiefei                | 5,000,000                         | -                                 | -                                   | 5,000,000                       | 1.14                   | 25/07/2003 | 26/10/2003 to 25/10/2009 |
| Total:                   | 104,378,000                       | -                                 | -                                   | 104,378,000                     |                        |            |                          |

Save as above disclosed, no options were granted or exercised under the Scheme during the six months ended 30th June, 2005.

**SUBSTANTIAL SHAREHOLDERS**

The register of interests in shares and short positions maintained under Part XV of the SFO shows that as at 30th June, 2005 the Company had been notified of the following:

|   | Capacity              | Number of shares           | Percentage of the issued capital |
|---|-----------------------|----------------------------|----------------------------------|
| China National Aviation Holding Company | Attributable Interest | 2,264,628,000 <sup>1</sup> | 68.4                             |
| Air China Limited                       | Beneficial owner      | 2,264,628,000 <sup>2</sup> | 68.4                             |
| Best Strikes Limited                    | Beneficial owner      | 187,656,000                | 5.6                              |
| On Ling Investments Limited             | Attributable Interest | 322,856,000 <sup>3</sup>   | 9.7                              |
| Novel Investments Holdings Limited      | Attributable Interest | 322,856,000 <sup>3</sup>   | 9.7                              |
| Novel Enterprises Limited               | Attributable Interest | 322,856,000 <sup>3</sup>   | 9.7                              |
| Novel Enterprises (BVI) Limited         | Attributable Interest | 322,856,000 <sup>3</sup>   | 9.7                              |
| Novel Credit Limited                    | Attributable Interest | 322,856,000 <sup>3</sup>   | 9.7                              |
| Novel Holdings (BVI) Limited            | Attributable Interest | 322,856,000 <sup>3</sup>   | 9.7                              |
| Westleigh Limited                       | Attributable Interest | 322,856,000 <sup>3</sup>   | 9.7                              |



*Note 1:* A state-owned enterprise established in the People's Republic of China. It owns approximately 51.16 per cent of the total issued share capital of Air China Limited and the entire issued share capital of China National Aviation Corporation (Group) Limited, a company incorporated in Hong Kong, which in turn owns approximately 14.64 per cent of the total issued share capital of Air China Limited. Accordingly its interests in the Company duplicate with those interest of Air China Limited.

*Note 2:* A joint stock limited company incorporated in the People's Republic of China with its H shares listed in Hong Kong and London. China National Aviation Corporation (Group) Limited, the Company's former immediate controlling shareholder, transferred its approximately 69 per cent shareholding interest in the Company to Air China Limited in September 2004 by way of a capital contribution in return for Air China Limited's non-H foreign shares, as such Air China Limited becomes the immediate controlling shareholder of the Company. Its interest in the Company duplicates with those interests of China National Aviation Holding Company.

*Note 3:* 5.6 per cent of the interest held by each of these companies in the Company duplicates with Best Strikes Limited's interest in the Company. The interests of these companies in the Company also duplicate each other.

Save as disclosed above, as at 30th June, 2005, no other person had an interest in the long and short position in the shares or underlying shares of the Company as recorded in the register required to be kept by the Company under Part XV of the SFO.

## **CORPORATE GOVERNANCE**

The Company has complied with the code provisions set out in Appendix 14 "Code on Corporate Governance Practices" ("the Code") to the Rules Governing the Listing of Securities on the Stock Exchange ("Listing Rules") (save for the relevant code provisions on internal control which are applicable to the accounting periods commencing on or after 1st July, 2005), with certain deviations from the code provisions A.1.3, B.1.4, C.3.4, D.1.1 and D.1.2 of the Code. The deviations mainly concern about the notice to regular board meetings, the terms of reference and the disclosure of information of the Remuneration and the Audit Committee, and the determination of authorities and duties delegated to the management by the Board.

## **MODEL CODE**

The Company has adopted the Model Code set out in Appendix 10 to the Listing Rules as the code of conduct regarding securities transactions by the Directors. Having made specific enquiry of all Directors, the Company confirmed that all Directors have complied throughout the six months ended 30th June, 2005 with the required standard set out in the Model Code.

## **AUDIT COMMITTEE**

The Audit Committee of the Company has discussed and reviewed with the Company's management the Interim Financial Information of the Group for the six months ended 30th June, 2005, and has also discussed among themselves matters including internal control and financial reporting.

## **NOMINATION COMMITTEE**

The Nomination Committee was established in August 2005 and is chaired by a non-executive director to make recommendations to the Board on the appointment of directors, evaluation of board composition and the management of board succession with reference to certain criteria as endorsed by the Committee. These criteria include appropriate professional knowledge and industry experience, personal ethics, integrity and personal skills, independence and time commitments. No meeting has yet been held.



### **REMUNERATION COMMITTEE**

The Remuneration Committee was established in August 2005 and is chaired by a non-executive director. The Committee's responsibility is to make recommendations to the Board on the remuneration policy for all directors and senior executives. No meeting has yet been held.

### **INTERIM DIVIDEND**

The Directors have declared an interim dividend of HK0.8 cent per share for the six months ended 30th June, 2005 (six months ended 30th June, 2004: HK0.6 cent per share) payable to the shareholders ("Eligible Shareholders") whose names appear on the Register of Members of the Company on Friday, 23rd September, 2005. Dividend will be despatched to the Eligible Shareholders on or about Thursday, 13th October, 2005.

### **CLOSURE OF REGISTER OF MEMBERS**

The Register of Members will be closed from Tuesday, 20th September, 2005 to Friday, 23rd September, 2005 both days inclusive, during which period no transfers of shares will be registered. In order to qualify for the interim dividend, all transfer documents together with the relevant share certificates must be lodged with the Company's Share Registrars, Computershare Hong Kong Investor Services Limited, 17th Floor, Hopewell Centre, 183 Queen's Road East, Hong Kong not later than 4:00 p.m. on Friday, 16th September, 2005.

By Order of the Board of Directors  
**KONG DONG**  
*Chairman*

Hong Kong, 30th August, 2005

**UNAUDITED CONDENSED CONSOLIDATED INCOME STATEMENT**

FOR THE SIX MONTHS ENDED 30TH JUNE, 2005

|  | Note | 2005<br><b>HK\$'000</b> | Restated<br>2004<br><i>HK\$'000</i> |
|--|------|-------------------------|-------------------------------------|
| Turnover                                   | 3    | <b>1,199,150</b>        | 788,129                             |
| Other revenue                              |      | <b>34,018</b>           | 2,226                               |
| Total revenue                              |      | <b>1,233,168</b>        | 790,355                             |
| Staff costs                                |      | <b>155,140</b>          | 107,421                             |
| Passenger catering and service costs       |      | <b>114,971</b>          | 43,064                              |
| Fuel costs                                 |      | <b>261,057</b>          | 144,635                             |
| Route operating costs                      |      | <b>247,039</b>          | 195,076                             |
| Aircraft maintenance costs                 |      | <b>109,725</b>          | 52,929                              |
| Aircraft leases and equipment costs        |      | <b>206,701</b>          | 161,840                             |
| Depreciation and amortisation costs        |      | <b>37,530</b>           | 40,900                              |
| Sales and promotion costs                  |      | <b>38,336</b>           | 26,029                              |
| Other operating costs                      |      | <b>43,899</b>           | 34,305                              |
| Total operating expenses                   |      | <b>1,214,398</b>        | 806,199                             |
| Operating profit/(loss)                    | 4    | <b>18,770</b>           | (15,844)                            |
| Finance costs                              | 5    | <b>(1,802)</b>          | –                                   |
| Share of profits less losses of associates |      | <b>120,498</b>          | 144,825                             |
| Profit before income tax                   |      | <b>137,466</b>          | 128,981                             |
| Income tax expenses                        | 6    | <b>(5,812)</b>          | (1,055)                             |
| Profit for the period                      |      | <b>131,654</b>          | 127,926                             |
| Attributable to:                           |      |                         |                                     |
| Equity holders of the Company              |      | <b>122,910</b>          | 120,644                             |
| Minority interests                         |      | <b>8,744</b>            | 7,282                               |
|  |      | <b>131,654</b>          | 127,926                             |
| Interim dividend                           | 7    | <b>26,501</b>           | 19,876                              |
|  |      | <b>HK cents</b>         | <i>HK cents</i>                     |
| Earnings per share                         | 8    |                         |                                     |
| – Basic                                    |      | <b>3.71</b>             | 3.64                                |
| – Diluted                                  |      | <b>3.67</b>             | 3.61                                |

**UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEET**

AS AT 30TH JUNE, 2005

|  | Note | 30th June,<br>2005<br>HK\$'000 | Restated<br>31st December,<br>2004<br>HK\$'000 |
|--|------|--------------------------------|--|
| <b>ASSETS</b>  |      |                                |  |
| <b>Non-current assets</b>  |      |                                |  |
| Property, plant and equipment  | 9    | 469,341                        | 495,786  |
| Land use rights  | 9    | 2,315                          | 2,355  |
| Intangible assets  | 9    | 529,240                        | 529,249  |
| Interests in associates  | 10   | 1,518,652                      | 1,603,586                                      |
| Lease and equipment deposits   |      | 55,433                         | 68,762   |
| Deferred income tax assets   |      | 20,342                         | 21,777   |
| Loans to associates  |      | 82,103                         | 82,103   |
|  |      | <u>2,677,426</u>               | <u>2,803,618</u>                               |
| <b>Current assets</b>  |      |                                |  |
| Available-for-sale investment  | 12   | 18,313                         | 18,313   |
| Derivative financial assets  |      | 15,144                         | –  |
| Inventories, at cost   |      | 54,343                         | 54,045   |
| Trade and other receivables  | 13   | 263,700                        | 258,465  |
| Cash and cash equivalents  | 14   | 985,206                        | 746,793  |
| Pledged bank deposits  | 14   | 74,627                         | 67,455   |
|  |      | <u>1,411,333</u>               | <u>1,145,071</u>                               |
| <b>Total assets</b>  |      | <u><b>4,088,759</b></u>        | <u><b>3,948,689</b></u>                        |
| <b>EQUITY</b>  |      |                                |  |
| <b>Capital and reserves attributable to the Company's equity holders</b> |      |                                |  |
| Share capital  | 15   | 331,268                        | 331,268  |
| Reserves   |      | 2,731,039                      | 2,636,368                                      |
|  |      | <u>3,062,307</u>               | <u>2,967,636</u>                               |
| <b>Minority interests</b>  |      | <u>249,172</u>                 | <u>282,292</u>                                 |
| <b>Total equity</b>  |      | <u><b>3,311,479</b></u>        | <u><b>3,249,928</b></u>                        |
| <b>LIABILITIES</b>   |      |                                |  |
| <b>Non-current liabilities</b>   |      |                                |  |
| Provision for overhaul and major checks                                  |      | <u>134,284</u>                 | <u>91,939</u>                                  |
| <b>Current liabilities</b>   |      |                                |  |
| Trade and other payables   | 16   | 476,912                        | 416,572  |
| Sales in advance of carriage   |      | 110,491                        | 118,061  |
| Current income tax liabilities   |      | 2,541                          | 2,972  |
| Short-term bank loans – unsecured  |      | 53,052                         | 69,217   |
|  |      | <u>642,996</u>                 | <u>606,822</u>                                 |
| <b>Total liabilities</b>   |      | <u><b>777,280</b></u>          | <u><b>698,761</b></u>                          |
| <b>Total equity and liabilities</b>                                      |      | <u><b>4,088,759</b></u>        | <u><b>3,948,689</b></u>                        |
| <b>Net current assets</b>  |      | <u><b>768,337</b></u>          | <u><b>538,249</b></u>                          |
| <b>Total assets less current liabilities</b>                             |      | <u><b>3,445,763</b></u>        | <u><b>3,341,867</b></u>                        |

**UNAUDITED CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN EQUITY**

FOR THE SIX MONTHS ENDED 30TH JUNE, 2005

|   | Attributable to equity holders<br>of the Company |                               |                                 |                                   | Total<br>HK\$'000 |
|---|--|-------------------------------|---------------------------------|-----------------------------------|-------------------|
|   | Share<br>capital<br>HK\$'000                     | Other<br>reserves<br>HK\$'000 | Retained<br>profits<br>HK\$'000 | Minority<br>interests<br>HK\$'000 |                   |
| Balance at 1st January, 2004                                  | 331,268  | 1,441,351                     | 869,712                         | 248,797                           | 2,891,128         |
| Share of currency translation differences<br>of associates    | -  | -                             | 101                             | -                                 | 101               |
| Net income recognised directly in equity                      | -  | -                             | 101                             | -                                 | 101               |
| Profit for the period   | -  | -                             | 120,644                         | 7,282                             | 127,926           |
| Dividends   | -  | -                             | (19,876)                        | -                                 | (19,876)          |
| Balance at 30th June, 2004                                    | <u>331,268</u>                                   | <u>1,441,351</u>              | <u>970,581</u>                  | <u>256,079</u>                    | <u>2,999,279</u>  |
| Balance at 1st January, 2005,<br>as previously reported       | 331,268  | 1,438,930                     | 1,197,438                       | 282,292                           | 3,249,928         |
| Opening adjustment for the adoption<br>of HKAS 39 (note 2(b)) | -  | (20,056)                      | 1,033                           | -                                 | (19,023)          |
| Balance at 1st January, 2005,<br>as restated                  | 331,268  | 1,418,894                     | 1,198,471                       | 282,292                           | 3,230,905         |
| Share of currency translation differences<br>of associates    | -  | -                             | 13                              | -                                 | 13                |
| Share of fair value gains of an associate                     | -  | 23,897                        | -                               | -                                 | 23,897            |
| Net income recognised directly in equity                      | -  | 23,897                        | 13                              | -                                 | 23,910            |
| Transfer  | -  | 3,859                         | (3,859)                         | -                                 | -                 |
| Profit for the period   | -  | -                             | 122,910                         | 8,744                             | 131,654           |
| Dividends   | -  | -                             | (33,126)                        | (41,864)                          | (74,990)          |
| Balance at 30th June, 2005                                    | <u>331,268</u>                                   | <u>1,446,630</u>              | <u>1,284,409</u>                | <u>249,172</u>                    | <u>3,311,479</u>  |

**UNAUDITED CONDENSED CONSOLIDATED CASH FLOW STATEMENT**

FOR THE SIX MONTHS ENDED 30TH JUNE, 2005

|  | <b>2005</b><br><b>HK\$'000</b> | 2004<br>HK\$'000 |
|--|--------------------------------|------------------|
| Net cash from operating activities                 | <b>130,629</b>                 | 14,604           |
| Net cash from investing activities                 | <b>198,593</b>                 | 20,842           |
| Net cash used in financing activities              | <b>(90,809)</b>                | (19,638)         |
| Net increase in cash and cash equivalents          | <b>238,413</b>                 | 15,808           |
| Cash and cash equivalents at 1st January           | <b>746,793</b>                 | 1,036,929        |
| Cash and cash equivalents at 30th June             | <b>985,206</b>                 | 1,052,737        |
| Analysis of balances of cash and cash equivalents: |                                |                  |
| Cash at bank and in hand                           | <b>350,823</b>                 | 178,524          |
| Short-term bank deposits                           | <b>709,010</b>                 | 909,925          |
| Pledged bank deposits                              | <b>(74,627)</b>                | (35,712)         |
|  | <b>985,206</b>                 | 1,052,737        |



## NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL INFORMATION

### 1. Basis of preparation and accounting policies

This Interim Financial Information has been prepared in accordance with Hong Kong Accounting Standard (“HKAS”) 34 “Interim Financial Reporting” issued by the Hong Kong Institute of Certified Public Accountants (“HKICPA”).

The Interim Financial Information should be read in conjunction with the 2004 annual accounts.

The accounting policies and methods of computation used in the preparation of the Interim Financial Information are consistent with those used in the 2004 annual accounts except that the Group has changed certain of its accounting policies following its adoption of new/revised Hong Kong Financial Reporting Standards (“HKFRS”) and HKAS (collectively the “new HKFRSs”) which are effective for accounting periods commencing on or after 1st January, 2005.

The Interim Financial Information has been prepared in accordance with those HKFRS standards and interpretations issued and effective as at the time of preparing the Interim Financial Information. The HKFRS standards and interpretations that will be applicable at 31st December, 2005, including those that will be applicable on an optional basis, are not known with certainty at the time of preparing the Interim Financial Information.

The changes to the Group’s accounting policies and the effect of adopting these new policies are set out in note 2 below.



## 2. Changes in principal accounting policies

In 2005, the Group adopted the new/revised standards of HKFRS below, which are relevant to its operations. The 2004 comparatives have been amended as required, in accordance with the relevant requirements.

|             |   |
|-------------|---|
| HKAS 1      | Presentation of Financial Statements                            |
| HKAS 2      | Inventories   |
| HKAS 7      | Cash Flow Statements  |
| HKAS 8      | Accounting Policies, Changes in Accounting Estimates and Errors |
| HKAS 10     | Events after the Balance Sheet Date                             |
| HKAS 16     | Property, Plant and Equipment                                   |
| HKAS 17     | Leases  |
| HKAS 21     | The Effects of Changes in Foreign Exchange Rates                |
| HKAS 23     | Borrowing Costs   |
| HKAS 24     | Related Party Disclosures                                       |
| HKAS 27     | Consolidated and Separate Financial Statements                  |
| HKAS 28     | Investments in Associates                                       |
| HKAS 31     | Investments in Joint Ventures                                   |
| HKAS 32     | Financial Instruments: Disclosures and Presentation             |
| HKAS 33     | Earnings per Share  |
| HKAS 36     | Impairment of Assets  |
| HKAS 38     | Intangible Assets   |
| HKAS 39     | Financial Instruments: Recognition and Measurement              |
| HKAS-Int 12 | Scope of HKAS-Int 12 Consolidation – Special Purpose Entities   |
| HKAS-Int 15 | Operating Leases – Incentives                                   |
| HKAS-Int 21 | Income Taxes – Recovery of Revalued Non-Depreciated Assets      |
| HKFRS 2     | Share-based Payments  |
| HKFRS 3     | Business Combinations   |

The following is a summary of material changes in principal accounting policies or presentation of financial statements as a result of the adoption of the new HKFRSs:

### (i) **HKAS 1**

The adoption of HKAS 1 has affected the presentation of minority interests, share of net after-tax results of associates and other disclosures.

### (ii) **HKAS 17**

The adoption of revised HKAS 17 has resulted in a change in the reclassification of land use rights from property, plant and equipment. The up-front prepayments made for the land use rights are expensed in the income statement on a straight-line basis over the term of the land use rights or where there is impairment, the impairment is expensed in the income statement.



**(iii) HKAS 24**

The adoption of HKAS 24 has affected the identification of related parties and some other related-party disclosures. Related parties include CNAH and its related parties, other state-owned enterprises and their subsidiaries directly or indirectly owned by the central government of the PRC (the “PRC government”), other entities and corporations in which the Company is able to control or exercise significant influence, key management personnel of the Company and CNAH Group as well as their close family members.

**(iv) HKAS 31**

The Group adopted the proportionate consolidation under HKAS 31 to account for its interests in jointly controlled entities. In prior years, the Group’s interests in jointly controlled entities were accounted for by the equity method. The adoption of the proportionate consolidation under HKAS 31 represents a change in accounting policy.

**(v) HKASs 32 and 39**

The adoption of HKASs 32 and 39 has resulted in a change in the accounting policy relating to the classification of available-for-sale financial assets. It has also resulted in the recognition of financial instruments at fair value and the change in the recognition and measurement of hedging activities.

**(vi) HKFRS 2**

The adoption of HKFRS 2 has resulted in a change in the accounting policy for share-based payments. Until 31st December, 2004, the provision of share options to employees did not result in an expense in the income statement. Effective on 1st January, 2005, the fair value of the employee services received in the exchange for the grant of the options is recognised as an expense.



**(vii) HKFRS 3, HKAS 36 and HKAS 38**

The adoption of HKFRS 3, HKAS 36 and HKAS 38 has resulted in a change in the accounting policy for goodwill. Until 31st December, 2004, goodwill was:

- Amortised on a straight line basis over its estimated useful life of not more than 20 years; and
- Assessed for an indication of impairment at each balance sheet date.

In accordance with the provisions of HKFRS 3:

- The Group ceased amortisation of goodwill from 1st January, 2005;
- Accumulated amortisation as at 31st December, 2004 has been eliminated with a corresponding decrease in the cost of goodwill; and
- From 1st January, 2005 onwards, goodwill is tested annually for impairment, as well as when there is indication of impairment.

The Group has reassessed the useful lives of its goodwill in accordance with the provisions of HKAS 38. No adjustment resulted from this reassessment.

All changes in the accounting policies have been made in accordance with the transition provisions in the respective standards. All standards adopted by the Group require retrospective application other than:

- HKFRS 2 – only retrospective application for all equity instruments granted after 7th November, 2002 and not vested at 1st January, 2005; and
- HKFRS 3 – prospectively after the adoption date.



The following is a summary of effect of adopting the new HKFRSs on the Interim Financial Information:

**(a) Condensed consolidated income statement**

*For the six months ended 30th June, 2005*

|   | Increase/(decrease)<br>Effect of adopting |                                |                     | Total<br>HK\$'000 |
|---|---|--------------------------------|---------------------|-------------------|
|   | HKAS 31<br>HK\$'000                       | HKASs 32<br>and 39<br>HK\$'000 | HKFRS 3<br>HK\$'000 |                   |
| Turnover  | 119,368                                   | –                              | –                   | 119,368           |
| Other revenue   | 93  | –                              | –                   | 93                |
| Total revenue   | <u>119,461</u>                            | <u>–</u>                       | <u>–</u>            | <u>119,461</u>    |
| Staff costs   | 30,789                                    | –                              | –                   | 30,789            |
| Passenger catering and service costs                          | 59,717                                    | –                              | –                   | 59,717            |
| Fuel costs  | –   | (15,144)                       | –                   | (15,144)          |
| Depreciation and amortisation costs                           | 5,634                                     | –                              | (18,515)            | (12,881)          |
| Other operating costs   | 6,873                                     | –                              | –                   | 6,873             |
| Total operating expenses                                      | <u>103,013</u>                            | <u>(15,144)</u>                | <u>(18,515)</u>     | <u>69,354</u>     |
| Operating profit  | 16,448                                    | 15,144                         | 18,515              | 50,107            |
| Finance costs   | (1,802)                                   | –                              | –                   | (1,802)           |
| Share of profit less losses of associates                     | –   | (1,033)                        | –                   | (1,033)           |
| Share of profit less losses of jointly<br>controlled entities | (14,646)                                  | –                              | –                   | (14,646)          |
| Profit before income tax                                      | –   | 14,111                         | 18,515              | 32,626            |
| Income tax expenses   | –   | –                              | –                   | –                 |
| Profit for the period   | <u>–</u>                                  | <u>14,111</u>                  | <u>18,515</u>       | <u>32,626</u>     |
| Earnings per share  | <i>HK cents</i>                           | <i>HK cents</i>                | <i>HK cents</i>     | <i>HK cents</i>   |
| – Basic   | –   | 0.43                           | 0.56                | 0.98              |
| – Diluted   | –   | 0.42                           | 0.56                | 0.97              |

There is no material impact of adopting the new HKFRSs on the condensed consolidated income statement for the six months ended 30th June, 2004 except for the reclassification of share of taxation of the associates from income tax expenses to share of profits less losses of associates (note 6).

**(b) Condensed consolidated balance sheet**

As at 30th June, 2005

|  | Increase/(decrease)<br>Effect of adopting |                     |                                |                     | Total<br>HK\$'000 |
|--|---|---------------------|--------------------------------|---------------------|-------------------|
|  | HKAS 17<br>HK\$'000                       | HKAS 31<br>HK\$'000 | HKASs 32<br>and 39<br>HK\$'000 | HKFRS 3<br>HK\$'000 |                   |
| Property, plant and equipment            | (2,315)                                   | 122,780             | -                              | -                   | 120,465           |
| Land use rights                          | 2,315                                     | -                   | -                              | -                   | 2,315             |
| Intangible assets                        | -   | 241,937             | -                              | 16,987              | 258,924           |
| Interests in associates                  | -   | -                   | 3,841                          | 1,528               | 5,369             |
| Interests in jointly controlled entities | -   | (356,343)           | -                              | -                   | (356,343)         |
| Deferred income tax assets               | -   | 2,682               | -                              | -                   | 2,682             |
| Available-for-sale investment            | -   | 18,313              | -                              | -                   | 18,313            |
| Derivative financial assets              | -   | -                   | 15,144                         | -                   | 15,144            |
| Inventories                              | -   | 6,821               | -                              | -                   | 6,821             |
| Trade and other receivables              | -   | 53,664              | -                              | -                   | 53,664            |
| Cash and cash equivalents                | -   | 29,340              | -                              | -                   | 29,340            |
| Pledged bank deposits                    | -   | 6                   | -                              | -                   | 6                 |
| <b>Total assets</b>                      | <b>-</b>                                  | <b>119,200</b>      | <b>18,985</b>                  | <b>18,515</b>       | <b>156,700</b>    |
| Trade and other payables                 | -   | 63,797              | -                              | -                   | 63,797            |
| Current tax liabilities                  | -   | 2,351               | -                              | -                   | 2,351             |
| Short-term bank loans – unsecured        | -   | 53,052              | -                              | -                   | 53,052            |
| <b>Total liabilities</b>                 | <b>-</b>                                  | <b>119,200</b>      | <b>-</b>                       | <b>-</b>            | <b>119,200</b>    |
| <b>Total equity</b>                      | <b>-</b>                                  | <b>-</b>            | <b>18,985</b>                  | <b>18,515</b>       | <b>37,500</b>     |



As at 31st December, 2004

|  | <b>Increase/(decrease)<br/>Effect of adopting</b> |   |   |
|--|---|---|---|
|  | <b>HKAS 17<br/>HK\$'000</b>                       | <b>HKAS 31<br/>HK\$'000</b>                 | <b>Total<br/>HK\$'000</b>                   |
| Property, plant and equipment            | (2,355)   | 126,308                                     | 123,953                                     |
| Land use rights                          | 2,355   | –   | 2,355                                       |
| Intangible assets                        | –   | 241,937                                     | 241,937                                     |
| Interests in jointly controlled entities | –   | (345,532)                                   | (345,532)                                   |
| Deferred income tax assets               | –   | 2,483                                       | 2,483                                       |
| Available-for-sale investment            | –   | 18,313                                      | 18,313                                      |
| Inventories                              | –   | 7,574                                       | 7,574                                       |
| Trade and other receivables              | –   | 55,867                                      | 55,867                                      |
| Cash and cash equivalents                | –   | 21,201                                      | 21,201                                      |
| Pledged bank deposits                    | –   | 6,235                                       | 6,235                                       |
|  | <hr/>   | <hr/>                                       | <hr/>                                       |
| Total assets                             | –   | 134,386                                     | 134,386                                     |
|  | <hr style="border-top: 1px dashed black;"/>       | <hr style="border-top: 1px dashed black;"/> | <hr style="border-top: 1px dashed black;"/> |
| Trade and other payables                 | –   | 62,833                                      | 62,833                                      |
| Current tax liabilities                  | –   | 2,336                                       | 2,336                                       |
| Short-term bank loans – unsecured        | –   | 69,217                                      | 69,217                                      |
|  | <hr/>   | <hr/>                                       | <hr/>                                       |
| Total liabilities                        | –   | 134,386                                     | 134,386                                     |
|  | <hr style="border-top: 1px dashed black;"/>       | <hr style="border-top: 1px dashed black;"/> | <hr style="border-top: 1px dashed black;"/> |
| Total equity                             | –   | –   | –   |
|  | <hr style="border-top: 3px double black;"/>       | <hr style="border-top: 3px double black;"/> | <hr style="border-top: 3px double black;"/> |

The adoption of HKASs 32 and 39 has resulted in a decrease in opening reserves and interests in associates at 1st January, 2005 by the same amount of approximately HK\$19,023,000.

### 3. Turnover and segment information

#### Turnover

|                           | <b>Six months ended<br/>30 June,</b>        |   |
|---------------------------|---|---|
|                           | <b>2005<br/>HK\$'000</b>                    | 2004<br>HK\$'000                            |
| Traffic revenue           |   |   |
| – Passenger services      | <b>736,672</b>                              | 607,596                                     |
| – Cargo and mail services | <b>343,111</b>                              | 180,533                                     |
| Airline catering revenue  | <b>119,367</b>                              | –   |
|                           | <hr/>                                       | <hr/>                                       |
|                           | <b>1,199,150</b>                            | 788,129                                     |
|                           | <hr style="border-top: 3px double black;"/> | <hr style="border-top: 3px double black;"/> |

**Primary reporting format – Business segments**

The Group is organised into four main business segments including airline operation, airport ground handling, airline catering, logistics and other businesses.

An analysis of the Group's revenue, results, assets and liabilities by business segments is as follows:

|  | Six months ended 30th June, 2005 |   |                                 |  | Group<br>HK\$'000 |
|--|----------------------------------|---|---------------------------------|--|-------------------|
|  | Airline<br>operation<br>HK\$'000 | Airport<br>ground<br>handling<br>HK\$'000 | Airline<br>catering<br>HK\$'000 | Logistics<br>and other<br>businesses<br>HK\$'000 |                   |
| Segment revenue  | <u>1,107,017</u>                 | -   | <u>119,368</u>                  | -  | <u>1,226,385</u>  |
| Segment results  | <u>5,477</u>                     | -   | <u>16,354</u>                   | -  | <u>21,831</u>     |
| Interest income  |                                  |   |                                 |  | 6,783             |
| Unallocated costs  |                                  |   |                                 |  | <u>(9,844)</u>    |
| Operating profit   |                                  |   |                                 |  | 18,770            |
| Finance costs  |                                  |   |                                 |  | (1,802)           |
| Share of profits less losses of associates                   | 54,337                           | 62,761                                    | 4,998                           | (1,598)  | <u>120,498</u>    |
| Profit before income tax                                     |                                  |   |                                 |  | 137,466           |
| Income tax expenses  |                                  |   |                                 |  | <u>(5,812)</u>    |
| Profit for the period  |                                  |   |                                 |  | <u>131,654</u>    |
| Capital expenditure  | 9,069                            | -   | 2,106                           | -  | 11,175            |
| Depreciation   | 31,887                           | -   | 5,594                           | -  | 37,481            |
| Amortisation   | 9                                | -   | 40                              | -  | 49                |
| Reversal of provision for impairment<br>of trade receivables | <u>(790)</u>                     | -   | -                               | -  | <u>(790)</u>      |



## At 30th June, 2005

|                         | Airline<br>operation<br>HK\$'000 | Airport<br>ground<br>handling<br>HK\$'000 | Airline<br>catering<br>HK\$'000 | Logistics<br>and other<br>businesses<br>HK\$'000 | Group<br>HK\$'000 |
|-------------------------|----------------------------------|---|---------------------------------|--|-------------------|
| Segment assets          | 1,123,615                        | 34,560                                    | 472,860                         | 47,542   | 1,678,577         |
| Interests in associates | 1,302,735                        | 120,371                                   | 120,111                         | (24,565)   | 1,518,652         |
| Unallocated assets      |                                  |   |                                 |  | 891,530           |
| Total assets            |                                  |   |                                 |  | <u>4,088,759</u>  |
| Segment liabilities     | 654,587                          | -   | 116,644                         | -  | 771,231           |
| Unallocated liabilities |                                  |   |                                 |  | 6,049             |
| Total liabilities       |                                  |   |                                 |  | <u>777,280</u>    |

## Six months ended 30th June, 2004 (Restated)

|  | Airline<br>operation<br>HK\$'000 | Airport<br>ground<br>handling<br>HK\$'000 | Airline<br>catering<br>HK\$'000 | Logistics<br>and other<br>businesses<br>HK\$'000 | Group<br>HK\$'000 |
|--|----------------------------------|---|---------------------------------|--|-------------------|
| Segment revenue                                  | <u>789,434</u>                   | <u>-</u>                                  | <u>-</u>                        | <u>-</u>   | <u>789,434</u>    |
| Segment results                                  | <u>4,131</u>                     | <u>-</u>                                  | <u>-</u>                        | <u>-</u>   | 4,131             |
| Interest income                                  |                                  |   |                                 |  | 921               |
| Unallocated costs                                |                                  |   |                                 |  | (20,896)          |
| Operating loss                                   |                                  |   |                                 |  | (15,844)          |
| Share of profits less losses of associates       | 91,578                           | 57,950                                    | -                               | (4,703)  | 144,825           |
| Profit before income tax                         |                                  |   |                                 |  | 128,981           |
| Income tax expenses                              |                                  |   |                                 |  | (1,055)           |
| Profit for the period                            |                                  |   |                                 |  | <u>127,926</u>    |
| Capital expenditure                              | 3,038                            | -   | -                               | -  | 3,038             |
| Depreciation                                     | 31,449                           | -   | -                               | -  | 31,449            |
| Amortisation                                     | 9,449                            | -   | -                               | -  | 9,449             |
| Provision for impairment of<br>trade receivables | <u>710</u>                       | <u>-</u>                                  | <u>-</u>                        | <u>-</u>   | <u>710</u>        |



At 31st December, 2004 (Restated)

|                         | Airline<br>operation<br>HK\$'000 | Airport<br>ground<br>handling<br>HK\$'000 | Airline<br>catering<br>HK\$'000 | Logistics<br>and other<br>businesses<br>HK\$'000 | Group<br>HK\$'000 |
|-------------------------|----------------------------------|---|---------------------------------|--|-------------------|
| Segment assets          | 1,093,647                        | 34,560                                    | 477,434                         | 47,542   | 1,653,183         |
| Interests in associates | 1,404,726                        | 106,721                                   | 115,113                         | (22,974)   | 1,603,586         |
| Unallocated assets      |                                  |   |                                 |  | 691,920           |
| Total assets            |                                  |   |                                 |  | <u>3,948,689</u>  |
| Segment liabilities     | 559,318                          | -   | 132,052                         | -  | 691,370           |
| Unallocated liabilities |                                  |   |                                 |  | 7,391             |
| Total liabilities       |                                  |   |                                 |  | <u>698,761</u>    |

**Secondary reporting format – Geographical segments**

The Group operates in three main geographical areas including China mainland, Taiwan and other regions (mainly Macau, Thailand and Philippines). The Group's airline operation business is mainly operated in places in China mainland, Taiwan and other regions. The Group's airline catering business is operated in China mainland.

|                         | Segment revenue<br>Six months ended<br>30th June, |                  | Segment result<br>Six months ended<br>30th June, |                  |
|-------------------------|---|------------------|--|------------------|
|                         | 2005<br>HK\$'000                                  | 2004<br>HK\$'000 | 2005<br>HK\$'000                                 | 2004<br>HK\$'000 |
| China mainland          | <b>551,830</b>                                    | 313,778          | <b>(22,056)</b>                                  | (19,948)         |
| Taiwan                  | <b>607,474</b>                                    | 428,883          | <b>77,695</b>                                    | 44,628           |
| Other regions           | <b>67,081</b>                                     | 46,773           | <b>(33,808)</b>                                  | (20,549)         |
|                         | <u><b>1,226,385</b></u>                           | <u>789,434</u>   | <u><b>21,831</b></u>                             | <u>4,131</u>     |
| Interest income         |   |                  | <b>6,783</b>                                     | 921              |
| Unallocated cost        |   |                  | <b>(9,844)</b>                                   | (20,896)         |
| Operating profit/(loss) |   |                  | <u><b>18,770</b></u>                             | <u>(15,844)</u>  |

The major revenue-earning assets of the Group in respect of airline operation are its aircraft fleet, all of which are registered in Macau. Since the Group's aircraft fleet is deployed flexibly across its route network, the Directors consider that there is no meaningful basis to allocating such assets to geographical segments.



The Group's assets and capital expenditure in respect of airline catering business are located in China Mainland.

The Group's other assets, other than those mentioned in the above, and capital expenditure are mainly located in Macau.

#### 4. Operating profit/(loss)

The following items have been included in arriving at operating profit/(loss):

|   | Six months ended<br>30 June, |                  |
|---|------------------------------|------------------|
|   | 2005<br>HK\$'000             | 2004<br>HK\$'000 |
| <b>Crediting</b>                                |                              |                  |
| Fair value gains on derivative financial assets | <u>18,365</u>                | <u>–</u>         |
| <b>Charging</b>                                 |                              |                  |
| Amortisation of intangible assets               | 9                            | 9,449            |
| Amortisation of land use rights                 | 40                           | –                |
| Cost of inventories expensed                    | 67,361                       | 46,060           |
| Depreciation of property, plant and equipment   | <u>37,481</u>                | <u>31,449</u>    |

#### 5. Finance costs

|  | Six months ended<br>30 June, |                  |
|--|------------------------------|------------------|
|  | 2005<br>HK\$'000             | 2004<br>HK\$'000 |
| Interest expenses on short-term bank loans | <u>1,802</u>                 | <u>–</u>         |

**6. Income tax expenses**

Hong Kong profits tax has been provided at the rate of 17.5% (six months ended 30th June, 2004: 17.5%) on the estimated assessable profit for the period. Macau complementary tax has been provided at the rate of 15.75% (six months ended 30th June, 2004: 15.75%) on the estimated assessable profit for the period. Taxation outside Hong Kong and Macau has been calculated on the estimated assessable profit for the period at the rates of taxation prevailing in the countries in which the Group operates.

|  | <b>Six months ended<br/>30 June,</b> |          |
|--|--------------------------------------|----------|
|  | <b>2005</b>                          | 2004     |
|  | <b>HK\$'000</b>                      | HK\$'000 |
| Current income tax                     |                                      |          |
| – Macau complementary tax              | –                                    | (100)    |
| – Taxation outside Hong Kong and Macau | <b>4,409</b>                         | 542      |
| – Over provisions in prior years       | <b>(66)</b>                          | –        |
| Deferred income tax                    | <b>1,469</b>                         | 613      |
|  | <b>5,812</b>                         | 1,055    |

Share of taxation of the associates amounting to HK\$26,573,000 (six months ended 30th June, 2004: HK\$21,743,000) is included in the condensed consolidated income statement as share of profits less losses of associates.

**7. Interim dividend**

|  | <b>Six months ended<br/>30 June,</b> |          |
|--|--------------------------------------|----------|
|  | <b>2005</b>                          | 2004     |
|  | <b>HK\$'000</b>                      | HK\$'000 |
| Interim dividend proposed of HK0.8 cent<br>(six months ended 30th June, 2004:<br>HK0.6 cent) per share | <b>26,501</b>                        | 19,876   |

- (a) At a meeting held on 23rd March, 2005, the Directors proposed a final dividend of HK\$1.0 cent per share for the year ended 31st December, 2004, which was paid on 28th June, 2005 and has been reflected as an appropriation of retained profits for the six months ended 30th June, 2005.
- (b) At a meeting held on 30th August, 2005, the Directors declared an interim dividend of HK0.8 cent per share for the year ending 31st December, 2005. This proposed dividend is not reflected as a dividend payable in these Interim Financial Information, but will be reflected as an appropriation of retained earnings for the year ending 31st December, 2005.



## 8. Earnings per share

### *Basic*

Basic earnings per share is calculated by dividing the profit attributable to equity holders of the Company by the weighted average number of shares in issue during the period.

|   | <b>Six months ended<br/>30 June,</b> |           |
|---|--------------------------------------|-----------|
|   | <b>2005</b>                          | 2004      |
|   | <b>HK\$'000</b>                      | HK\$'000  |
| Profit attributable to equity holders of the Company      | <b>122,910</b>                       | 120,644   |
| Weighted average number of shares<br>in issue (thousands) | <b>3,312,680</b>                     | 3,312,680 |
| Basic earnings per share (HK cents per share)             | <b>3.71</b>                          | 3.64      |

### *Diluted*

Diluted earnings per share is calculated based on the profit attributable to the equity holders of the Company and the weighted average number of shares in issue during the period, after adjusting for the number of dilutive potential shares deemed to be issued at no considerations as if all outstanding share options granted by the Company had been exercised.

|   | <b>Six months ended<br/>30 June,</b> |           |
|---|--------------------------------------|-----------|
|   | <b>2005</b>                          | 2004      |
|   | <b>HK\$'000</b>                      | HK\$'000  |
| Profit attributable to the equity holders of the Company                        | <b>122,910</b>                       | 120,644   |
| Weighted average number of shares<br>in issue (thousands)                       | <b>3,312,680</b>                     | 3,312,680 |
| Adjustment for assumed conversion of<br>share options (thousands)               | <b>35,741</b>                        | 29,951    |
| Weighted average number of shares<br>for diluted earnings per share (thousands) | <b>3,348,421</b>                     | 3,342,631 |
| Diluted earnings per share (HK cents per share)                                 | <b>3.67</b>                          | 3.61      |

**9. Capital expenditure**

|   | <b>Goodwill</b><br><b>HK\$'000</b> | <b>Others</b><br><b>HK\$'000</b> | <b>Total</b><br><b>intangible</b><br><b>assets</b><br><b>HK\$'000</b> | <b>Property,</b><br><b>plant and</b><br><b>equipment</b><br><b>(notes (i)</b><br><b>and (ii))</b><br><b>HK\$'000</b> | <b>Land</b><br><b>use rights</b><br><b>HK\$'000</b> |
|---|------------------------------------|----------------------------------|---|--|---|
| Opening net book amount as at<br>1st January, 2005, as previously<br>reported | 287,301                            | 9                                | 287,310   | 371,833  | -   |
| Proportionate consolidation<br>of interests in jointly controlled entities    | <u>241,939</u>                     | <u>-</u>                         | <u>241,939</u>  | <u>123,953</u>   | <u>2,355</u>  |
| Opening net book amount<br>as at 1st January, 2005, as restated               | 529,240                            | 9                                | 529,249   | 495,786  | 2,355   |
| Additions   | -                                  | -                                | -   | 11,175   | -   |
| Disposals   | -                                  | -                                | -   | (139)  | -   |
| Amortisation/depreciation charge  | <u>-</u>                           | <u>(9)</u>                       | <u>(9)</u>  | <u>(37,481)</u>  | <u>(40)</u>   |
| Closing net book amount as at<br>30th June, 2005                              | <u>529,240</u>                     | <u>-</u>                         | <u>529,240</u>  | <u>469,341</u>   | <u>2,315</u>  |
| Opening net book amount as at<br>1st January, 2004                            | 306,141                            | 54                               | 306,195   | 399,378  | -   |
| Additions   | -                                  | -                                | -   | 3,038  | -   |
| Disposals   | -                                  | -                                | -   | (1,034)  | -   |
| Amortisation/depreciation charge  | <u>(9,419)</u>                     | <u>(30)</u>                      | <u>(9,449)</u>  | <u>(31,449)</u>  | <u>-</u>  |
| Closing net book amount<br>as at 30th June, 2004                              | 296,722                            | 24                               | 296,746   | 369,933  | -   |
| Acquisition of jointly controlled entities                                    | 243,198                            | -                                | 243,198   | 125,061  | 2,365   |
| Additions   | -                                  | -                                | -   | 35,371   | -   |
| Disposals   | -                                  | -                                | -   | (22)   | -   |
| Amortisation/depreciation charge  | <u>(10,680)</u>                    | <u>(15)</u>                      | <u>(10,695)</u>   | <u>(34,557)</u>  | <u>(10)</u>   |
| Closing net book amount as at<br>31st December, 2004                          | <u>529,240</u>                     | <u>9</u>                         | <u>529,249</u>  | <u>495,786</u>   | <u>2,355</u>  |



- (i) As of 30th June, 2005, the property, plant and equipment included buildings of net book amount of approximately HK\$38,893,000 (31st December, 2004: HK\$40,763,000) relating to the buildings of BACL, a jointly controlled entity of the Group, situated on pieces of allocated land held by a related company. Air China, an immediate holding company of the Company, is procuring to transfer those land from the related company to Air China in order to ensure Air China will legally and/or beneficially own the interests and benefits of such land. Air China agrees that BACL can continue to use the land at nominal consideration until such time Air China obtains the legal title of the land. A lease agreement would then be entered into between Air China and BACL for a term of up to 30th April, 2023 at a rent to be calculated on the basis of the original costs for obtaining such land use rights. Accordingly, the Directors of the Company did not take into account any losses and costs arising from the inability to use any land currently used by BACL in the preparation of these financial statements.

Air China has further agreed to complete, at its expense, the formal procedures for transferring the building ownership rights of part of the production facilities from Air China to BACL. Such part of the production facilities were agreed to be injected by Air China into BACL as part of its initial capital contribution when BACL was established. No lease agreement has been entered between BACL and Air China.

- (ii) As of 30th June, 2005, the property, plant and equipment included buildings of net book amount of approximately HK\$37,419,000 (31st December 2004: HK\$38,044,000) relating to a new inflight meals production building held by SWACL, a jointly controlled entity of the Group, which was put into use in 2004. However, SWACL was advised by Chengdu Shuangliu International Airport ("Shuangliu Airport") on 7th August, 2003 that this new inflight meals production building is situated in an area where the extension of airport premises to be located. As a result, such new inflight meals production building might need to be demolished on or before 2015.

The Directors of the Company consider that this is only a suggestion proposed by Shuangliu Airport and so far SWACL did not receive any formal notification from the relevant government authorities regarding this. Nevertheless, the Directors of the Company consider that SWACL had obtained all necessary approvals before constructing this production building and they are confident that SWACL is able to receive fair compensations from Shuangliu Airport should SWACL be requested to demolish the new production building. The Directors of the Company consider that this matter is currently at a preliminary stage of development, accordingly, it is too early to consider any potential impact to SWACL and the Group.

## 10. Interests in associates

|  | <b>30th June,<br/>2005</b> | Restated<br>31st December,<br>2004 |
|--|----------------------------|------------------------------------|
|  | <b>HK\$'000</b>            | <i>HK\$'000</i>                    |
| Hong Kong Dragon Airlines Limited ("Dragonair")          | <b>1,302,735</b>           | 1,404,727                          |
| Menzies Macau Airport Services Limited ("Menzies Macau") | <b>60,267</b>              | 63,273                             |
| Others   | <b>155,650</b>             | 135,586                            |
|  | <b><u>1,518,652</u></b>    | <u>1,603,586</u>                   |

The interests in associates include unamortised goodwill of HK\$52,708,000 (31st December, 2004: HK\$52,708,000).

**11. Interests in jointly controlled entities**

At 30th June, 2005, the Group's proportionate share of the assets, liabilities, revenue and expenses of the jointly controlled entities are as follows:

|  | <b>30th June,<br/>2005</b> | Restated<br>31st December,<br>2004 |
|--|----------------------------|------------------------------------|
|  | <b>HK\$'000</b>            | HK\$'000                           |
| Assets   |                            |                                    |
| Non-current assets   | <b>125,462</b>             | 128,791                            |
| Current assets   | <b>108,144</b>             | 109,190                            |
|  | <b>233,606</b>             | 237,981                            |
| Liabilities  |                            |                                    |
| Current liabilities  | <b>(119,200)</b>           | (134,386)                          |
| Net assets   | <b>114,406</b>             | 103,595                            |
|  | <b>Six months ended</b>    |                                    |
|  | <b>30 June,</b>            |                                    |
|  | <b>2005</b>                | 2004                               |
|  | <b>HK\$'000</b>            | HK\$'000                           |
| Revenue  | <b>119,461</b>             | –                                  |
| Operating expenses   | <b>(103,013)</b>           | –                                  |
| Finance costs  | <b>(1,802)</b>             | –                                  |
| Profit before income tax   | <b>14,646</b>              | –                                  |
| Income tax expense   | <b>(3,835)</b>             | –                                  |
| Net profit   | <b>10,811</b>              | –                                  |
|  | <b>30th June,<br/>2005</b> | 31st December,<br>2004             |
|  | <b>HK\$'000</b>            | HK\$'000                           |
| Proportionate interest in jointly controlled entities' commitments ( <i>note 18(b)</i> ) | <b>3,591</b>               | –                                  |

There are no contingent liabilities relating to the Group's interests in jointly controlled entities, and no contingent liabilities of the entities itself.

On 7th July, 2005, the Group approved an additional capital contribution in a jointly controlled entity amounted to RMB30,000,000 (equivalent to approximately HK\$28,222,000).

**12. Available-for-sale investment**

|                     | <b>30th June,<br/>2005</b> | Restated<br>31st December,<br>2004 |
|---------------------|----------------------------|------------------------------------|
|                     | <i>HK\$'000</i>            | <i>HK\$'000</i>                    |
| Unlisted investment | <b>18,313</b>              | 18,313                             |

Unlisted investment represents BACL's equity investment of 10% in China National Aviation Finance Co., Ltd. ("Finance Company"). Pursuant to a share transfer agreement entered into between BACL and CNAH in August 2004, BACL agreed to dispose of its investment in the Finance Company at a consideration of approximately RMB34.6 million. The Group's share of the consideration amounts to RMB20.8 million (equivalent to approximately HK\$19.5 million). The completion of the share transfer agreement is subject to the approval from China Banking Regulatory Commission and such approval has not been obtained as at 30th June, 2005. CNAH has provided an undertaking to the Group for the Group's share of any gain or loss that might arise from the disposal of the Finance Company by BACL, accordingly, the Directors of the Company did not take into account any gain or loss arising from the proposed disposal in these condensed consolidated financial information.

**13. Trade and other receivables**

Trade and other receivables include trade receivables from third parties, the immediate holding company, an associate and related companies. The credit terms granted to sales agents and other trade customers are ranging from 15 days to 90 days. The age analysis of trade receivables is as follows:

|                | <b>30th June,<br/>2005</b> | Restated<br>31st December,<br>2004 |
|----------------|----------------------------|------------------------------------|
|                | <i>HK\$'000</i>            | <i>HK\$'000</i>                    |
| Within 30 days | <b>184,153</b>             | 180,644                            |
| 31 – 60 days   | <b>23,591</b>              | 19,360                             |
| 61 – 90 days   | <b>4,412</b>               | 8,628                              |
| Over 90 days   | <b>9,062</b>               | 12,649                             |
|                | <b>221,218</b>             | 221,281                            |

**14. Cash and cash equivalents and pledged bank deposits**

Cash and cash equivalents and pledged bank deposits include HK\$209,394,000 (31st December, 2004: HK\$81,855,000) denominated in RMB which are held by the Group with bank accounts operating in China mainland where exchange controls apply.

**15. Share capital**

|  | <b>Number<br/>of shares<br/>(Thousands)</b> | <b>HK\$'000</b> |
|--|---|-----------------|
| At 1st January, 2004 and 2005, 30th June, 2005 | <u>3,312,680</u>                            | <u>331,268</u>  |

The authorised share capital of the Company comprises of 4,000,000,000 shares with a par value of HK\$0.1 per share. All issued shares are fully paid.

**16. Trade and other payables**

Trade and other payables include trade payables to third parties, an associate, a fellow subsidiary and related companies. The age analysis of the trade payables is as follows:

|                | <b>30th June,<br/>2005<br/>HK\$'000</b> | Restated<br>31st December,<br>2004<br>HK\$'000 |
|----------------|---|--|
| Within 30 days | <b>133,893</b>                          | 103,314  |
| 31 – 60 days   | <b>42,885</b>                           | 39,569   |
| 61 – 90 days   | <b>10,848</b>                           | 12,392   |
| Over 90 days   | <b>7,968</b>                            | 9,040  |
|                | <u><b>195,594</b></u>                   | <u>164,315</u>                                 |

**17. Contingent liabilities**

As of 30th June, 2005, the Group had given a guarantee to a bank for loan facilities granted to an associate of HK\$20,000,000 (31st December, 2004: HK\$15,000,000).

As of 30th June, 2005, the Group had given a guarantee to a bank for loan facilities granted to a jointly controlled entity of RMB 115,000,000 (equivalent to approximately HK\$108,184,000). Loans of RMB 58,300,000 (equivalent to approximately HK\$54,845,000) were drawdown by the jointly controlled entity as at 30th June, 2005. The Group's proportionate share of bank loans of HK\$32,907,000 had been included in the condensed consolidated balance sheet as at 30th June, 2005 (31st December, 2004: Nil).

**18. Commitments**

- (a) The Group is a party to an agreement with third parties (the “Consortium Partners”) in respect of the joint development and operation of Tradeport Logistics Centre at the South Commercial District of HK Airport (the “Project”). The Group has 25% interest in the Project. The Group’s attributable share of capital commitments in respect of the Projects is approximately HK\$78,000,000 (31st December, 2004: HK\$78,000,000).

In the event of default of any of the Consortium Partners, the Group will be required to provide additional funds for the Project. The Group and the Consortium Partners have jointly given a guarantee to the Hong Kong Airport Authority in respect of their obligations to provide sufficient funding for the Project. Should the Group be required to perform its obligations under the guarantee in the event of default of all of the Consortium Partners, the maximum amount of the additional liabilities assumed, in addition to the Group’s estimated share of capital commitments as disclosed above, would be approximately HK\$234,000,000 (31st December, 2004: HK\$234,000,000).

**(b) Capital commitments**

The Group’s proportionate share of capital expenditure of the jointly controlled entities in respect of property, plant and equipment at the balance sheet date but not yet incurred is as follows:

|                                 | <b>30th June,<br/>2005<br/>HK\$’000</b> | 31st December,<br>2004<br>HK\$’000 |
|---------------------------------|---|------------------------------------|
| Contracted but not provided for | <b><u>3,591</u></b>                     | <u>–</u>                           |

**19. Related party transactions**

The Group is part of a larger group of companies under Air China and has extensive transactions and relationships with members of the Air China group. Because of these relationships, it is possible that the terms of transactions between the Group and members of Air China group are not the same as those that would result from transactions with or among other related parties or wholly unrelated parties.

Air China is controlled by CNAH, a state-owned enterprise which is wholly owned by the PRC government. As the Company is indirectly controlled by the PRC government, state-owned enterprises and their subsidiaries, in addition to the group companies of Air China, directly or indirectly owned by the PRC government are also related parties of the Group.



A portion of the Group's business activities are conducted with other state-owned enterprises. For the purpose of related party transactions disclosure, the Group has identified, to the extent practicable, those corporate customers and suppliers which are state-owned enterprises based on their immediate ownership structure. It should be noted, however, that a substantial portion of the Group's business activities are conducted in the PRC and the influence of the PRC government in the Chinese economy is pervasive. In this regard, the PRC government indirectly holds interests in many companies. In addition, a portion of the Group's services provided are of a retail nature to end users, which include transactions with the employees of state-owned enterprises on corporate business, their key management personnel and close family members. Due to the vast volume and the pervasiveness of these transactions, the Group is unable to determine the aggregate amount of these transactions for disclosure. Therefore, the revenue from provision of services disclosed below does not include retail transactions with these related parties. However, the Group believes that meaningful information in respect of related party transactions has been adequately disclosed.



The following is a summary of significant transactions carried out with related parties in the ordinary course of business for the six months ended 30th June, 2005:

**(a) Revenue and expenses**

|   | <b>Six months ended</b> |              |
|---|-------------------------|--------------|
|   | <b>30 June,</b>         |              |
|   | <b>2005</b>             | 2004         |
|   | <b>HK\$'000</b>         | HK\$'000     |
| <b>Revenue:</b>   |                         |              |
| Value of tickets sold to ( <i>note i</i> ):                                   |                         |              |
| – An associate  | <b>565</b>              | 1,229        |
| – Fellow subsidiaries   | <b>2,880</b>            | 1,508        |
| – Related companies   | <b>145</b>              | 7,021        |
| Lease of an aircraft to immediate holding company ( <i>note ii</i> )          | <b>24,940</b>           | –            |
| Sales of goods ( <i>note iii</i> ):   |                         |              |
| – Immediate holding company   | <b>60,475</b>           | –            |
| – An associate  | <b>5,272</b>            | –            |
| – A fellow subsidiary   | <b>80</b>               | –            |
| – Related companies   | <b>1,366</b>            | –            |
| – Other state-owned enterprises   | <b>8,058</b>            | –            |
|   | <b>_____</b>            | <b>_____</b> |
| <b>Operating expenses:</b>  |                         |              |
| Management fee paid to:   |                         |              |
| – Immediate holding company ( <i>note iv</i> )                                | <b>3,000</b>            | 3,000        |
| – A fellow subsidiary ( <i>note v</i> )                                       | <b>1,800</b>            | 1,800        |
| Landing, loading, parking and other airport charges paid to:                  |                         |              |
| – A fellow subsidiary ( <i>note vi</i> )                                      | <b>42,497</b>           | 31,829       |
| – Other state-owned enterprises ( <i>note xi</i> )                            | <b>19,347</b>           | 17,480       |
| Ground handling costs paid to an associate ( <i>note vii</i> )                | <b>63,731</b>           | 55,609       |
| Technical and ground handling costs paid to an associate ( <i>note viii</i> ) | <b>1,983</b>            | 2,107        |
| Inflight meal services expenses paid to a related company ( <i>note ix</i> )  | <b>24,528</b>           | 20,298       |
| Lease rental paid to fellow subsidiaries ( <i>note x</i> )                    | <b>826</b>              | –            |
| Fuel costs paid to other state-owned enterprises ( <i>note xi</i> )           | <b>34,200</b>           | 2,826        |
| Finance cost paid to other state-owned banks ( <i>note xi</i> )               | <b>1,802</b>            | –            |
|   | <b>_____</b>            | <b>_____</b> |

(i) Air tickets were sold to the related ticket sales agents in accordance with the pricing policy of the Group.

(ii) The Group entered into a lease agreement with Air China pursuant to which the Group leases aircraft to Air China at a monthly fee of US\$359,000 (equivalent to approximately HK\$2,796,000) with monthly maintenance hour charge of US\$470 (equivalent to approximately HK\$4,000) per block hour.



(iii) The inflight meal services rendered were charged at terms pursuant to agreements entered into by BACL and SWACL with relevant related parties.

(iv) Pursuant to the management services agreement dated 27th August, 2003 entered into between the Company and CNACG, a fellow subsidiary, CNACG agreed to provide secretarial, personnel, accounting and general office administrative services to the Group for a period of two years from 1st July, 2003 to 30th June, 2005 at a monthly fee of HK\$500,000.

On 28th July, 2005, the Company and CNACG renewed the management services agreement with the same terms under the management services agreement dated 27th August, 2003. Pursuant to the renewed management services agreement, CNACG has agreed to provide secretarial, personnel, accounting and general office administrative services to the Group for a period of three years from 1st July, 2005 to 30th June, 2008 at a monthly fee of HK\$500,000.

(v) The Group entered into a management services agreement with CNAC (Macau) Aviation Limited pursuant to which CNAC (Macau) Aviation Limited provides general management services including but not limited to secretarial, personnel, accounting and general office administrative services to CNAC Macau at a monthly fee of HK\$300,000.

(vi) The airport related charges paid to ADA-Administrative Airport Limited ("ADA") were either at terms pursuant to the tariff published by the Macau Airport or at terms pursuant to agreements entered into by the Group with ADA or the Macau Airport.

(vii) The ground handling services rendered were charged at terms pursuant to agreements entered into by the Group with Menzies Macau.

(viii) The technical and ground handling services rendered were charged at terms pursuant to agreements entered into by the Group with Dragonair.

(ix) The inflight meal services rendered were charged at terms pursuant to agreements entered into by the Group with Macau Catering Services Company Limited, a 34.5% owned associate held by a minority shareholder of Air Macau.

(x) The Group entered into a lease agreement with Easy Advance Limited and Wise Advice Limited, fellow subsidiaries, pursuant to which Easy Advance Limited and Wise Advice Limited lease office premises and certain car parks to the Group at a monthly rental of MOP 141,800 (equivalent to approximately HK\$138,000).

(xi) The above transactions with other state-owned enterprises and banks were entered into in accordance with the terms as set out in the agreements governing the transactions or as mutually agreed between the parties.

**(b)** On 25th August, 2004, CNACG entered into two license agreements with the Company pursuant to which CNACG has agreed to grant licenses to the Company, free of royalty, for the rights to use those trademarks in Hong Kong and Macau, respectively, so long as the Company is a direct or indirect subsidiary of CNAH ("License Agreements").

No royalty charge was levied under the License Agreements in respect of the use of these trademarks during the period.



## (c) Period-end balances arising with related parties comprised:

|   | <b>30th June,<br/>2005<br/>HK\$'000</b> | 31st December,<br>2004<br>HK\$'000 |
|---|---|------------------------------------|
| Receivables from related parties ( <i>note 13</i> ) |   |                                    |
| Immediate holding company                           | <b>38,921</b>                           | 36,246                             |
| An associate  | <b>1,685</b>                            | 1,017                              |
| Related companies                                   | <b>2,163</b>                            | 2,610                              |
| Other state-owned enterprises                       | <b>5,845</b>                            | 9,911                              |
|   | <b>48,614</b>                           | 49,784                             |
| Bank deposits                                       |   |                                    |
| Other state-owned banks                             | <b>747,285</b>                          | 513,705                            |
| Payables to related parties ( <i>note 16</i> )      |   |                                    |
| An associate  | <b>18,128</b>                           | 14,698                             |
| Fellow subsidiary                                   | <b>19,226</b>                           | 15,720                             |
| Related companies                                   | <b>32</b>                               | 62                                 |
| Other state-owned enterprises                       | <b>12,978</b>                           | 6,833                              |
|   | <b>50,364</b>                           | 37,313                             |
| Short-term bank loans                               |   |                                    |
| Other state-owned banks                             | <b>53,052</b>                           | 69,217                             |

## (d) Key management compensation

|   | <b>Six months ended<br/>30 June,</b> |                  |
|---|--------------------------------------|------------------|
|   | <b>2005<br/>HK\$'000</b>             | 2004<br>HK\$'000 |
| Directors' fees                                 | <b>1,740</b>                         | 1,670            |
| Salaries and other short-term employee benefits | <b>3,778</b>                         | 3,260            |
|   | <b>5,518</b>                         | 4,930            |



中航興業有限公司

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