

# REPORT OF DIRECTORS

The Board of Directors (the "Board") of the Company is pleased to present its report together with the audited financial statements of the Group for Year 2006.

## GROUP ACTIVITIES

The Group is the dominant provider of information technology solutions for China's aviation and travel industries. The core businesses of the Group include aviation information technology service, distribution of information technology service, etc..

The analysis of the Group's financial performance is set out under the section "Financial Review".

No analysis of the Group's revenues and contribution to operating profit by geographical areas is presented, as revenues and results of the Group during Year 2006 were principally derived from the operations of the Group in the PRC.

## SHARE CAPITAL STRUCTURE

The issued share capital of the Company as at December 31, 2006 amounted to 888,157,500 shares, with a par value of RMB1.00 each. As at December 31, 2006, the share capital structure of the Company was as follows:

<b>Shares</b>	<b>Number of shares as at December 31, 2006</b>	<b>Percentage to the total number of shares in issue as at December 31, 2006 (%)</b>
Domestic Shares	577,303,500	65.00
H Shares	310,854,000	35.00

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## SUBSTANTIAL SHAREHOLDERS

As at December 31, 2006, pursuant to the register required to be maintained under Section 336 of the Securities and Futures Ordinance (Chapter 571 of the Laws of Hong Kong) (the "Ordinance"), the following substantial shareholders held an interest of 5% or more in their respective class of share capital of the Company:

Name of shareholder	Class and no. of Securities (Note 1)	Capacity	Percentage of respective class of share capital	Percentage of total share capital
OppenheimerFunds, Inc.	42,467,220 H shares of RMB1 each (L)	Investment Manager	9.65% (Note 2)	4.78%
Matthews International Capital Management, LLC	28,239,000 H shares of RMB1 each (L)	Investment Manager	9.08%	3.18%
Templeton Asset Management Limited	26,988,000 H shares of RMB1 each (L)	Investment Manager	8.68%	3.04%
JPMorgan Chase & Co.	8,688,000 H shares of RMB1 each (L)	Investment Manager	2.79%	0.98%
	11,882,000 H shares of RMB1 each (L)	Custodian Corporation/ approved lending agent	3.82%	1.34%
	11,882,000 H shares of RMB1 each (P)	(Note 3)	3.82%	1.34%
J.P.Morgan Fleming Asset Management (Asia) Inc.	22,199,000 H shares of RMB1 each (L)	Investment Manager	7.14%	2.50%
J.P.Morgan Fleming Asset Management Holdings Inc.	22,199,000 H shares of RMB1 each (L)	Investment Manager	7.14%	2.50%
JF Asset Management Limited	22,199,000 H shares of RMB1 each (L)	Investment Manager	7.14%	2.50%

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Name of shareholder	Class and no. of Securities (Note)	Holding capacity	Percentage of respective class of share capital	Percentage of total share capital
Platinum Asset Management Limited	4,324,876 H shares of RMB1 each (L)	Investment Manager	1.39%	0.49%
	14,407,050 H shares of RMB1 each (L)	Trustee (other than a bare trustee)	4.63%	1.62%
China TravelSky Holding Company	198,496,500 Domestic shares of RMB1 each (L)	Beneficial owner	34.38%	22.35%
China Southern Air Holding Company	116,460,500 Domestic shares of RMB1 each (L)	Beneficial owner	20.17%	13.11%
China Eastern Air Holding Company	109,414,500 Domestic shares of RMB1 each (L)	Beneficial owner	18.95%	12.32%
China National Aviation Holding Company	89,433,500 Domestic shares of RMB1 each (L)	Beneficial owner	15.49%	10.07%

*Notes:*

- (1) (L) - Long Position, (P) - Lending Pool
- (2) Such percentage is shown in the corporate substantial shareholder notice of OppenheimerFunds, Inc. filed on December 6, 2006. However, the number of H shares held by OppenheimerFunds, Inc. stated in such notice was 42,467,220, which, if correct, represents 13.66%, instead of 9.65% (as stated in such notice) of the total issued capital of H shares of the Company. OppenheimerFunds Inc. had not filed any corporate substantial shareholder notice with the Company. In the register of members of the Company, it did not show that any H shares of the Company were held in the name of OppenheimerFunds Inc. Therefore, the Company is unable to ascertain the actual number of H shares held by OppenheimerFunds Inc as at December 31, 2006.
- (3) The capacity in which the 11,882,000 H shares are held by JP Morgan Chase & Co. was not stated in the corporate substantial shareholders notice of JP Morgan Chase & Co. filed on December 8, 2006.

Save as disclosed above, as at December 31, 2006, no other persons or companies held an interest or short positions of 5% or more of the issued share capital or in the respective class of shares of the Company pursuant to the register required to be maintained under Section 336 of the Ordinance.

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## PUBLIC FLOAT

As at the latest practicable date prior to the printing of this report, the Company has maintained the prescribed public float under the Listing Rules, based on the information that is publicly available to the Company and within the knowledge of the Directors.

## INTERESTS OF DIRECTORS, SUPERVISORS AND CHIEF EXECUTIVE IN THE SHARE CAPITAL OF THE COMPANY

As at December 31, 2006, none of the Directors, Supervisors or chief executive had any interest or short position in any shares, underlying shares and debentures of the Company or any of its associated corporations (as defined in Part XV of the Ordinance) that is required to be recorded in the register maintained in accordance with Section 352 of the Ordinance, or any interest or short position required to be notified to the Company and the Stock Exchange pursuant to the Model Code for Securities Transactions by Directors of Listed Issuers ("Model Code") as set out in Appendix 10 to the Listing Rules. None of the Directors, Supervisors or chief executive of the Company or their respective associates had been granted or had exercised any rights to subscribe the securities of the Company or any of its associated corporation (as defined in Part XV of the Ordinance) in Year 2006.

## SERVICE CONTRACTS OF DIRECTORS AND SUPERVISORS

Each member of the second Board and Supervisory Committee of the Company has entered into a service agreement with the Company. All Directors and Supervisors of the second Board and Supervisory Committee will serve a term up to January 9, 2007. The third Board and Supervisory Committee have been set up on January 9, 2007 upon election at the extraordinary general meeting of the Company held on January 9, 2007. Each Director and Supervisor of the third Board and Supervisory Committee has entered into a service agreement with the Company and will serve a term of three years. For the year ended December 31, 2006, no Directors or Supervisors, proposed to enter into a service agreement which would not expire or determinable by the Company within one year without payment of compensation (other than statutory compensation).

## INTERESTS OF DIRECTORS AND SUPERVISORS IN CONTRACTS

Certain members of the second and third Board and Supervisory Committee are also members of management of various Chinese commercial airlines which are shareholders of the Company. The contracts or transactions entered into between the Company or any of its subsidiaries and such airline shareholders have been referred to in the section "Connected Transactions" of this Report of Directors. Save as disclosed in that section, none of the Directors or Supervisors of the Company had a material, direct or indirect, interest in any contract of significance to which the Company or any of its subsidiaries was a party during Year 2006.

## REMUNERATION OF DIRECTORS AND SUPERVISORS

Details of the remuneration of Directors and Supervisors are set out in *Note 7* to the financial statements.

## INTEREST CAPITALIZED

No interest was capitalized for the Group in Year 2006.

## PROPERTY, PLANT AND EQUIPMENT

Movements in property, plant and equipment of the Group during Year 2006 are summarised in *Note 13* to the financial statements.

## RESERVES

Details of movements in reserves of the Group for Year 2006 are set out in the consolidated statement of changes in shareholders' equity.

## DIVIDENDS

The Board recommends the payment of a final dividend of RMB0.22 per share for Year 2006.

## EMPLOYEES' RETIREMENT SCHEME

Details of the employees' retirement scheme of the Group are set out in *Note 8* to the financial statements.

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## MAJOR SUPPLIERS AND CUSTOMERS

Société Internationale de Télécommunications Aeronautiques S.C. ("SITA S.C.") was the largest supplier to the Group for the year ended December 31, 2006 and the total network usage fees paid by the Group to SITA S.C. in Year 2006 accounted for 8.6% of the Group's total operating expenses (excluding depreciation and amortization expenses). During Year 2006, the total amount paid to the five largest suppliers of the Group accounted for 19.8% of the Group's total operating expenses (excluding depreciation and amortization expenses).

Sales to the largest customer of the Group, China Southern Airlines Company Limited, the subsidiary of China Southern Air Holding Company, accounted for 17.6% of the Group's total revenues for the year ended December 31, 2006. During Year 2006, total sales to the Group's five largest customers accounted for 57.1% of the Group's total revenues. Three of these top five customers, China Southern Airlines Company Limited, China Eastern Airlines Corporation Limited and Air China Limited, the respective substantial shareholders of China Southern Air Holding Company, China Eastern Air Holding Company, and China National Aviation Holding Company, are the substantial shareholders of the Company, holding an aggregate of approximately 35.5% of the issued share capital of the Company as at December 31, 2006. The aggregate revenue derived from the above major customers is set out in *Note 37* to the financial statements.

Save as disclosed in this report and in *Note 37* to the financial statements, none of the Directors, Supervisors and their associates nor any shareholder (which to the knowledge of the Directors hold more than 5% of the Company's issued share capital) had any interest in any of the aforementioned suppliers and customers.

## SUBSIDIARIES AND ASSOCIATED COMPANIES

Particulars of the Company's subsidiaries and associated companies as at December 31, 2006 are set out in *Note 1* to the financial statements.

## CONNECTED TRANSACTIONS

### Continuing Connected Transactions

During Year 2006, the Group continued to carry out the following transactions, which constitute connected transactions as defined in the Listing Rules, and are required to be disclosed in accordance with Chapter 14A of the Listing Rules:

(a) *Provision of Services and Technological Support by the Group to the Company's Promoters*

In Year 2006, the Group continued to provide certain promoters of the Company (other than CTHC) or as the case may be, their respective subsidiaries (namely Hainan Airlines Company Limited, China Eastern Air Wuhan Company Limited, Shanghai Airlines Company Limited, Shandong Airlines Company Limited, Shenzhen Airlines Company Limited, Sichuan Airlines Company, China Southern Airlines Company Limited, China Eastern Air Holding Company and China National Aviation Holding Company) with aviation information technology service and technical support and its related business services. The service fees payable by such promoters (or, as the case may be, their respective subsidiaries) to the Group was determined in accordance with the pricing schedule prescribed by the General Administration of Civil Aviation of China (中國民用航空總局). Such promoters, and, as the case may be, their respective subsidiaries, being associates of such promoters, are connected persons of the Company.

For Year 2006, total service fees paid by such promoters (or, as the case may be, their respective subsidiaries) to the Group amounted to approximately RMB1,147.9 million (2005: RMB1,058.8 million). Please refer to *Note 37* to the financial statements for further details and financial information relating to the provision of such services by the Group during Year 2006. Please also refer to the announcement and circular dated March 17, 2006 and April 7, 2006 respectively in relation to the continuing connected transaction for further details, in particular, the annual cap for this continuing connected transaction for the year ended December 31, 2006 disclosed therein.

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(b) *Lease of Properties by the Company from CTHC*

The Company continued to lease two properties from CTHC in Year 2006. Since CTHC is one of the promoters of the Company and a substantial shareholder of the Company, CTHC is regarded as a connected person of the Company. Details and financial information relating to such leases during Year 2006 are set out in *Note 37* to the financial statements.

For Year 2006, total rental and usage fees paid by the Company to CTHC amounted to approximately RMB38,609,000 (2005: RMB38,609,000).

(c) *Transaction between SITA Information Networking Computing (UK) Limited (“SITA INC. UK”) and InfoSky Technology Co., Ltd. (“InfoSky”), a subsidiary of the Company*

During Year 2006, the total charges in relation to air cargo services paid by InfoSky to SITA INC. UK amounted to US\$2,395,217 (2005:US\$714,241) based on the charges agreed by both parties and with reference to usage. As Société Internationale de Télécommunications Aéronautiques Greater China Holdings Limited (“SITAGCH”) is a substantial shareholder of InfoSky, SITAGCH is a connected person of the Company, and as SITA INC. UK is a fellow subsidiary of SITAGCH, SITA INC. UK is a connected person of the Company.



(d) *Membership fees and Data Network Services Usage Fees Paid by the Company to SITA S.C.*

During Year 2006, the Company, as a member of SITA S.C., continued to engage SITA S.C. in providing all types of services and data network services to the Company. The data network services usage fees were determined based on the usage and the pricing schedule set by SITA S.C. applicable to all users of the data network services of SITA S.C.. The membership fees are determined with reference to the ratio of the total amount of bills for the services charged to the Company by SITA S.C, Société Internationale de Télécommunications Aéronautiques NV or their respective wholly-owned subsidiaries in the previous financial year to the total amount of all income receivable by all members of SITA S.C. in that financial year.

Since both SITAGCH and SITA S.C. are collectively owned, directly or indirectly, by the members of the Air Transport Community. The Air Transport Community is a group formed by many communities of interest entities within the air transport industry, the members of which include the members of SITA and customers, and many associations, councils and committees of the industry across the world. SITA S.C. is therefore considered as a connected person of the Company.

For Year 2006, the membership fee and data network usage fees payable by the Company to SITA S.C. amounted to RMB55,521,777 (2005: RMB38,576,816).

(e) *Transactions between the Company and the Service Companies*

The service companies (the "Service Companies") are the companies established between the Company and certain promoters for distributing the products of the Company and providing better service to customers in different regions. Since such promoters are entitled to exercise, or control the exercise of 10% or more of the voting power at any general meeting of the Service Companies, the Service Companies are regarded as connected persons of the Company. The Service Companies pay fees to the Company for using mainframe resources, linking with the Company's data network, and connection and installation of terminal equipment and printers at the rates prescribed by the General Administration of Civil Aviation of China (中國民航總局) or on a cost basis if applicable.

The Service Companies which also provide front end technical supports for airport passenger processing system (APP system), are entitled to sharing the profit generated from APP system with the Company.

For Year 2006, the Company's fees received from the Service Companies and the revenue of APP System shared by the Service Companies aggregated to RMB29,362,606 (2005: RMB35,096,947).

In the opinion of the Independent Non-executive Directors, the above items (a) to (e) of the continuing connected transactions and the agreements governing those transactions:

- (i) were entered into by the Group in the ordinary and usual course of its business;

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- (ii) were conducted either
  - (a) on normal commercial terms (the term applicable to transactions of similar nature and are carried out by similar entities); or
  - (b) (where there is no available comparison) on terms that are no less favorable than those available to or from independent third parties; and
- (iii) were conducted on the terms of the relevant agreement governing those transactions, which are fair and reasonable and in the interest of the shareholders of the Company as a whole; and
- (iv) if they fall within any of the following categories, did not exceed the upper limits set out below for the financial year ended December 31, 2006:

Categories of transactions	Cap Amount
Transaction between the Group and certain promoters of the Company or as the case may be, subsidiaries of promoters of the Company	RMB1,498.00 million (please refer to the circular of the Company dated April 7, 2006 for further details)
Leasing properties from CTHC	RMB40.00 million
Transaction between InfoSky and SITA INC.UK	US\$5.00 million
Transaction between the Company and the Service Companies	RMB84.00 million
Transaction between the Company and SITA S.C.	RMB72.00 million

The Board has received a letter of confirmation from the auditors stating that the above-items (a) to (e) of the continuing connected transactions:

- (a) have been approved by the Board;
- (b) were conducted in accordance with the pricing policies of the Company;
- (c) were conducted in accordance with the terms of the respective agreements and documents governing those transactions; and
- (d) the aggregate amounts of the relevant transactions incurred in Year 2006 have not exceeded their respective annual caps (as referred to in item (iv) above).

## OTHER CONNECTED TRANSACTIONS

On June 6, 2006, the Company entered into computer software development service agreement with Asia Technology Development Center of Beijing (“Asia Technology”), pursuant to which the Company agreed to engage Asia Technology to provide computer software development services. As Asia Technology, being an indirect wholly owned subsidiary and associate of CTHC, the promoter and a substantial shareholder of the Company, Asia Technology is a connected person of the Company and the said technology development service agreements constituted connected transactions under the Listing Rules. The total consideration payable by the Company under the above agreement is RMB18,800,000. Since each of the applicable percentage ratios referred to in Rule 14A.32(1) of the Listing Rules in relation to such transaction is less than 2.5%, such transactions was therefore subject to reporting and announcement requirements under the Listing Rules and was exempt from the approval of the Company’s independent shareholders requirement. The Company has published an announcement on June 6, 2006 setting out the terms of such transaction.

On September 7, 2006, each of the Company and InfoSky has entered into an aviation information technology service implementation agreement with SITA S.C. respectively. As described in the paragraph headed “Continuing Connected Transactions” above, SITA S.C. is the connected person of the Company and the transactions contemplated under the agreements constitute connected transactions under the Listing Rules. Pursuant to the aforesaid agreements, approximately US\$3,358,000 and approximately US\$887,000 will be payable to the Company and InfoSky respectively by SITA S.C.. Since each of the applicable percentage ratios referred to in Rule 14A.32(1) of the Listing Rules in relation to such transactions in aggregate is less than 2.5%, such transactions were therefore subject to reporting and announcement requirements under the Listing Rules and were exempt from the approval from the Company’s independent shareholders requirement. The Company has published an announcement on September 8, 2006 setting out the terms of such transactions.

The Directors confirm that the related party transactions referred to in Note 37 to the financial statements are connected transactions or continuing connected transactions of the Company and they have complied with the disclosure requirements in accordance with Chapter 14A of the Listing Rules.

## TRUST DEPOSITS AND IRRECOVERABLE OVERDUE TIME DEPOSITS

As at December 31, 2006, the Group did not have any trust deposits or irrecoverable overdue time deposits. All of the Group’s cash deposits are deposited with commercial banks and are in compliance with applicable laws and regulations.

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## TAX RELIEF AND EXEMPTION

The Company is not aware of any tax relief and exemption available to shareholders by reason of their holding of the Company's securities.

## PURCHASE, SALE OR REDEMPTION OF SECURITIES

For Year 2006, the Group did not purchase, sell or redeem any of the Company's securities.

## AUDIT COMMITTEE AND COMPLIANCE WITH CODE OF CORPORATE GOVERNANCE PRACTICES

The Audit Committee of the Company has reviewed the accounting policy and practice adopted by the Company and has also discussed certain other matters relating to audit, internal control and financial reporting including the review of the audited consolidated financial statements of the Group for Year 2006. Details of the Company's compliance with the requirements of the Code of Corporate Governance Practices set out in Appendix 14 to the Listing Rules for Year 2006 are set out in the "Corporate Governance Report" contained in this annual report.

## PRE-EMPTIVE RIGHTS

There is no provision regarding pre-emptive rights under the articles of association of the Company or the PRC laws.

## MATERIAL LITIGATION

The Group was not involved in any material litigation or dispute in Year 2006.

## AUDITORS

Since the date of incorporation of the Company to December 31, 2001, Arthur Andersen & Co in Hong Kong and Arthur Andersen • Hua Qiang in the PRC were the Company's international and PRC auditors, respectively.

PricewaterhouseCoopers (Certified Public Accountants in Hong Kong) and PricewaterhouseCoopers Zhong Tian CPAs Ltd. Co. (Certified Public Accountants in the PRC) are the Company's international and PRC auditors from Year 2002 to Year 2006 respectively.

A resolution relating to the appointment of PricewaterhouseCoopers (Certified Public Accountants in Hong Kong) and PricewaterhouseCoopers Zhong Tian CPAs Ltd. Co. (Certified Public Accountants in the PRC) as the Company's International and PRC auditors for the year ending December 31, 2007 respectively will be proposed at the forthcoming annual general meeting of the Company in 2007.

By order of the Board

**Zhu Yong**

*Chairman*

March 28, 2007