AIR CHINA
中國國際航空公司

北京2008 年奧運會航空客運合作夥伴
AIRLINE PARTNER OF THE BEIJING 2008 OLYMPIC GAMES

Annual Report 2007

Air China Limited

stock code: 753 HongKong
601111 Shanghai
AIRC London

Air China is the only national flag carrier of China and the exclusive airline partner of the 2008 Beijing Olympic Games. Air China has been selected as one of the 2007 Top 20 Globally Most Competitive Chinese Companies and has officially become a member of the Star Alliance, the world's largest airline alliance, since December 2007.

Air China is headquartered in Beijing, the capital of China, with Shanghai and Chengdu as its two increasingly important hubs. As at 31 December 2007, by joining the Star Alliance the routes network of Air China could cover 155 countries and regions as well as 895 destinations. Air China continues to maintain its core values of providing safe, convenient, comfortable and customised services, and dedicates to offer distinguished services and excellent experience to global passengers and cargo forwarders.

The strategic objectives of Air China are "to build up international competitive strength, continue to enhance development potentials, offer its customers with unique and excellent experience and realise a sustainable growth so as to create value to all the relevant parties".

In addition, Air China also directly or indirectly holds interests in the following airlines: Air Macau Company Limited (51%), Air China Cargo Co., Ltd. (51%), Shandong Airlines Company Limited (22.8%), Shenzhen Airlines Company Limited (25%) and Cathay Pacific Airways Limited (17.5%).

Contents

Corporate Information

REGISTERED CHINESE NAME
中國國際航空股份有限公司

ENGLISH NAME
Air China Limited

REGISTERED OFFICE
9/F, Blue Sky Mansion
28 Tianzhu Road
Zone A, Tianzhu Airport Industrial Zone
Shunyi District
Beijing
China

PRINCIPAL PLACE OF BUSINESS IN HONG KONG
5th Floor, CNAC House
12 Tung Fai Road
Hong Kong International Airport
Hong Kong

WEBSITE ADDRESS
www.airchina.com.cn

DIRECTORS
Kong Dong
Wang Shixiang
Yao Weiting
Ma Xulun
Christopher Dale Pratt
Chen Nan Lok, Philip
Cai Jianjiang
Fan Cheng
Hu Hung Lick, Henry
Wu Zhipan
Zhang Ke
Jia Kang

SUPERVISORS
Sun Yude
Liao Wei
Zhou Guoyou
Liu Feng
Liu Guoqing

LEGAL REPRESENTATIVE OF THE COMPANY
Li Jiaxiang

JOINT COMPANY SECRETARIES
Huang Bin
Li Man Kit *(ACIS, ACS)*

QUALIFIED ACCOUNTANT
David Tze-kin Ng *(CPA)*

AUTHORISED REPRESENTATIVES
Cai Jianjiang
Li Man Kit

LEGAL ADVISER TO THE COMPANY
Haiwen & Partners (as to PRC Law)
Freshfields Bruckhaus Deringer
(as to Hong Kong and English Law)

INTERNATIONAL AUDITORS
Ernst & Young

H SHARE REGISTRAR AND TRANSFER OFFICE
Computershare Hong Kong Investor Services Limited
Rooms 1712-1716, 17th Floor
Hopewell Centre
183 Queen's Road East
Wanchai
Hong Kong

LISTING VENUES
Hong Kong, London and Shanghai

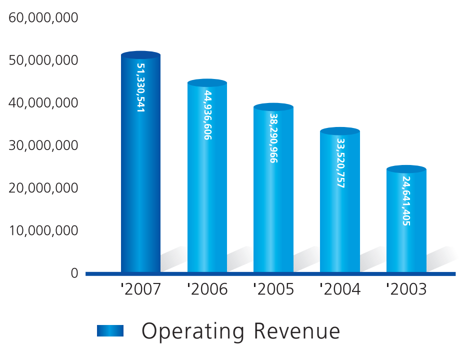
Summary of Financial Information

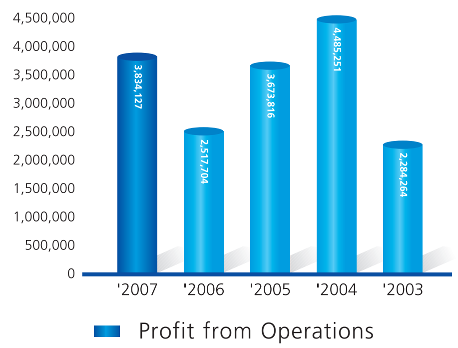
(in RMB'000)

	2007	2006	2005	2004	2003
Operating Revenue	**51,330,541**	44,936,606	38,290,966	33,520,757	24,641,405
Profit from operations	**3,834,127**	2,517,704	3,673,816	4,485,251	2,284,264
Profit before tax	**5,606,113**	3,929,221	3,374,254	3,559,559	178,279
Profit after tax (including profit attributable to minority shareholders)	**4,121,500**	3,305,097	2,470,380	2,548,695	88,498
Profit attributable to minority shareholders	**(107,497)**	617,256	64,124	162,731	(71,106)
Profit attributable to shareholders of the Company	**4,228,997**	2,687,841	2,406,256	2,385,964	159,604
EBITDA[1]	**9,411,048**	7,813,232	8,186,496	7,948,503	5,661,736
EBITDAR[2]	**11,961,669**	10,206,623	9,928,427	9,207,230	6,753,854
Earnings per share attributable to shareholders of the Company (RMB)	**0.356**	0.262	0.255	0.360	N/A
Return on shareholders' equity (%)	**13.49**	9.04	11.98	14.42	2.32

(1) EBITDA represents earnings before finance revenue (including interest income, net exchange gains, net gains on fuel derivatives and dividend income from available-for-sale investments), finance costs, enterprise income taxes, gain on disposal of an associate, share of profits and losses of associates, depreciation and amortisation as computed under the International Financial Reporting Standards.

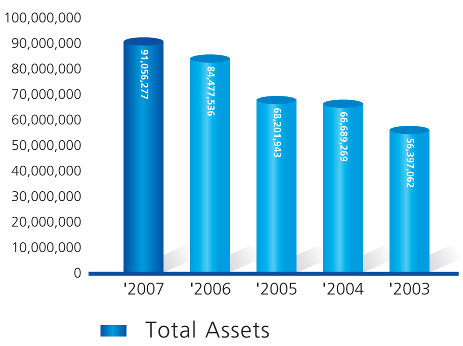
(2) EBITDAR represents EBITDA less operating lease expenses on aircraft and engines as well as other operating lease expenses.





(in RMB'000)

	31 December 2007	31 December 2006	31 December 2005	31 December 2004	31 December 2003
Total assets	**91,056,277**	84,477,536	68,201,943	66,689,269	56,397,062
Total liabilities	**59,548,924**	52,741,843	46,651,337	48,660,727	48,081,813
Minority interests	**150,216**	2,011,435	1,458,365	1,480,287	1,422,380
Shareholders' equity (excluding minority interests)	**31,357,137**	29,724,258	20,092,241	16,548,255	6,892,869
Shareholders' equity per share (RMB)	**2.64**	2.43	2.13	1.83	N/A



Summary of Operating Data

The following summary includes the operating data of Air China Limited (the "Company"), Air China Cargo Co., Ltd. ("Air China Cargo") and Air Macau Company Limited ("Air Macau")

	2007	2006	Increase/(decrease)
Traffic			
RPK (in millions)	**70,025.8**	63,361.6	10.52%
International	**30,200.8**	27,120.1	11.36%
Mainland China	**36,534.4**	32,970.3	10.81%
Hong Kong and Macau	**3,290.6**	3,271.1	0.60%
RFTK (in millions)	**3,875.5**	3,477.5	11.44%
International	**2,948.6**	2,603.6	13.25%
Mainland China	**776.3**	723.9	7.24%
Hong Kong and Macau	**150.5**	150.1	0.23%
Passengers (in thousands)	**37,256.2**	33,971.2	9.67%
International	**7,356.5**	6,696.0	9.86%
Mainland China	**27,931.2**	25,253.2	10.60%
Hong Kong and Macau	**1,968.6**	2,022.0	(2.64%)
Cargos and mails carried (tonnes)	**1,103,914.0**	1,019,359.3	8.29%
Kilometers flown (in millions)	**519.6**	484.9	7.16%
Block hours (in thousands)	**817.6**	755.2	8.27%
Number of flights	**294,905**	280,814	5.02%
International	**56,288**	50,753	10.91%
Mainland China	**219,237**	209,656	4.57%
Hong Kong and Macau	**19,380**	20,405	(5.02%)
RTK (in millions)	**10,170.3**	9,174.2	10.86%
Capacity			
ASK (in millions)	**89,233.7**	83,492.3	6.88%
International	**39,206.5**	36,038.0	8.79%
Mainland China	**45,558.7**	42,902.2	6.19%
Hong Kong and Macau	**4,468.5**	4,551.9	(1.83%)
AFTK (in millions)	**6,868.1**	6,404.4	7.24%
International	**5,099.9**	4,615.4	10.50%
Mainland China	**1,531.3**	1,524.6	0.44%
Hong Kong and Macau	**236.9**	264.4	(10.42%)
ATK (in millions)	**14,938.7**	13,959.2	7.02%

Summary of Operating Data

	2007	2006	Increase/(decrease)
Load factor			
Passenger load factor (RPK/ASK)	**78.47%**	75.89%	2.59ppt
International	**77.03%**	75.25%	1.78ppt
Mainland China	**80.19%**	76.85%	3.34ppt
Hong Kong and Macau	**73.64%**	71.86%	1.78ppt
Cargo and mail load factor (RFTK/AFTK)	**56.43%**	54.30%	2.13ppt
International	**57.82%**	56.41%	1.41ppt
Mainland China	**50.70%**	47.48%	3.21ppt
Hong Kong and Macau	**63.52%**	56.78%	6.75ppt
Yield			
Yield per RPK (RMB)	**0.6231**	0.5929	5.10%
International	**0.5913**	0.5629	5.05%
Mainland China	**0.6429**	0.6082	5.71%
Hong Kong and Macau	**0.6955**	0.6875	1.16%
Yield per RFTK (RMB)	**1.8927**	2.0577	(8.02%)
International	**1.8504**	2.1260	(12.97%)
Mainland China	**1.5239**	1.3183	15.60%
Hong Kong and Macau	**4.6267**	4.4393	4.22%
Fleet			
Total number of aircraft in service at year end	**234**	225	9
Daily utilization (block hours per day per aircraft)	**9.92**	10.10	(1.81%)
Unit cost			
Operating expenses per ASK (RMB)	**0.55**	0.52	5.77%
Operating expenses per ATK (RMB)	**3.28**	3.14	4.46%

Chairman's Statement

Dear Shareholders,

In 2007, China's economy continued to maintain the trend of a rapid but steady growth and the market demand for air transportation remained robust. The Company has, while ensuring its flight safety, improved the service quality and realised steady growth in profitability as well as created more value to all relevant parties.

During the reporting period, the Group (including the Company and its subsidiaries and joint ventures) recorded a total traffic turnover of 10.17 billion tonne kilometres and carried 37.256 million passengers and handled 1.104 million tonnes of cargos and mails, representing an increase of 10.9%, 9.7% and 8.3% respectively as compared with the corresponding period of last year. The Group's total revenue from business operations (including air traffic revenue and other operating revenue) amounted to RMB51.33 billion and profit before tax amounted to RMB5.606 billion, representing an increase of 14.23% and 42.68% respectively as compared with the corresponding period of last year. The Group achieved new height in terms of profitability and continued to maintain its leading position among domestic airlines in China.

As compared with the same period last year, the share of profit generated from air transportation business in our total profit has increased. The Company's investment return has increased substantially owing to strong performance of Cathay Pacific Airways Limited ("Cathay Pacific"), while the appreciation of Renminbi also contributed positively to our profit.

Strengthening the hub building and solidifying the market position. By the end of 2007, the number of aircraft serving Beijing has reached 132, representing 60% of our total capacity. In order to optimise and expand our route network, five international routes (including Beijing-Sapporo and Beijing-Athens routes) and a number of domestic routes were launched, the number of connecting flights has steadily increased and the number of transit passengers has significantly increased. Our passenger throughput at Beijing hub accounted for 44.6% of the total passenger throughput of all domestic airlines at Beijing Capital International Airport, and the Company's market position in Beijing is thus strengthened. The market shares of the Company in Chengdu and Shanghai have also been steadily increasing.

Substantial progress in forming alliance and business cooperation and further enhanced market influence. In December 2007, the Company was formally admitted to the Star Alliance, the largest airline alliance in the world, and thereafter the route network coverage of the Star Alliance extended to 155 countries and regions with 895 destinations. By taking the advantage of its admission to the alliance, the Company is able to fully expand its geographical coverage. Starting from 26 March 2008, the Company will commence its full operation at Terminal 3 of the Beijing Capital International Airport, which may help to realise the strategy of "Move Under One Roof" with other members of the Star Alliance and to facilitate a smooth operation of connecting flights between the Company and other members of the Star Alliance.

During the reporting period, the Company continued to strengthen its business cooperation with Cathay Pacific by setting up a jointly operated Beijing-Hong Kong route. The sales teams of the two companies in Beijing and Hong Kong were combined and a mechanism for regular capacity and scheduling coordination was set up. We have been also successfully promoting our cooperation in areas of procurement, cabin service, aircraft maintenance and IT.

Innovative services and products and marketing means and excellent market integration results. During the reporting period, the Company fully completed the renovation scheme for its first class and business class cabins in March. In August, the Company introduced the "Forbidden Pavilion" for its first class cabin and "Capital Pavilion" for its business class cabin and in October the Junior Phoenix Card (知音寶貝卡) was launched. Our newly purchased aircraft are all equipped with new designed seats to provide upgraded services for our first class and business class customers. The introduction of various services and products are intended to provide more options for our customers. In this regard, the Company aggressively promoted e-commerce, self-service check-in, online check-in and electronic passenger ticketing operation. As a result of further expanding the through check-in business, the average monthly through check-in business handled by overseas and domestic airports substantially increased. While resource integration of both international and domestic markets was also strengthened, our Europe route started to post a profit while loss in the North America route was largely reduced. Our operating results were better than expected and positive effects of integration also started to reveal in other regions.

Enhancing service quality and brand value by leveraging on 2008 Olympic Games and "Quality Service Year" campaign. During the reporting period, the Company continued to further strengthen its notion of providing safe, convenient, comfortable and customised services by launching the "Quality Service Year" campaign. By leveraging our status as the sole passenger airline partner of Beijing 2008 Olympic Games, the Company has formulated and refined the service assurance plan for 2008 Olympic Games and passed the examination and review of 26 Good Luck Beijing test events and pre-competitions to fully prepare itself for providing high quality services during the Olympic Games. In 2007, the Company was enlisted in the "World's Top Five Hundred Brands" and the "2007 Top 20 Globally Most Competitive Chinese Companies". The Company was ranked No.27 for the "Top 500 Most Valuable Chinese Brands". The Company's brand value was further enhanced.

Emphasising energy saving and emission reduction and further strengthening cost control. During the reporting period, the Company adopted various measures to improve the energy efficiency. Such measures include strengthening the management on the use of aircraft ramp supporting facilities, eliminating inefficient load, optimising air route, increasing the overall load factor, introducing and using additional fuel saving aircraft and engines. These measures not only lowered unit fuel consumption level but also reduced the carbon dioxide emission and noise pollution. Meanwhile, our cashflow management, debt management and financing management were also improved through various measures such as central procurement, fuel saving, fuel hedging and maintenance expenses control. Cost control was further strengthened accordingly.

Looking ahead in 2008, the Company believes that China's economy and the air transportation market will continue to remain buoyant. However, competition in the air transportation market has become increasingly fierce, especially with the implementation of the liberalization policy, the Chinese aviation industry will face stronger challenges. In response to the changing market situation, the Company has adjusted its corporate strategies from time to time and set higher business development objectives to "build up international competitive strength, continue to enhance development potentials, offer its customers with unique and excellent experience and realise a sustainable growth so as to create value to all the relevant parties".

I believe, with the support of our shareholders and the joint effort of our management and colleagues, the Company will continue to improve its services, increase its revenue, strengthen its cost control and create better returns for its shareholders, its employees as well as the society.

孔栋

Acting Chairman of the Board
Kong Dong

Beijing, the PRC,
17 March 2008

Business Overview

BUSINESS REVIEW OF PASSENGER SERVICE OPERATION

In 2007, the Company's passenger traffic reached 67,000 million RPKs, representing an increase of 11.10% from 2006. Passenger traffic from international routes, Mainland China routes and Hong Kong and Macau routes increased by 12.10%, 10.80% and 2.70% respectively. The higher growth in international routes compared with Mainland China and Hong Kong and Macau routes reflected the robust growth potential of the international aviation markets. The number of passengers carried increased by 10.60% from 2006 to 34.841 million with an average passenger load factor of 78.60%, representing an increase of 2.6 percentage points from 2006. The available seat kilometres of the Company increased by 7.30% from 2006 to 85,270 million kilometers. The revenue per RPK increased by 5.08% from 2006 to RMB0.62.

Air Macau: For 2007, while the available seat kilometers reached 3,964 million representing a decrease of 2.14% from 2006, passenger traffic decreased by 0.43% from 2006 to 3,026 million RPKs, and the number of passengers carried decreased by 2.10% from 2006 to 2.415 million. Passenger load factor for 2007 was 76.35%, representing an increase of 1.3 percentage points from 2006.

BUSINESS REVIEW OF CARGO SERVICE OPERATION

In 2007, the cargo and mail traffic of the Company's joint venture Air China Cargo and the bellyhold space of the Company's passenger aircraft increased by 12.30% from 2006 to 3,690 million RFTKs. Cargo and mail carried increased by 10.60% from 2006 to 934,000 tonnes while cargo and mail load factor increased by 2.1 percentage points from 2006 to 55.80%. The available freight tonne kilometres increased by 8.20% from 2006 to 6,620 million, and cargo yield per tonne kilometer decreased by 7.20% from 2006 to RMB1.80.

Air Macau: For 2007, while the available fright tonne kilometres reached 249 million, representing a decrease of 13.30% from 2006, turnover volume of cargo and mail decreased by 3.75% from 2006 to 185 million RFTKs, and cargo and mail carried decreased by 2.81% from 2006 to 169,800 tonnes. Cargo and mail load factor for 2007 was 74.31%, representing an increase of 7.4 percentage points from 2006.

BUSINESS REVIEW OF THE COMPANY'S INVESTMENTS IN AIRLINES

Shandong Airlines Company Limited ("Shandong Airlines")

The Company holds 22.8% of the share capital of Shandong Airlines, and 49.4% of the share capital of Shandong Aviation Group Corporation, which in turn holds 42% of the share capital of Shandong Airlines. During 2007, the total traffic turnover of Shandong Airlines increased by 3.99% from 2006 to 600 million tonne kilometres, while passengers carried decreased by 0.19% from 2006 to 5.36 million.

Shenzhen Airlines Company Limited ("Shenzhen Airlines")

The Company holds 25% of the share capital of Shenzhen Airlines. During 2007, the total traffic turnover of Shenzhen Airlines increased by 34% from 2006 to 1.42 billion tonne kilometers, while passengers carried increased by 33.70% from 2006 to 9.52 million.

HUB BUILDING

During 2007, the Company continued to increase its investments in its transport capacity in the Beijing market by launching new international routes to Sydney, Sapporo, Athens and domestic routes to Zhuhai, Yichang, Xuzhou and other cities, realigning the structure of routes originating from Beijing to Macau, Los Angeles and Ho Chi Minh City and increasing the flight frequency of key routes serving Europe and America (e.g. the flight frequency to Frankfurt is increased to 21 flights per week). As a result of the increased coverage of route network and opportunities for hub connections, the number of transit passengers served by the Beijing hub amounted to 3.51 million, accounting for 17% of the total number of passengers carried. As such, the position of the Beijing hub has been strengthened.

As Shanghai is becoming an important hub in the global aviation network, the Company has accelerated the construction of the Shanghai hub, increased the routes between Shanghai and each of the bases of Air China and its branches and continued to expand its investments in the transport capacity and the flight frequency of the routes originating from Shanghai. Meanwhile, more routes between Shanghai and major cities in Japan and Korea as well as the regional routes originating from Shanghai were launched and were connected with the routes originating from Shanghai to Europe and America and the key domestic routes throughout China.

The construction of the Chengdu hub remained in progress with increased routes and flights.

SERVICE AND PRODUCTS

The Company continues to adhere to the service commitment of providing safe, convenient, comfortable and customised service, to roll out the "Quality Service Year" activities, to implement quality control measures for its quality service commitment and to improve its standard of service.

Under the terms of admission to Star Alliance, the Company upgrades its overall service standard to create a competitive edge for its service and products in order to compete in the global market.

In 2007, the Company completed the renovation work for its "New First and Business Class Cabins". By using its best efforts to develop innovative service and products, in August 2007, the Company launched two new cabins, namely the "Forbidden Pavilion" (new first class) and "Capital Pavilion" (new business class), characterized by rich traditional Chinese heritage. In addition to upgrading the hardware facilities to meet the international advanced standard, passengers are offered several value-added services for free to cater for the needs of high-end passengers. Services available in the Forbidden Pavilion and Capital Pavilion cabins were launched step by step in routes between China and America and routes between China and Europe, and will be extended to more other routes in the future.

Through introducing new aircraft models, optimizing cabin layout and deploying international first class seating arrangement (with entertainment system equipped at seat back), the Company has also improved its service quality in terms of its hardware facilities.

FLEET

During the reporting period, there was a net increase of 13 aircraft (in which 29 aircraft were introduced and 16 aircraft were retired) for both the Company and Air China Cargo. As at 31 December 2007, the Company and Air China Cargo operated a fleet of 220 aircraft in total, with the average age of aircraft reduced to 7.3 years (compared to 7.6 years in 2006). Details of the fleet are set out in the table below:

Business Overview

Type of Aircraft	Owned	Number of Aircraft Finance leased	Number of Aircraft Operating leased	Total
Passenger Aircraft	**98**	**59**	**55**	**212**
Airbus	25	29	6	60
Boeing	73	30	49	152
Freighters	**5**		**3**	**8**
Total	**103**	**59**	**58**	**220**

As at 31 December 2007, the Company had completed its renovation work for both the first and business class cabins for 15 aircraft, including the renovation work for the last 3 A340 aircraft.

The Company entered into a wet lease agreement with Shandong Airlines in December 2007, pursuant to which the Company leased 4 additional B737-800 aircraft.

In July 2007, the Company entered into an aircraft purchase agreement with Airbus S.A.S. in respect of the purchase of 23 A320 aircraft.

As at 31 December 2007, Air Macau operated a fleet of 14 aircraft, including 13 passenger aircraft and one freighter.

OLYMPIC MARKETING

By leveraging on the promotional platform of the Olympic Games, the Company produced and launched to the market the "Air China Products for the Opening/Closing Ceremonies of 2008 Beijing Olympic Games", the "Air China Products for Various Phases of the Beijing Olympic Games" and the "Reception Products". The Company has made impressive achievements in developing promotional products for the Olympic Games and diversified the sales channels and the promotional means of both domestic and overseas sales offices. In 2007, the Company recorded an aggregate sales revenue of RMB360 million in respect of products bearing the Olympic Games logos, involving more than 800 sets of products for the opening and closing ceremonies and 68 sets of products for various phases of the Olympic Games.

E-COMMERCE

In 2007, the e-commerce business also enjoyed a rapid growth. At the same time, the Company speeded up the establishment of its call centers, with six domestic and overseas call centers being established. The Company has setup 13 overseas direct sales websites and established cooperation relationship with various search-engine companies so as to improve our sales services and functions on a continuous basis.

Business Overview

The Company launched electronic passenger ticketing operations at 100 domestic and overseas destinations. Itineraries were also made available to passengers at 50 airports. During the year, 26.11 million electronic passenger tickets were sold, representing an increase of 184% over the same period last year. The Company developed business cooperation in respect of the interline electronic ticketing with 40 domestic and overseas airlines, the number of which were therefore accumulated to 51. Its ranking in the International Air Transport Association (IATA)'s league table of the electronic tickets sales was accordingly jumped to the 30th place. 39 self-service check-in equipment had been installed at 10 domestic airports, which enabled approximately 1.279 million passengers to complete the boarding procedures by using the self-service check-in equipments at the Beijing Capital Airport, representing a 8.1% service rate. The Company also commenced the online check-in service in 10 major domestic cities, including Beijing, Wuhan, Chengdu, Shenzhen and Dalian.

POST BALANCE SHEET EVENTS

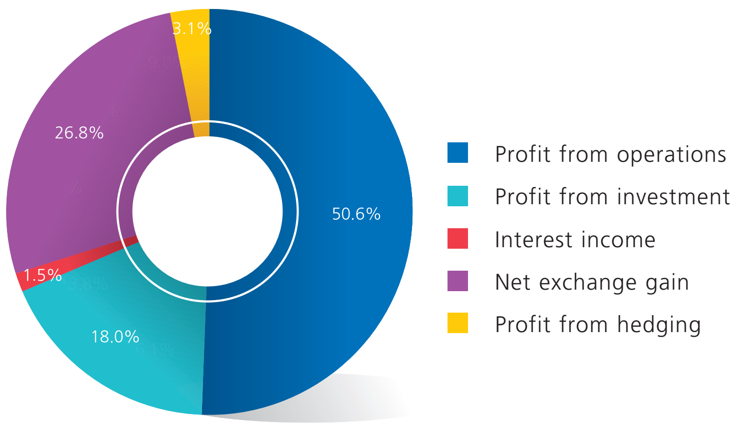
Upon the approval of the 4th meeting of the second board of directors of the Company and the written consent from our controlling shareholders , on 3 January 2008, China National Aviation Company Limited ("CNAC"), a wholly-owned subsidiary of the Company, entered into an agreement with Gold Leaf Enterprises Holdings Ltd. ("Gold Leaf") and CITIC Pacific Limited ("CITIC Pacific") to acquire in cash all the issued shares of Fine Star Enterprises Corp. ("Fine Star") held by Gold Leaf, so as to indirectly acquire 25% equity interest in Air China Cargo held by Fine Star for a consideration of RMB857,003,819.

The following discussion and analysis are based on the Group's consolidated financial statements prepared in accordance with International Financial Reporting Standards ("IFRS"), and are designed to assist the readers in understanding the information provided in this report further so as to fully comprehend the financial performance of the Group as a whole.

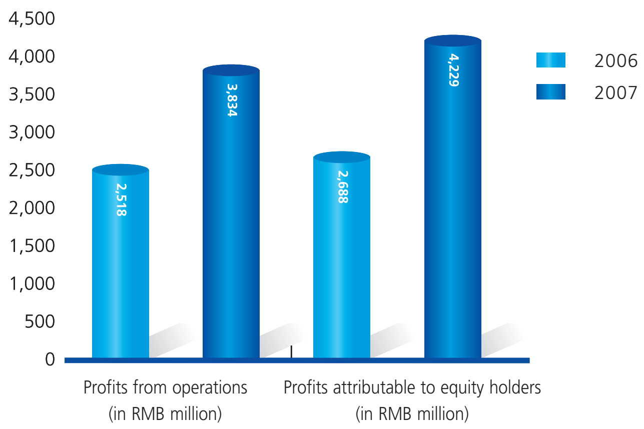
ANALYSIS OF THE PROFITABILITY

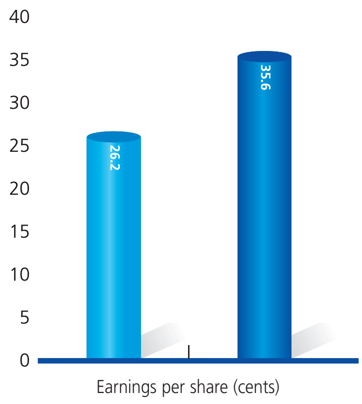
In 2007, the profit before tax realised by the Group was RMB5.606 billion, representing an increase of RMB1.677 billion or 42.68%, in which the Group's profit from operations was RMB3.834 billion, representing an increase of RMB1.316 billion or 52.29% compared with 2006, and the net exchange gains was RMB2.030 billion, representing an increase of RMB1.046 billion or 106.41%, and the share of profits and losses of associates was RMB1.365 billion, representing an increase of RMB847 million or 163.72% as compared with 2006. The profit structure of the Group was further improved.

The pie chart below shows the profit before tax and interest expenses of the Group:



The bar charts below show the change in profit from operations, profit attributable to equity holders of the Company and earnings per share:





TURNOVER

In 2007, the Group's total turnover was RMB51.330 billion, representing a 14.23% growth over 2006.

REVENUE CONTRIBUTION BY GEOGRAPHICAL SEGMENT

	2007		2006		Change
(in RMB'000)	**Amount**	**Percentage**	Amount	Percentage	
Mainland China	**27,702,479**	**53.97%**	23,868,328	53.12%	16.06%
Hong Kong and Macau	**2,848,675**	**5.55%**	2,770,579	6.17%	2.82%
Europe	**7,616,370**	**14.84%**	6,203,536	13.81%	22.77%
North America	**4,678,276**	**9.11%**	3,806,678	8.47%	22.90%
Japan and Korea	**4,475,578**	**8.72%**	4,256,753	9.47%	5.14%
Other Asia Pacific regions	**4,009,163**	**7.81%**	4,030,732	8.97%	(0.54%)
Total	**51,330,541**	**100%**	44,936,606	100%	14.23%

REVENUE CONTRIBUTION BY BUSINESS SEGMENT

	2007		2006		Change
(in RMB'000)	**Amount**	**Percentage**	Amount	Percentage	
Air passenger	**43,632,090**	**85.00%**	37,564,903	83.60%	16.15%
Air cargo	**4,085,456**	**7.96%**	4,041,227	8.99%	1.09%
Engineering services	**487,710**	**0.95%**	481,021	1.07%	1.39%
Airport terminal services	**509,450**	**0.99%**	496,741	1.11%	2.56%
Others	**2,615,835**	**5.10%**	2,352,714	5.24%	11.18%
Total	**51,330,541**	**100%**	44,936,606	100%	14.23%

AIR PASSENGER REVENUE

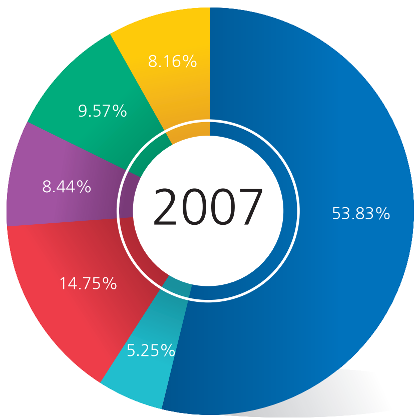
In 2007, the Group's air passenger revenue was RMB43.632 billion, representing an increase of RMB6.067 billion or 16.15% as compared with 2006, which was mainly affected by factors in respect of the increase in traffic capacity, passenger load factor and revenue per seat kilometer as follows:

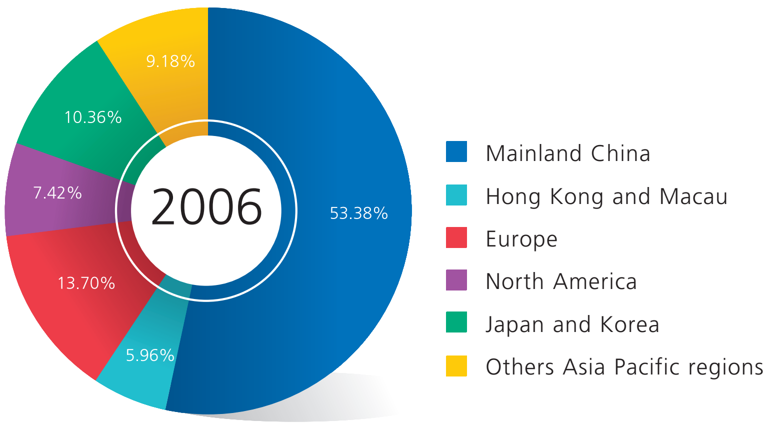
	2007	2006	Change
Available seat kilometres *(million)*	**89,233.74**	83,492.25	6.88%
Passenger load factor *(%)*	**78.47**	75.89	2.59%
Passenger yield per kilometre *(RMB)*	**0.62**	0.59	5.08%

As compared with those factors attributable to the revenue growth in 2006, the increase in traffic capacity, passenger load factor and revenue level contributed to an increase of revenue of RMB2.583 billion, RMB1.368 billion and RMB2.116 billion in 2007 respectively.

AIR PASSENGER REVENUE CONTRIBUTED BY GEOGRAPHICAL SEGMENT

	2007		2006		Change
(in RMB'000)	**Amount**	**Percentage**	Amount	Percentage	
Mainland China	**23,486,436**	**53.83%**	20,051,081	53.38%	17.13%
Hong Kong and Macau	**2,288,552**	**5.25%**	2,239,280	5.96%	2.20%
Europe	**6,437,813**	**14.75%**	5,145,804	13.70%	25.11%
North America	**3,680,386**	**8.44%**	2,785,877	7.42%	32.11%
Japan and Korea	**4,173,935**	**9.57%**	3,890,891	10.36%	7.27%
Other Asia Pacific regions	**3,564,968**	**8.16%**	3,451,970	9.18%	3.27%
Total	**43,632,090**	**100%**	37,564,903	100%	16.15%





SIGNIFICANT REVENUE GROWTH CONTRIBUTED BY EUROPE AND US ROUTES

The Company increased its efforts in developing the air passenger markets in Europe and the US in 2007. By targeting at the right markets and initiating the appropriate marketing strategies together with deploying the proper aircraft models, business from the overall Europe and US regions became profitable during the year. At the same time, there was also an improvement in the operating performance of the large-capacity aircraft serving long-haul routes.

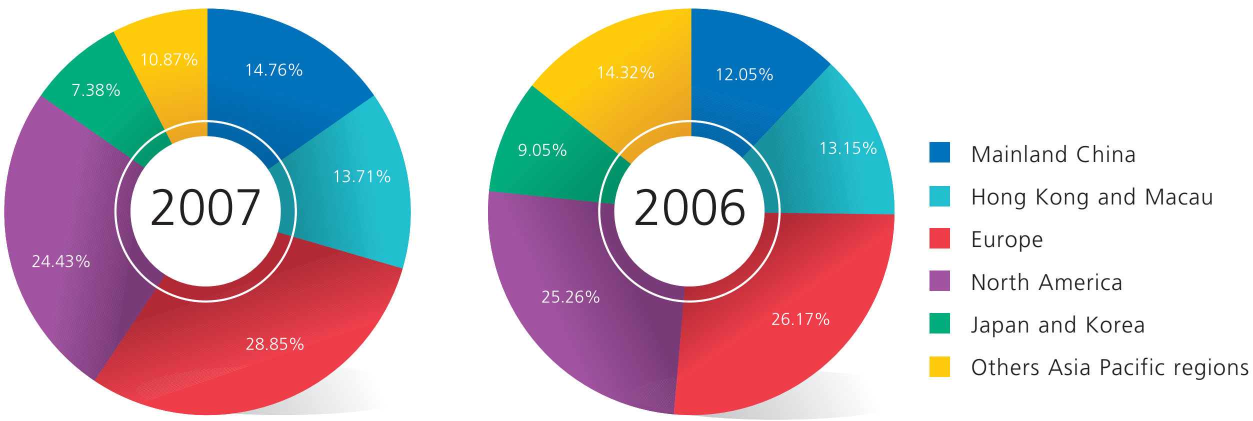
AIR CARGO REVENUE

In 2007, the Group's air cargo and mail revenue was RMB4.085 billion, representing an increase of RMB44 million or 1.09% compared with 2006.

	2007	2006	Change
Available freight tonne kilometres *(million)*	**6,868.1**	6,404.4	7.24%
Load factor *(%)*	**56.43**	54.30	2.13%
Cargo yield per tonne kilometre *(RMB)*	**1.98**	2.16	(8.33%)

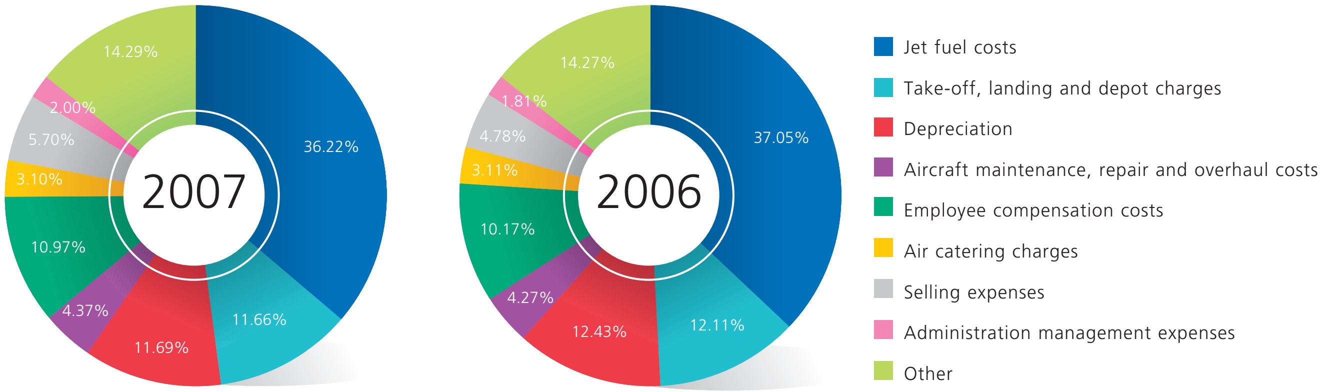
AIR CARGO REVENUE CONTRIBUTED BY GEOGRAPHICAL SEGMENT

	2007		2006		Change
(in RMB'000)	**Amount**	**percentage**	Amount	percentage	
Mainland China	**603,048**	**14.76%**	486,771	12.05%	23.89%
Hong Kong and Macau	**560,123**	**13.71%**	531,299	13.15%	5.43%
Europe	**1,178,557**	**28.85%**	1,057,732	26.17%	11.42%
North America	**997,890**	**24.43%**	1,020,801	25.26%	(2.24%)
Japan and Korea	**301,643**	**7.38%**	365,862	9.05%	(17.55%)
Other Asia Pacific regions	**444,195**	**10.87%**	578,762	14.32%	(23.25%)
Total	**4,085,456**	**100%**	4,041,227	100%	1.09%



OPERATING EXPENSES

In 2007, the Group recorded aggregate operating expenses of RMB47.496 billion, representing an increase of 11.97% compared with RMB42.419 billion in 2006. The elements comprising the operating expenses as well as the ratio and change of each of those elements are set out below:



- Jet fuel costs increased by 9.45% to RMB17.201 billion in 2007 from RMB15.716 billion in 2006 and accounted for 36.22% of operating expenses compared with 37.05% in 2006. Factors affecting the jet fuel costs include the jet fuel price and the consumption level of jet fuel, and in which the rise in jet fuel price and increase in the consumption of jet fuel caused an increase in operating cost of RMB0.383 billion and RMB1.102 billion respectively.

- Take-off, landing and depot charges increased by 7.82% to RMB5.538 billion in 2007 from RMB5.136 billion in 2006, primarily due to the increase in the number of flights operated. The percentage of the take-off, landing and depot charges to the operating expenses decreased from 12.11% to 11.66%.

- Due to the business needs during the year, there was an increase in the number of aircraft ranging from the self-owned aircraft to those under finance leases and operating leases, which resulted in an increase in the aircraft maintenance, repair and overhaul costs accordingly.

- Employee compensation costs increased due to the increase in the number of flight hours, number of employees and employees' basic income.

- The increase in the air catering charges was primarily due to an increase in the number of passengers carried.

- The increase in the sale commission and the royalty from the sales of the relevant IT systems was brought by the increase in business revenue. The marketing expenses increased to RMB2.709 billion in 2007 from RMB2.027 billion in 2006, representing an increase of 33.65%, and their percentage to the profit from operations was up from 4.78% to 5.70%.

- General and administrative expenses increased primarily due to business growth and more frequently incurred donation expenses for Olympic Games in 2007.

- Other operating expenses mainly include the aircraft and engines operating lease expenses, civil aviation infrastructure construction fund and the daily expenses arising from core air traffic business not included in the aforesaid items. The growth of business inevitably drove such expenses upwards.

PROFIT CONTRIBUTION BY BUSINESS SEGMENT

(RMB'000)	2007	2006	Change
Air businesses	**3,695,437**	2,281,754	61.96%
Engineering services	**12,478**	34,835	(64.18%)
Airport terminal services	**111,793**	175,445	(36.28%)
Others	**14,419**	25,670	(43.83%)
Total	**3,834,127**	2,517,704	52.29%

ANALYSIS OF ASSETS STRUCTURE

As at 31 December 2007, the total assets of the Group amounted to RMB91.056 billion, representing an increase of 7.79% from 31 December 2006, of which the current assets accounted for RMB9.830 billion, representing 10.80% of the total assets, while non-current assets accounted for RMB81.226 billion, representing 89.20% of the total assets.

Among the current assets, cash and cash equivalents were RMB3.907 billion, decreased by 24.28% compared with those recorded as at 31 December 2006, while accounts receivable decreased by 1.44% to RMB2.794 billion compared with those recorded as at 31 December 2006. Among the non-current assets, the net book value of property, plant and equipment as at 31 December 2007 was RMB61.692 billion, representing an increase of 12.64% compared with those recorded as at 31 December 2006.

DEBT STRUCTURE ANALYSIS

	Bank loans, other loans and corporate bonds		Obligations under finance leases	
(RMB'000)	31 December 2007	31 December 2006	31 December 2007	31 December 2006
Within one year	**10,978,835**	11,139,021	**2,216,680**	2,354,905
In the second year	**4,039,529**	2,649,697	**2,821,518**	1,996,954
In the third to fifth years (inclusive)	**8,181,988**	5,581,186	**5,484,352**	6,061,709
After five years	**4,393,774**	4,471,094	**5,022,323**	3,189,192
Total	**27,594,126**	23,840,998	**15,544,873**	13,602,760

ASSETS MORTGAGE

As at 31 December 2007, the Group mortgaged certain aircraft and premises with an aggregate net book value of approximately RMB34.240 billion (compared with RMB34.251 billion as at 31 December 2006) pursuant to certain bank loans and finance lease agreements. In addition, certain bank deposits of the Group in the sum of approximately RMB119 million (compared with approximately RMB212 million as at 31 December 2006) were pledged against the obligations in respect of certain bank loans, operating leases and financial derivatives of the Group. The Group also pledged certain number of shares in an associated company with an aggregate market value of approximately RMB7.609 billion as at 31 December 2007 (compared with approximately RMB7.695 billion as at 31 December 2006).

COMMITMENTS AND CONTINGENT LIABILITIES

As at 31 December 2007, capital commitments of the Group increased substantially from RMB42.944 billion in 2006 to approximately RMB58.878 billion, primarily used for the purchase of certain aircraft and relevant flight equipment to be delivered in the coming years and the construction of certain properties.

As at 31 December 2007, the Group had contingent liabilities in respect of bank loans and other guarantees and other matters arising in the ordinary course of business. Details of contingent liabilities of the Group are set out in note 46 to the Group's 2007 annual consolidated financial statements.

CAPITAL EXPENDITURE

In 2007, the capital expenditure of the Company amounted to RMB15.293 billion in total. Among the capital expenditure of the Company, the total investment in aircraft and engines was RMB10.026 billion, including prepayments of RMB3.824 billion for the purchases of aircraft for 2007 and onwards.

Other capital expenditure amounted to RMB5.267 billion, which mainly involved the improvement of first class and business class cabins of certain aircraft, investment in the ancillary project in Terminal 3 of the Beijing Capital International Airport, preparation for the 11th Five Years Plan as well as investment in certain long-term external investment projects.

CASH FLOW ANALYSIS

In 2007, the Group's net cash inflow from operating activities increased by 17.55% to RMB7.302 billion from RMB6.212 billion in 2006, primarily due to the increase in business revenue. Net cash outflow from investment activities during the year decreased by 15.94% to RMB10.212 billion from RMB12.148 billion in 2006, primarily due to the relatively substantial cash outflow arising out of the acquisition of the Cathay Pacific's equity interests in 2006. The Group recorded a net cash inflow from financing activities of RMB1.839 billion, representing a decrease of RMB5.470 billion from RMB7.309 billion in 2006, primarily due to the proceeds of approximately RMB8.570 billion raised by way of the A shares initial public offering and the additional issue of H shares in 2006.

The Group experienced a higher increase in the net operating cash flow of the Group for the current period, which secured the Group to enhance its cash structure.

RISKS ANALYSIS

- Analysis of the long-term solvency

  As at 31 December 2007, the Group's gearing ratio, which represents total liabilities divided by total assets, was 65.40%, representing an increase of 2.97 percentage points from 62.43% as at 31 December 2006, primarily due to the introduction of additional aircraft and the increase of debt financing activities. Although the gearing ratio of the Group for the current period slightly moved upwards, its solvency position in the long term was relatively strong insofar as it continued to dominate a leading position in the industry while the prevailing gearing ratios of other air carriers stood at a relatively high level.

- Analysis of the short-term solvency and the long- and short-term debt structure

  As at 31 December 2007, the Group's current ratio, which represents current assets divided by current liabilities, was 0.36, representing a decrease of 0.05 percentage point from 0.41 as at 31 December 2006, while its EBITDA interest cover was 4.78 times, representing an increase of 18.12% from 4.16 times as at 31 December 2006, resulting that the Group maintained a relatively sufficient operating cash flow position. The Company is in the process of optimizing both its long-term and short-term debt structures step by step to align with the changes in the financial market. The Group had already obtained bank facilities with an aggregate amount of up to RMB80.172 billion from a number of banks in the PRC and was therefore in a position to fully meet its own demand on current capital.

- Foreign exchange and interest rate exposure

  As at 31 December 2007, foreign currency denominated loans, mainly those denominated in US dollars, Hong Kong dollars and Japanese Yen, constitute a large proportion of the Group's loans. The Group basically maintained a balance of its foreign currency denominated incomes and expenditures. The Group will continue to effectively eliminate any foreign exchange risk by means of financial derivative products based on the major trend of foreign exchange and in accordance with its forecast on its overall incomes and expenditures.

  For managing risks associated with interest rates, the Company will attempt to make use of the swap transactions and other derivative products and to rationalize the ratios between the fixed and floating interest rates relating to the interest-bearing debts so as to eliminate any risks arising from interest rate.

- Investment risk

  As at 31 December 2007, regarding the air carriers that the Group had invested in, except for Shandong Airlines and Shenzhen Airlines, neither Air Macau nor Air China Cargo generated any profit from operations. Further efforts are needed to promote the consolidation and optimization of the businesses of the companies that the Group had made its investment in. There is also room for a substantial improvement in their financial position and operating results.

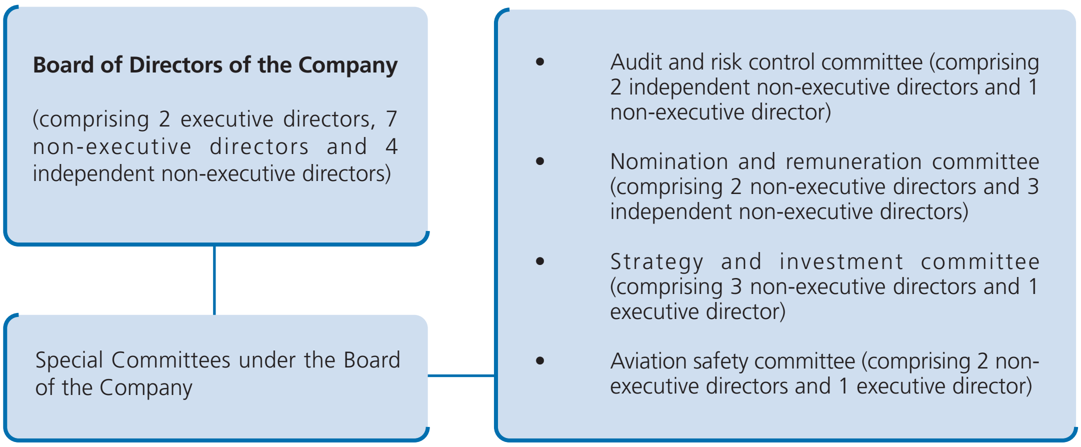
- Risk associated with the fluctuation in the jet fuel price

  The Group is exposed to the fluctuations in jet fuel price in its daily operation. International jet fuel prices have been historically, and will in the future continue to be, subject to price volatility and fluctuation in supply and demand. The Group's strategy for managing its jet fuel price risk aims to protect itself against sudden and significant price increases. To the extent as permitted by the relevant laws in the PRC, the Group has been engaging in fuel hedging transactions since March 2001. The hedging instruments used were mainly derivatives of Singapore Kerosene together with Brent crude oil and New York crude oil, which are closely linked to the price of jet fuel. In 2007, the net gain on fuel derivatives achieved by the Group was RMB236 million, representing an increase of 108.85% compared with RMB113 million in 2006.

Information on financial risk management objectives and polices in other aspects of the Group's operations are set out in note 49 to the Group's 2007 annual consolidated financial statements.

The Company has been maintaining and enhancing the level of its corporate governance so as to ensure greater accountability and transparency and bring long-term return to its shareholders. The Company has complied with the principles and code provisions of the Code on Corporate Governance Practices (the "Code") under Appendix 14 of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the "Listing Rules") in 2007. The Company's corporate governance practices in 2007 are summarised and discussed below.

GOVERNANCE STRUCTURE



MAJOR CORPORATE GOVERNANCE PRINCIPLES AND PRACTICES OF THE COMPANY

A. Board of Directors (the "Board")

The Board must include at least three independent non-executive directors

- As at 31 December 2007, the Board of the Company comprises thirteen directors, out of which four are independent non-executive directors. The directors of the Company are elected at the shareholders' general meeting for a three-year term of office, and are eligible for re-election upon expiry of the term.

- Pursuant to the Listing Rules, each of the independent non-executive directors has confirmed his independence with the Stock Exchange. Each of the independent non-executive directors re-confirmed his independence on 31 December 2007. The Company considered that they were independent.

Deviation: Nil

The Board should have a balance of skills and experience appropriate for the requirements of the business of the Company

- With reference to the nature of the objectives of the Company's specialised operations, the non-executive directors' extensive expertise and experience in the fields of aviation, finance and financial management provide substantial support for the effective performance of the Board.

- The list of the directors and their biographical details and their respective roles in the Board and Board committees are set out in this annual report and published on the Company's website.

Deviation: Nil

Distinguished roles of the Chairman and President

- The Chairman, concurrently a non-executive director, is responsible for leading the Board and ensuring the Board's efficient operation and that all major and relevant issues are discussed by the Board in a prompt and constructive manner.

- The Chairman shall be elected and dismissed by a majority of all directors. The term of office of the Chairman shall be three years, and the Chairman is eligible for re-election upon expiry of the term.

- The Company has a President who shall be nominated, appointed or dismissed by the Board.

- The President is authorised to oversee the Group's business operations and implement its strategies to attain overall commercial goals.

Deviation: Nil

Non-executive directors should be appointed for a specific term, and all directors appointed to fill a casual vacancy should be subject to election by shareholders at the first general meeting after their appointment

- The term of office of the existing non-executive directors is three years.

Deviation: Nil

The Board should assume responsibility for the leadership and control of the Company and be collectively responsible for promoting the success of the Company

- The Board is accountable to the shareholders' general meeting and determines the investment proposals of the Company and delimits the approval authority regarding disposal of the Company's fixed assets according to the authorisation of the shareholders' general meeting. The Company formulates the Rules and Procedures for Shareholders' General Meetings, Rules and Procedures for Board Meetings and Rules and Procedures for Senior Management Meetings.

- The President shall be authorised by the Board to implement various strategies and oversee the day-to-day operations of the Company.

- The Board shall have independent access to the senior management personnel for enquiries in relation to the Company's management.

- The Board shall have specialised committees, the chairmen of which shall report to the Board on a regular basis.

Deviation: Nil

The Board should meet regularly to carry out its duties. The Board and its committees shall be provided with adequate information in a timely manner

- Board meetings are held regularly throughout the year and will generally include annual meetings, interim meetings and meetings for the first and third quarters. Board meetings will be convened by the Chairman and a 10-day notice will be served to all directors before each meeting. The meetings may be attended through personal participation or other electronic means of communication.

- The Secretary to the Board shall be responsible for the communications and liaison with all directors from the time the notice is served to the commencement of the meeting, and will provide the necessary information to the directors for facilitating their decision-making on matters set out in the agenda.

- For the purpose of considering resolutions or matters during Board meetings, the directors may require presence of the persons in charge of the relevant departments to answer queries, so that the directors can have a thorough understanding of the key issues and the general situation.

- All directors shall have access to the Board Secretary. Under the leadership of the Board and the Chairman, the Board Secretary shall take the initiative to acquaint himself with the implementation progress of the Board resolutions, and report to and advise the Board and the Chairman in a timely manner on major issues arising in the course of implementation.

- Minutes of Board meetings shall be kept by the Board Secretary and made available for inspection by any director at anytime.

- All directors have actively participated in the business operations of the Company. Attendance of all directors at the Board meetings in 2007 is as follows:

Attendance of Directors at the Board meetings in 2007		
No. of meetings	**13**	
Non-Executive Directors		
Li Jiaxiang *(Chairman)*	13/13	100%
Kong Dong	13/13	100%
Wang Shixiang	13/13	100%
Yao Weiting	13/13	100%
Ma Xulun	12/13	92.3%
Christopher Dale Pratt	11/13	84.6%
Chen Nan Lok Philip	12/13	92.3%
Executive Directors		
Cai Jianjiang *(President)*	13/13	100%
Fan Cheng	13/13	100%
Independent Non-Executive Directors		
Hu Hung Lick, Henry	13/13	100%
Wu Zhipan	13/13	100%
Zhang Ke	13/13	100%
Jia Kang	13/13	100%
Average attendance rate:		**97.6%**

Each director is required to keep abreast of his responsibilities as a director of the Company and of the operating manner, business activities and developments of the Company

- The management shall provide members of the Board and Board committees with proper and sufficient information in a timely manner so as to update them with the latest developments of the Company and facilitate their discharge of duties.

- Newly appointed directors shall be given introduction in relation to the Company to ensure that they have a proper understanding of the management, business and governance practices of the Company.

- The Company also encourages its directors to participate in seminars and courses conducted by eligible institutions so as to enable them to boost necessary skills and update them with the latest changes or developments in laws, the Listing Rules and the Code with which they are required to comply in discharging their duties.

Deviation: Nil

The Company should arrange appropriate insurance in respect of potential legal actions against its directors

- The Company has purchased liability insurance for its directors and senior management.

Deviation: Nil

Compliance with the Model Code for Securities Transactions by Directors of Listed Companies ("Model Code")

- After making specific enquiries, the Company confirmed that each director and each supervisor have complied with the required standards of the Model Code as set out in Appendix 10 of the Listing Rules throughout 2007.

- The Model Code contained in Appendix 10 of the Listing Rules requires the Board to adopt written guidelines regarding transactions of securities of the issuer by its employees on terms no less exacting than the required standard of the Model Code. On 5 September 2005, the Company adopted a code of conduct regarding securities transactions by directors on terms no less exacting than the required standards of the Model Code. The code of conduct of the Company also applies to supervisors and the relevant employees.

Deviation: Nil

B. Remuneration of Directors and Senior Management

Issuers should establish a remuneration committee with certain authorities and obligations under specific written terms. A majority of the members of the remuneration committee should be independent non-executive directors

- The Company has established a nomination and remuneration committee to recommend to our Board regarding the compensation of other executive directors as well as candidates to fill vacancies on our Board. In addition, the nomination and remuneration committee reviews the performance and determines the compensation structure of the senior management.

- Most of the members of the nomination and remuneration committee are independent non-executive directors. As at 31 December 2007, the members of the nomination and remuneration committee were Mr. Li Jiaxiang, Mr. Kong Dong, Dr. Hu Hung Lick, Henry, Mr. Zhang Ke and Mr. Wu Zhipan, with Mr. Wu Zhipan acting as the chairman of such committee.

- Attendance at the meetings of the nomination and remuneration committee in 2007 is as follows:

Attendance at the meetings of the nomination and remuneration committee in 2007		
No. of meetings	**4**	
Wu Zhipan	4/4	100%
Li Jiaxiang	3/4	75%
Kong Dong	4/4	100%
Hu Hung Lick, Henry	1/2	50%
Zhang Ke	4/4	100%
Average attendance rate:		**85%**

- The articles of association of the Company provides that a shareholder holding 5% or more of the total shares of the Company is entitled to nominate a director through the nomination and remuneration committee, which will scrutinize the candidates for directorship and senior management according to the standards set out in the articles of association of the Company and report to the Board.

- At the first meeting of the nomination and remuneration committee of 2007 held on 31 January 2007, it was considered and approved that Mr. Ma Xulun no longer served as President of the Company and would be otherwise appointed, Mr. Cai Jianjiang would be the candidate for president and no longer served as a vice president, and that Mr. Tan Zhihong would be the candidate for vice president.

- At the second meeting of the nomination and remuneration committee of 2007 held on 14 June 2007, it was proposed that, as Mr. Zheng Baoan had resigned from the posts of Secretary of the Board and Joint Company Secretary due to changes in positions, Mr. Huang Bin to be appointed by the Board as Secretary of the Board and Joint Company Secretary of Air China. It was approved that the first batch of Share Appreciation Rights (SAR) would be granted, and the grantees of SAR should enter into a performance evaluation contract with the Company, under which the Company was entitled to revoke part or all of the SAR granted to those who failed to pass the evaluation.

- At the third meeting of the nomination and remuneration committee of 2007 held on 6 July 2007, it was proposed that Mr. Li Huxiao to be appointed as a vice president of the Company.

- At the fourth meeting of the nomination and remuneration committee of 2007 held on 28 August 2007, it was proposed that Mr. Li Jiaxiang, Mr. Kong Dong, Mr. Wang Shixiang, Mr. Yao Weiting, Mr. Ma Xulun, Mr. Christopher Dale Pratt, Mr. Chen Nan Lok Philip, Mr. Cai Jianjiang and Mr. Fan Cheng would be nominated as the candidates for the non-independent directors of the second Board of the Company. Mr. Hu Hung Lick, Henry, Mr. Zhang Ke, Mr. Wu Zhipan and Mr. Jia Kang would be nominated as the candidates for the independent directors of the second Board of the Company. Mr. Sun Yude, Mr. Liao Wei and Mr. Zhou Guoyou would be nominated as the candidates for the shareholder representative supervisors of the second Supervisory Committee.

- Remuneration payable to directors shall be determined according to the terms of their respective employment contract, if any, and the recommendation of the nomination and remuneration committee. Details of the remuneration of the directors are set out in the financial statements.

Deviation: Nil

C. Accountability and Audit

The Board should present a balanced, clear and comprehensible assessment of the company's performance, position and prospects

- The Company has established an audit and risk control committee to review the financial information of the Company and the relevant disclosure, and review the internal control systems of the Company.

- The Company has published its annual and interim results, in accordance with the requirements of the Listing Rules and other relevant laws and regulations, in a timely manner within four months and three months respectively after the end of the relevant periods.

- The Company has set up an investor relation webpage, on which figures of operating results are published monthly in order to improve the transparency of the Company's performance and to provide the latest developments of the Company in a timely manner.

- The Company has good environment for the implementation of internal controls. The Company has set up an effective electronic information system to support business development. The electronic information system comprises various operation systems, settlement system and a core accounting and audit platform, i.e. the Oracle financial information system. For treasury management, the Company implemented a global online banking management system. An effective accounting information system was also established.

Deviation: Nil

The Board should ensure that the Company maintains a sound and effective internal control system to safeguard the shareholders' investments and the Company's assets

- The Board takes ultimate responsibility for the internal controls of the Company, and will review the effectiveness of the system through the audit and risk control committee. The audit and risk control committee has conducted a review of the effectiveness of the internal control system of the Company.

Deviation: Nil

The Board should establish formal and transparent arrangements for how to apply the financial reporting and internal control principles and for how to maintain an appropriate relationship with the Company's auditors

- The audit and risk control committee comprises one non-executive director and two independent non-executive directors, who are proficient in financial matters. The audit and risk control committee is primarily responsible for:

    1. making recommendations to the Board on the appointment and replacement of the external auditors;

    2. reviewing and monitoring the internal audit system of the Company and its implementation;

    3. liaison between the internal auditors and external auditors;

    4. reviewing the financial information of the Company and the relevant disclosure;

    5. reviewing the internal control system of the Company;

    6. other matters authorised by the Board of the Company.

- The primary duties of the audit and risk control committee are to review and supervise our financial reporting process. The audit and risk control committee currently comprises two independent non-executive directors, Mr. Wu Zhipan and Mr. Zhang Ke, and one non-executive director, Mr. Yao Weiting, with Mr. Zhang Ke acting as chairman of the committee.

- Attendance at the meetings of the audit and risk control committee in 2007 is set out as follows:

Attendance at meetings of the audit and risk control committee in 2007		
No. of meetings	**4**	
Zhang Ke	4/4	100%
Yao Weiting	1/4	25%
Wu Zhipan	4/4	100%
Average attendance rate:		**75%**

- The audit and risk control committee passed the following resolutions at its sixth meeting held on 16 March 2007: considering and approving the audited financial statements of the Company for the year 2006 prepared under Accounting Standards for Business Enterprises and Accounting Regulations for Business Enterprises and IFRS respectively; considering the profit appropriation proposal of the Company for the year 2006; and approving the reappointment of Ernst & Young as the Company's international auditors and Ernst & Young Hua Ming as domestic auditors for the year ended 31 December 2007.

- At the seventh meeting of the audit and risk control committee held on 27 April 2007, the 2007 First Quarterly Report of the Company was considered and approved.

- At the eighth meeting of the audit and risk control committee held on 18 October 2007, the 2007 Third Quarterly Report of the Company was considered and approved.

- At the ninth meeting of the audit and risk control committee held on 28 December 2007, the 2008 financial plan, the 2008 capital expenditure plan, and the 2008 cash flow and financing plans of the Company were considered and approved.

Deviation: Nil

The responsibility of the directors in relation to the financial statements

The Company prepares and publishes annual reports, interim reports and quarterly reports each year. The responsibilities of the directors in relation to the financial statements are set out below and shall be read together with the Report of the Independent Auditors set out on page 50 to page 51.

- *Annual reports and accounts*

  The directors acknowledged that they are responsible for preparing the financial statements for each financial year so as to present a true and fair view of the financial position of the Company and the Group, and of the financial performance and cash flows of the Group.

- *Accounting policy*

  When preparing the financial statements of the Company and the Group, the directors have consistently applied appropriate accounting policies under the relevant accounting standards.

- *Accounting records*

  The directors are responsible for keeping accounting records of the Company, which will reflect the financial position of the Company with reasonable accuracy, enabling the Group to prepare the financial statements in accordance with the requirements of the Listing Rules, Hong Kong Companies Ordinance and the relevant accounting standards.

- *Ongoing operation*

  After making appropriate enquiries, the directors believe that the Group has sufficient resources for operation in the foreseeable future. Accordingly, the Group's financial statements should be prepared on a going concern basis.

The statement of reporting responsibility of the auditors is set out in the Report of the Independent Auditors on page 50 to page 51.

Auditors' Remuneration

The international and domestic auditors of the Company are Ernst & Young and Ernst & Young Hua Ming respectively. Breakdown of the remuneration to the Company's external auditors for audit service provided and other non-audit service assignments for the year ended 31 December 2007 are as follows:

- *Audit Services*

  An aggregate amount of approximately RMB14,261,000 was charged for the review of the Group's financial statements for the three months ended 31 March 2007 and the six months ended 30 June 2007, and the audit of the Group's financial statements for the year ended 31 December 2007.

- *Non-Audit Service Assignments*

  An aggregate amount of approximately RMB1,890,000 was charged for agreed-upon procedures performed on the Group's internal control.

D. Delegation by the Board

The Company should formalise the functions reserved to the Board and those delegated to management. There shall be division of responsibility between the Board committees, and each committee should be formed with certain authorities under specific terms.

- To regulate the operations of the Board of the Company, the Company has formulated and revised the Rules and Procedures for Board Meetings (the "Meeting Rules"), setting out the authorities and authorisations of the Board. The terms of reference of the President, who shall be accountable to the Board, are set out in the articles of association of the Company. The revised Meeting Rules stipulate the limits on the Board's power to approve an investment, which have come into effect upon the approval to the amendment of the articles of association by the relevant state authorities.

- The Company has established an audit and risk control committee in compliance with the Code. The primary duties of the audit and risk control committee are to review and supervise our financial reporting process. The audit and risk control committee currently comprises two independent non-executive directors, Mr. Wu Zhipan and Mr. Zhang Ke, and one non-executive director, Mr. Yao Weiting, with Mr. Zhang Ke acting as chairman of the committee.

- The Company has established a nomination and remuneration committee to recommend to our Board regarding the compensation of other executive directors as well as candidates to fill vacancies on our Board. In addition, the nomination and remuneration committee reviews the performance and determines the compensation structure of the senior management. The current members of the nomination and remuneration committee as at 31 December 2007 were Mr. Li Jiaxiang, Mr. Kong Dong, Dr. Hu Hung Lick, Henry, Mr. Zhang Ke and Mr. Wu Zhipan, with Mr. Wu Zhipan acting as the chairman of such committee.

- The Company has established a strategy and investment committee to analyse and identify our development strategy and to decide on matters related to our investment as authorised by the Board. The current members of the strategy and investment committee are Mr. Kong Dong, Mr. Wang Shixiang, Mr. Ma Xulun and Mr. Cai Jianjiang, with Mr. Cai Jianjiang as the chairman of such committee.

- The Company has established an aviation safety committee with Mr. Wang Shixiang, Mr. Ma Xulun and Mr. Cai Jianjiang as its current members and Mr. Wang Shixiang as the chairman of such committee.

The supervisory committee is responsible for monitoring our financial matters and supervising the conduct of our Board and the management. The functions and authority of the supervisory committee include: reviewing the financial reports and other financial information prepared by the Board and proposed to be tabled before the shareholders' general meeting, as well as supervising the work of the directors, President, Vice President and other senior personnel so as to prevent the abuse of power or actions detrimental to the Company's interests. The current members of the supervisory committee are Mr. Sun Yude, Mr. Liao Wei, Mr. Zhou Guoyou, Mr. Liu Feng and Mr. Liu Guoqing, with Mr. Sun Yude acting as the chairman. In the event that any director has conflict of interests with the Company, a supervisor may negotiate with the director concerned or bring the case to court on behalf of the Company. Resolution of meetings of the supervisory committee will be passed by at least two-thirds of all supervisors.

Deviation: Nil

E. Communications of the Company

The Board should endeavour to maintain an on-going dialogue with shareholders and in particular, use general meetings to communicate with shareholders.

- The Company has established and maintains various communication channels with the shareholders such as the publication of annual reports, interim reports and quarterly reports, press releases and announcements on the Company's website. The Company has also implemented the Investors Relation Management System.

- The annual general meetings represent an effective means for the shareholders to exchange views with the Board. The Chairman of the Board, as well as the respective chairman of the audit and risk control committee, nomination and remuneration committee, strategy and investment committee and aviation safety committee will attend the general meetings to answer queries raised by shareholders.

- At the annual general meetings, the Board will report to the shareholders and make announcements in respect of the implementation of resolutions which have been passed on the previous annual general meetings and shall be carried out by the Board.

- Resolutions in respect of independent matters, including the election and replacement of the directors of the Company, shall be separately tabled before the annual general meeting.

Deviation: Nil

The Board of the Company hereby presents this report and the audited consolidated financial statements of the Group for the year ended 31 December 2007 to all the shareholders.

GROUP ACTIVITIES AND RESULTS

The Group is a provider of air passenger, air cargo and airline-related services. The results of the Group for the year ended 31 December 2007 and the financial positions of the Company and the Group as at the same date are set out in the audited financial statements on pages 52 to 138 of this annual report.

FIVE-YEAR FINANCIAL HIGHLIGHTS

The summary of the Group's results, assets, liabilities and minority interest under IFRS for the five years ended 31 December 2007 are set out under the section headed "Summary of Financial Information" on page 3 of this annual report.

SHARE CAPITAL

As at 31 December 2007, the total share capital of the Company was RMB12,251,362,273, divided into 12,251,362,273 shares with a par value of RMB1.00 each. The following table sets out the share capital structure of the Company as at 31 December 2007:

Category of Shares	Number of shares	Percentage of the total issued share capital
A shares	7,845,678,909	64.04%
H shares	4,405,683,364	35.96%
Total	12,251,362,273	100%

SIGNIFICANT INTERESTS AND SHORT POSITIONS IN SHARES AND UNDERLYING SHARES OF THE COMPANY

As at 31 December 2007, to the knowledge of the directors, supervisors and chief executives of the Company, the interests and short positions of the following persons (other than a director, supervisor or chief executive of the Company) who have an interest or short position in the shares, underlying shares and debentures of the Company which would fall to be disclosed to the Company pursuant to the Securities and Futures Ordinance (the "SFO"), or who are, directly or indirectly, interested in 10% or more of the nominal value of any class of share capital carrying rights to vote in all circumstances at general meetings of the Company are as follows:

Name of shareholder	Type of interests	Type and number of shares of the Company	Percentage of the total issued share capital of the Company	Percentage of the total issued domestic shares of the Company	Percentage of the total issued H shares of the Company	Short position
China National Aviation Holding Company ("CNAHC")	Beneficial owner	4,949,066,567 A shares	40.40%	63.08%	–	–
CNAHC[1]	Attributable interests	1,380,482,920 A shares	11.26%	17.60%	–	–
China National Aviation Corporation (Group) Limited ("CNACG")	Beneficial owner	1,380,482,920 A shares	11.26%	17.60%	–	–
Cathay Pacific	Beneficial owner	2,161,052,455 H Shares	17.64%	–	49.05%	–
Swire Pacific Limited[2]	Attributable interests	2,161,052,455 H Shares	17.64%		49.05%	–
John Swire & Sons Limited[2]	Attributable interests	2,161,052,455 H Shares	17.64%	–	49.05%	–
John Swire & Sons (H.K.) Limited[2]	Attributable interests	2,161,052,455 H Shares	17.64%	–	49.05%	–
Mirae Asset Global Investments (Hong Kong) Limited	Investment manager	221,958,000 H Shares	1.81%	–	5.04%	–
Morgan Stanley[3]	Investment manager	218,213,614 H Shares	1.78%	–	4.95%	–
		61,300,215 H Shares (Short position)	0.50%	–	1.39%	61,300,215 H Shares

Name of shareholder	Type of interests	Type and number of shares of the Company	Percentage of the total issued share capital of the Company	Percentage of the total issued domestic shares of the Company	Percentage of the total issued H shares of the Company	Short position
JPMorgan Chase & Co.	Investment manager	204,635,760 H Shares	1.67%	–	4.64%	–
		69,125,475 H Shares (Short position)	0.56%	–	1.57%	69,125,475 H Shares
		53,174,760 H Shares (Lending pool)	0.43%		1.21%	–
Citigroup Inc.	Investment manager	109,781,800	0.90%	–	2.49%	–
		H Shares	0.21%		0.59%	26,129,800
		26,129,800	0.23%		0.63%	H Shares
		H Shares (Short position)				
		27,904,000 H Shares (Lending pool)				

Notes:

Based on the information available to the directors, supervisors and chief executives of the Company (including such information available on the website of the Hong Kong Stock Exchange) and so far as the directors, supervisors and chief executives are aware, as at 31 December 2007:

1. By virtue of CNAHC's 100% interest in CNACG, CNAHC is deemed to be interested in the 1,380,482,920 A shares of the Company directly held by CNACG.

2. By virtue of John Swire & Sons Limited's 100% interest in John Swire & Sons (H.K.) Limited as at 31 December 2007 and their approximately 35.74% equity interest and 55.43% voting rights in Swire Pacific Limited, and Swire Pacific Limited's approximately 39.91% interest in Cathay Pacific, John Swire & Sons Limited, John Swire & Sons (H.K.) Limited and Swire Pacific Limited are deemed to be interested in the 2,161,052,455 H shares of the Company directly held by Cathay Pacific.

3. Morgan Stanley, through its controlled entities, had an attributable interest in 218,213,614 H shares of the Company and maintained a short position of 61,300,215 H shares of the Company, out of which Morgan Stanley Investment Management Company directly held 140,818,000 H shares, Morgan Stanley & Co International Limited directly held 32,509,159 H shares and maintained a short position of 27,094,277 H shares, Morgan Stanley Hong Kong Securities Limited directly held 71,327 H shares and maintained a short position of 134,000 H shares, MorganStanley Asset & Investment Trust Management Co., Limited directly held 8,642,000 H shares, MSDW Equity Finance Services I (Cayman) Limited directly held 10,609,916 H shares and maintained a short position of 10,609,916 H shares, Morgan Stanley Swiss Holdings GmbH directly held 45 H shares, Morgan Stanley Capital (Cayman Islands) Limited maintained a short position of 882,000 H shares, Morgan Stanley Capital Services Inc. directly held 1,683,720 H shares, Morgan Stanley Capital (Luxembourg) S.A. directly held 947,940 H shares, Morgan Stanley & Co. Inc. directly held 22,931,507 H shares and maintained a short position of 22,568,822 H shares and Morgan Stanley Uruguay Ltda directly maintained a short position of 11,200 H shares.

Save as disclosed above, as at 31 December 2007, to the knowledge of the directors, supervisors and chief executive of the Company, no other person (other than a director, supervisor or chief executive of the Company) had an interest or short position in the shares, underlying shares and debentures of the Company which would fall to be disclosed to the Company pursuant to the SFO, or otherwise was, directly or indirectly, interested in 10% or more of the nominal value of any class of share capital carrying rights to vote in all circumstances at general meetings of the Company.

PUBLIC FLOAT

Pursuant to public information available to the Company and to the best knowledge of the directors of the Company, the Company has maintained a public float as required by the Listing Rules and agreed by the Stock Exchange throughout the current reporting period.

DIVIDENDS

The Board recommends to distribute 25% out of the profit after tax of RMB3.352 billion (after provision for provident fund) as final dividend for the year ended 31 December 2007 and recommends the payment of a final dividend of RMB0.684 per 10 shares, totalling approximately RMB837.987 million, based on the lower of that calculated in accordance with IFRS and China Accounting Standards. A resolution for the dividend payment will be submitted for consideration at the annual general meeting. The dividend will be denominated and declared in Renminbi. The relevant exchange rate will be the mean of the average rate of Renminbi to Hong Kong dollars as announced by the People's Bank of China for the week prior to the date of declaration of dividends.

TAXATION ON DIVIDEND

Taxes paid by PRC companies are generally PRC withholding tax levied at a flat rate of 20%. However, pursuant to one of the rules of the taxation authority of the PRC, dividends paid by companies in the PRC to shareholders on shares listed on an overseas stock exchange, such as H shares, are not subject to the abovementioned PRC withholding tax.

PURCHASES, SALES AND REDEMPTION OF SHARES

During the year ended 31 December 2007, neither the Company nor any of its subsidiaries purchased, sold or redeemed any of the Company's securities. For this purpose, the expression "securities" has the meaning ascribed to it under the Listing Rules.

PRE-EMPTIVE RIGHTS

None of the articles of association of the Company provide for any pre-emptive rights requiring the Company to offer new shares to existing shareholders in proportion to their existing shareholdings.

Report of the Directors

DIRECTORS AND SUPERVISORS OF THE COMPANY

Directors

Name	Age	Position in the Company	Date of appointment as director
Kong Dong	59	Vice chairman and non-executive director	30 October 2007
Wang Shixiang	58	Vice chairman and non-executive director	30 October 2007
Yao Weiting	60	Non-executive director	30 October 2007
Ma Xulun	43	Non-executive director	30 October 2007
Christopher Dale Pratt	51	Non-executive director	30 October 2007
Chen Nan Lok, Philip	52	Non-executive director	30 October 2007
Cai Jianjiang	44	Executive director and president	30 October 2007
Fan Cheng	52	Executive director and vice president	30 October 2007
Hu Hung Lick, Henry	88	Independent non-executive director	30 October 2007
Wu Zhipan	51	Independent non-executive director	30 October 2007
Zhang Ke	54	Independent non-executive director	30 October 2007
Jia Kang	53	Independent non-executive director	30 October 2007

Supervisors

Name	Age	Position in the Company	Date of appointment as supervisor
Sun Yude	53	Chairman of Supervisory Committee	30 October 2007
Liao Wei	43	Supervisor	30 October 2007
Zhou Guoyou	56	Supervisor	30 October 2007
Liu Feng	49	Supervisor	30 October 2007
Liu Guoqing	45	Supervisor	30 October 2007

INDEPENDENCE OF THE INDEPENDENT NON-EXECUTIVE DIRECTORS

The Company has confirmed its receipt of, from each of the independent non-executive directors of the Company, a confirmation of his independence pursuant to Rule 3.13 of the Hong Kong Listing Rules. The Company considers all of the independent non-executive directors to be independent.

BOARD COMMITTEES

The Board committees include the strategy and investment committee, audit and risk control committee, nomination and remuneration committee and aviation safety committee. The composition of each committee is set out in the "Corporate Governance Report" in this annual report.

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

As at 31 December 2007, none of the directors and supervisors of the Company has interests or short positions in the shares, underlying shares or debentures of the Company or its associated corporations (within the meaning of Part XV of the SFO) which were notified to the Company and the Hong Kong Stock Exchange pursuant to Divisions 7 and 8 of Part XV of the SFO (including interests or short positions which have been taken or deemed to be taken under such provisions of the SFO), or recorded in the register maintained by the Company pursuant to Section 352 of the SFO, or which were notified to the Company and the Stock Exchange pursuant to the Model Code for Securities Transaction by Directors of Listed Companies.

REMUNERATION OF DIRECTORS AND SUPERVISORS

Details of the remuneration of directors and supervisors are set out in note 10 to the financial statements.

INTERESTS OF DIRECTORS AND SUPERVISORS IN SERVICE CONTRACTS, CONTRACTS AND BUSINESS

Each of the directors was appointed by the Company on 30 October 2007 for a term of three years.

None of the directors has any existing or proposed service contract with any member of the Group which is not expiring or terminable by the Group within one year without payment of compensation (other than statutory compensation).

None of the directors or supervisors of the Company is materially interested in any contract or arrangement subsisting as at 31 December 2007 and which is significant in relation to the business of the Group.

Mr. Christopher Dale Pratt is a non-executive director of the Company and is concurrently the chairman and executive director of Cathay Pacific. Mr. Chen Nan Lok, Philip is a non-executive director of the Company and concurrently the Vice Chairman and non-executive director of Cathay Pacific. Cathay Pacific is a substantial shareholder of the Company and wholly owns Hong Kong Dragon Airlines Limited ("Dragonair"). Cathay Pacific and Dragonair compete or are likely to compete either directly or indirectly with some aspects of the business of the Company as they operate airline services to certain destinations, which are also served by the Company.

Save as above, none of the directors or supervisors of the Company and their respective associates (as defined in the Listing Rules) has any competing interests which would be required to be disclosed under Rule 8.10 of the Listing Rules if each of them were a controlling shareholder of the Company.

CONVENTION OF BOARD MEETINGS AND COMPLIANCE WITH THE CODE ON CORPORATE GOVERNANCE PRACTICES

The Company held 13 Board meetings during the year. The Company has been improving its corporate governance structure since listing. The Board is committed to conducting normative operations to protect the interests of the Company and its shareholders. The directors of the Company are of the opinion that the Company has complied with the requirements set out in the Code on Corporate Governance Practices in Appendix 14 of the Listing Rules.

Report of the Directors

EMPLOYEES

As at 31 December 2007, the Company had 19,972 employees and its subsidiaries and joint ventures had 15,831 employees. The following table sets forth the numbers and percentages of employees in different departments of the Company:

Employees	31 December 2007	31 December 2006	Net change
Flight crew	**4,890**	**4,621**	**269**
Pilots	2,502	2,364	138
Flight attendants	2,388	2,257	131
Ground crew	**15,082**	**14,251**	**831**
Ground services	2,632	2,486	146
Maintenance	2,074	1,960	114
Others	2,015	1,904	111
Marketing and sales	1,862	1,760	102
Management	6,499	6,141	358
Total	**19,972**	**18,872**	**1,100**

Note: The method used in staff statistic was changed during the reporting period, under which, staff involved in the exercise of management function in each category were grouped under the management category. As such, figures under the 2006 column as shown in the table were adjusted from last year for comparison purpose.

COMPENSATION POLICY

The remuneration of the employees of the Company includes salary and other subsidies. The Company also provides medical insurance, unemployment insurance, endowment insurance, birth insurance and other social benefits to its employees.

Annual salary systems have been adopted for chief executives in state-owned enterprises since 2005 under the requirements of the State-owned Assets Supervision and Administration Commission.

In order to provide incentives to the flight crew, the Board of the Company considered and approved the Proposal on the Reform of Remuneration and Benefits System for the Flight Crew, which came into effect on 1 March 2006.

EMPLOYEES AND EMPLOYEES' PENSION SCHEME

202 employees of the Company retired in 2007. These retired employees are entitled to benefits under the social pension scheme approved and provided by the labour and social security authority of the local government. Details of the staff pension scheme and other welfare are set out in note 11 to the financial statements.

SHARE APPRECIATION RIGHTS

The Directors and Senior Management Stock Appreciation Rights Handbook of the Company was considered and approved on the general meeting held on 28 December 2006. The First Phase Stock Appreciation Rights Scheme was implemented by the Company on 15 June 2007 and the total number of shares granted was 14.94 million shares. Details of the Share Appreciation Rights Scheme are set out in note 43 to the audited financial statements.

SUBSIDIARIES AND ASSOCIATED COMPANIES

Details of the subsidiaries, joint ventures and associates of the Company as at 31 December, 2007, are set out respectively in notes 19 and 21 to the audited financial statements.

BANK AND OTHER BORROWINGS

Details of the bank loans, other loans and corporate bonds of the Company and the Group are set out in note 36 to the consolidated financial statements.

FIXED ASSETS

Movements in the fixed assets of the Group for the year ended 31 December 2007 are set out in note 16 to the audited financial statements.

CAPITALISED INTERESTS

Details of the capitalised interests of the Group for the year ended 31 December 2007 are set out in note 8 to the audited financial statements.

RESERVES

Movements in the reserves of the Company and the Group during the year are set out in note 42 to the consolidated financial statements and the Consolidated Statement of Changes in Equity.

DONATIONS

For the year ended 31 December 2007, the Group made donations for charitable and other purposes amounting to RMB72,310,000.

MAJOR CUSTOMERS AND SUPPLIERS

For the year ended 31 December 2007, the purchases from the largest supplier accounted for 24.58% of the total purchases of the Group, while purchases from the five largest suppliers accounted for 48.82%. None of the directors or supervisors of the Company, their associates, nor any shareholder, who to the knowledge of the directors own 5% or more of the Company's share capital, had any interest in the five largest suppliers of the Company.

For the year ended 31 December 2007, the sales of the Group to the five largest customers accounted for not more than 30% of the total purchase of the Group.

PROPERTY TITLE CERTIFICATE

The Company effected changes of titles of assets e.g. land use rights, buildings and vehicles, in accordance with its undertakings as disclosed in the Company's prospectus for the public offering of its shares. The transfer procedures for the vehicles of the Company's headquarters and branches have been completed save for a few regions. The title transfer procedures for the land use rights and buildings of the Company's headquarters and branches have been substantially completed. The transfer of titles of the remaining properties is still in progress and the directors consider that this should not have any material adverse effect on the operation of the Company.

MATERIAL LEGAL PROCEEDINGS

As at 31 December 2007, save as disclosed in note 46 to the audited financial statements, the audited Company was not involved in any significant litigation or arbitration. To the knowledge of the Company, there was no litigation or claim of material importance pending, to be initiated or initiated against the Company.

CONNECTED TRANSACTIONS

The Group has entered into a number of transactions on a continuing basis with CNAHC and its associates (as defined under the Listing Rules) and other connected persons of the Group. The agreements for connected transactions have been renewed as appropriate in accordance with the Listing Rules. Description of the renewed agreements is set out in the Company's circular dated 1 December 2006. Details of those connected transactions conducted in 2007, which are not exempt under Rule 14A.33 of the Listing Rules, are as follows:

I. Continuing Connected Transactions Between the Group and CNAHC Group

Trademark Licensing

Pursuant to a trademark licence agreement (the "Trademark Licence Agreement") entered into between the Company and CNAHC on 1 November 2004, and subject to the Non-Competition Agreement between the two parties, the Company granted to CNAHC and its wholly-owned or controlled subsidiaries a licence to use 17 registered trademarks which the Company held in connection with the business operations of CNAHC and its wholly-owned or controlled subsidiaries but not related to the core businesses of the Company on a royalty-free basis. The Company reserves the right to use or license any independent third party to use the above trademarks, or to transfer the trademarks to any independent third party provided that the interest of the existing licensee is not prejudiced. The term of the agreement shall commence on the date of incorporation of the Company and end on 31 December 2014.

On 28 March 2006, the Company and CNAHC entered into a Trademark Licence Supplementary Agreement, whereby the Company granted to CNAHC a licence to use trademark no. 1125894 in connection with the business operations of CNAHC and its wholly-owned or controlled subsidiaries on a royalty-free basis and on the same terms and conditions as the Trademark Licence Agreement. As such, the total number of registered trademarks licenced by the Company to CNAHC and its wholly-owned or controlled subsidiaries amounted to 18.

Construction Project Management Services

The Company entered into a construction project management agreement (the "Construction Project Management Agreement") and a supplemental agreement thereto with China National Aviation Construction and Development Company ("CNACD"), a wholly-owned subsidiary of CNAHC on 1 November 2004 and 10 November 2006 respectively.

Pursuant to these agreements:

- CNACD will provide the Company project management services on projects involving the construction of any property or industrial plant/facility with budgeted costs of RMB20 million or above;
- in return for its project management services, the Company pay CNACD a fee of up to 2% of the construction budget if the budget is RMB1 billion or more, and up to 2.5% if the budget is below RMB1 billion;
- if the actual settlement price of the project managed by CNACD is higher than the total budgeted amount, CNACD will pay the Company the difference between the actual settlement price and the total budgeted amount, unless the difference is caused by (i) a change of government policies; (ii) factors attributed to the Company; or (iii) force majeure; and
- If CNACD acquires land relating to a project on the Company's behalf, the Company will pay CNACD an agency fee of up to 2% of all the fees and expenses in relation to the land acquisition (including, among other things, land acquisition fee, formality fee, labour expenses and travelling expenses, but excluding land premium).

The Construction Project Management Agreement has expired on 31 December 2006 and as provided in its supplemental agreement, among others, its term has been extended to 31 December 2009.

Properties Leasing

The Company entered into a properties leasing framework agreement (the "Properties Leasing Framework Agreement") and a supplemental agreement thereto with CNAHC on 1 November 2004 and 10 November 2006 respectively.

Pursuant to these agreements, the Company will lease from CNAHC 16 properties with an aggregate gross floor area of approximately 59,318.88 sq. m. for various uses, including as business premises, offices and storage facilities. The Company will also lease to CNAHC 6 properties with an aggregate gross floor area of approximately 7,996.55 sq. m. for various uses, including as business premises and offices. The rents payable under these agreements are and will continue to be determined in accordance with relevant PRC Laws or market rates. The annual increment of the rent will not exceed 5%.

The Properties Leasing Framework Agreement has expired on 31 December 2006 and as provided in its supplemental agreement, among others, its term has been extended to 31 December 2009.

Tourism Co-operation Services

The Company entered into a tourism services cooperation agreement (the "Tourism Cooperation Agreement") and a supplemental agreement thereto on 1 November 2004 and 10 November 2006 respectively with China National Aviation Tourism Company ("CNATC").

Pursuant to these agreements, the Company has agreed to provide the following services to CNATC:

- Commercial charter flight services: the Company will provide charter services (including chartered routes) to customers procured by CNATC at market rates.

- Package tours co-operation services: the Company and CNATC will sell package tours combining (i) the Company's airline tickets with (ii) accommodation at hotels owned and operated by CNATC. For the airline tickets in such packages sold by CNATC, CNATC will pay the Company in accordance with the pricing principle under the "Sales Agency Framework Agreement" while the Company will pay CNATC for the hotel fee portion of the packages.

- Reciprocal frequent-flyer programme ("FFP") co-operation services: CNATC will join the Company's FFP under which the Company's Companion Card members are encouraged to stay at CNATC's hotels by receiving mileage credits for such stay. As consideration, CNATC will pay the Company the equivalent value represented by those mileage credits.

Pursuant to the Tourism Cooperation Agreement, CNATC agreed to provide the following services to the Company:

- FFP co-operation services: Under the FFP, if the Company's Companion card members redeem their mileage credits for free, discounted or upgraded stay at CNATC's hotels, the Company will reimburse CNATC for such redemption at a price similar to our arrangements with other FFP partners.

- Hotel accommodation services: CNATC will provide hotel accommodation services to the Company's employees on duty and passengers affected by our flight delays or cancellations, for which services the Company will pay relevant fees to CNATC at group rates.

- Air travel special services: including but not limited to the newly launch ground transportation service to and from the airport for first class and business class flyers.

The Tourism Cooperation Agreement has expired on 31 December 2006 and as provided in its supplemental agreement, among others, its term has been extended to 31 December 2009.

Mutual Provision Services

The Company entered into a Mutual Provision services agreement (the "Mutual Provision Services Agreement") and a supplemental agreement thereto with CNAHC on 1 November 2004 and 10 November 2006 respectively, pursuant to which:

- CNAHC will provide the Company with various ancillary services, including but not limited to:

  (i) catering Services;

  (ii) supply of various items for in-flight services;

  (iii) manufacturing and repair of airline-related ground equipment and vehicles;

  (iv) cabin decoration and equipment;

  (v) passenger cabin and cargo cabin ancillary parts (including seats);

  (vi) warehousing services;

  (vii) cabin cleaning services; and

  (viii) printing of air tickets and other documents.

- The Company will provide certain welfare-logistics services to the retired employees of CNAHC and its subsidiaries.

The charges payable by the Company to CNAHC for the mutual provision services above, shall be based on prevailing market rate or, if no prevailing market rate is available, fair and reasonable price determined after arm's length negotiation. The management fee payable by CNAHC to the Company for the welfare-logistics services provided to its retired employees shall be based on a fee rate of 4%. The amount will be credited to the Company before the relevant quarter payment is made.

The Mutual Provision Services Agreement has expired on 31 December 2006 and as provided in its supplemental agreement, among others, its term has been extended to 31 December 2009.

Line Maintenance and Other Ground Services

The Company entered into a standard ground handling agreement (the "Standard Ground Handling Agreement") with China Aircraft Services Limited ("CASL"), a 40%-owned subsidiary of CNACG, on 17 April 2004, pursuant to which CASL would provide line maintenance and other ground services to the Company at the Hong Kong International Airport. The services are charged at market rates.

The Standard Ground Handling Agreement was renewed in January 2006. All charges set out in the agreement shall remain unchanged for 12 months and shall continue hereafter unless otherwise agreed mutually by both parties in writing.

Sales Agency Services for Air Tickets and Cargo Spaces

The Company entered into a sales agency framework agreement (the "Sales Agency Services Framework Agreement") and a supplemental agreement thereto with CNAHC on 1 November 2004 and on 10 November 2006, respectively.

Pursuant to these agreements, certain associates of CNAHC acting as the Company's sales agents will:

- purchase air tickets and cargo spaces from the Company at wholesale prices and resell such air tickets and cargo spaces to end-purchasers; or

- procure purchasers for the Company's air tickets and cargo spaces on a commission basis.

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

- for domestic routes, 3% of the ticket price;

- for Hong Kong and Macau routes, 7% of the ticket price; and

- for international routes, 9% of the ticket price.

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

The Sales Agency Services Framework Agreement has expired on 31 December 2006 and as provided in its supplemental agreement, among others, its term has been extended to 31 December 2009.

Financial Services

On 1 November 2004 and 10 November 2006, the Company entered into a financial services agreement (the "Financial Services Agreement") and a supplemental agreement thereto with China National Aviation Finance Co., Ltd. ("CNAF") respectively which is owned as to 74.89% by CNAHC and 19.31% by the Company.

Pursuant to these agreements, CNAF has agreed to provide the Company a range of financial services including the following:

- deposit services;

- loan and finance leasing services;

- negotiable instrument and letter of credit services;

- trust loan and trust investment services;

- underwriting services for debt issuances;

- intermediary and consulting services;

- guarantee services;

- settlement services;

- internet banking services; and

- any other services provided by CNAF under the approval of the China Banking Regulatory Commission ("CBRC").

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

The Financial Services Agreement has expired on 31 December 2006 and as provided in its supplemental agreement, among others, its term has been extended to 31 December 2009.

Subcontracting of Charter Flight Services

The Company entered into a charter flight service framework agreement (the "Charter Flight Service Framework Agreement") and a supplemental agreement thereto on 1 November 2004 and 10 November 2006 respectively with CNAHC.

Pursuant to these agreements, CNAHC will subcontract to the Company its obligation of government charter flight that it undertakes from the PRC government. The Company's hourly rate of the charter flight service fee will be calculated on the basis of the following formula which includes total cost and reasonable margins:

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

Total cost includes all direct costs and indirect costs.

The Charter Flight Service Framework Agreement has expired on 31 December 2006 and as provided in its supplemental agreement, among others, its term has been extended to 31 December 2009.

II. Continuing Connected Transactions between the Group and the Lufthansa Group

Deutsche Lufthansa AG ("Lufthansa") holds 40% equity interest in and is a substantial shareholder of Ameco, a joint venture of the Company, and is therefore a connected person of the Company under the Listing Rules.

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

- Aircraft maintenance, repair and overhaul services ("MRO Services") provided by the Company to the Lufthansa Group;
- mutual provision of catering services;
- mutual provision of ground handling services in China and Germany;
- mutual provision of ticket sales agency services;
- airline codeshare arrangement under which the actual carrier's flights can be marketed under the airline designator code of the partner carrier and revenue earned from these arrangements are allocated between the parties based on negotiated terms according to airline industry standards;
- special prorate arrangement under which a carrier agrees to accept passengers from another carrier and receive payment directly from that carrier; and
- other airline co-operation arrangements between the Lufthansa Group and the Company.

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

III. Continuing Connected Transactions between the Group and the Beijing Capital Airports Group

Capital Airports Holding Company holds 24% equity interest in and is a substantial shareholder of Air China Cargo, and therefore is a connected person of the Company under the Listing Rules. The Company has entered into various transactions under various agreements with Beijing Capital Airports Group in the ordinary course of its business. On 10 November 2006, the Company entered into a service framework agreement ("Service Framework Agreement") with Beijing Capital Airports Group for, including, among others:

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

All the services provided by the Beijing Capital Airports Group to the Company are charged on the pricing terms which are prescribed, approved or recommended by PRC governmental authorities or if no provisions by the state, charged according to relevant market rate.

The Service Framework Agreement is valid for three years from 1 January 2007 to 31 December 2009 but renewable upon expiry.

IV. Transactions Caps and Actual Transactions Amount in 2007

Actual transactions amount and transactions caps of the above-mentioned continuous transactions during the year ended 31 December 2007 are as follows:

Transactions	Total transaction amount for the year ended 31 December 2007 Cap RMB (in millions)	Actual amount RMB (in millions)
Transactions with the CNAHC Group:		
Construction project management services	40.00	10.19
Properties leasing	55.00	53.14
Tourism service cooperation	59.20	47.81
Comprehensive services	80.00	79.21
Line maintenance and other group services	45.00	26.73
Financial services:		
Maximum daily outstanding deposits with CNAF	2,500.00	1,053.07
Maximum daily outstanding loans from CNAF	2,500.00	317.44
Subcontracting of charter flights	700.00	448.75
Sales agency services:		
Aggregate sales of airline tickets and cargo space to CNAHC Group for resale to end purchasers	357.00	246.64
Aggregate ticket and cargo agency commission and amount of incentives paid by the Company to CNAHC Group	63.00	41.69
Transactions with the Lufthansa Group:		
Aggregate amount paid by the Company to the Lufthansa Group	775.20	703.19
Aggregate amount paid by the Lufthansa Group to the Company	592.80	591.49
Transactions with the Beijing Capital Airports Group:		
Aggregate amount paid by the Company to the Beijing Capital Airports Group	1,026.00	980.00

V. Confirmation from Independent Non-executive Directors

The Independent Non-Executive directors of the Company have confirmed that all connected transactions in the year ended 31 December 2007 to which the Company was a party have been entered into:

1. in the ordinary and usual course of business of the Company;

2. either:

   (i) on normal commercial terms; or

   (ii) where there was no comparable transactions to judge whether they were on normal commercial terms, on terms no less favourable to the Company than terms available to or from independent third parties, where applicable; and

3. in accordance with terms that were fair and reasonable and in the interests of the shareholders of the Company as a whole.

VI. Confirmation from the Auditors

Ernst & Young, the auditors of the Company, has confirmed by a letter to the Board that the above connected transactions:

1. have been approved by the Board;

2. were conducted in accordance with the pricing policies as stated in the relevant agreements;

3. were entered into in accordance with the relevant agreements governing such transactions; and

4. have not exceeded the cap amounts disclosed in the Company's circular dated 1 December 2006.

CONTRACT OF SIGNIFICANCE

Save as disclosed in "Connected Transactions" of this report of directors, none of the Company or any of its subsidiaries entered into any contract of significance with the controlling shareholder or any of its subsidiaries, and there is no contract of significance in relation to provision of services by the controlling shareholder or any of its subsidiaries to the Company or any of its subsidiaries. None of the shareholders entered into any arrangement to waive or agree to waive any dividend.

AUDITORS

The Company appointed Ernst & Young and Ernst & Young Hua Ming as its international auditors and domestic auditors respectively for the year ended 31 December 2007. Ernst & Young have audited the attached financial statements prepared in accordance with International Financial Reporting Standards. The Company has retained Ernst & Young and Ernst & Young Hua Ming since the date of its listing. A resolution in respect of the reappointment of Ernst & Young and Ernst & Young Hua Ming as the Company's international and domestic auditors respectively for the year ending 31 December 2008 will be proposed at the forthcoming annual general meeting of the Company.

Report of the Supervisory Committee

To all shareholders,

The supervisory committee of the Company (the "Supervisory Committee") has carried out its duties in accordance with the Company's articles of association and relevant requirements in 2007. Members of the Supervisory Committee attended Board meetings, inspected relevant documents and conducted seminars, exercising effective supervision over the conduct and decision-making process of Board meetings and enforcement of resolutions for compliance with the relevant laws and regulations and the Company's articles of association, with the aim of safeguarding the interests of the Company and shareholders as a whole.

The Supervisory Committee is of the opinion that the decision-making process of the Company complied with the relevant laws and regulations, and the Company's articles of association and was well-regulated. The directors and senior management of the Company observed their fiduciary duties and worked diligently and legally. The Supervisory Committee is not aware that the directors and senior management of the Company acted in breach of the laws and regulations and the articles of association of the Company or against the interests of the Company.

The Supervisory Committee considers that the Company's 2007 financial statements reflected a true and fair view of the financial position and financial performance of the Company, and the unqualified opinion expressed in the auditors' report issued by Ernst & Young is objective and fair. In the opinion of the Supervisory Committee, the Company has achieved satisfactory results in 2007. It is expected that the Company will continue to exercise robust cost control and risk management.

The Supervisory Committee is of the opinion that the connected transactions between the Company and its connected persons were conducted at fair market price without prejudice to the interests of the Company and its minority shareholders.

In 2008, the Supervisory Committee will continue to perform its duties in safeguarding the interests of the shareholders of the Company in strict adherence to the Company's articles of associations and relevant requirements.

By Order of the Supervisory Committee

Sun Yude
Chairman of the Supervisory Committee

Beijing, PRC
17 March 2008

Profile of Directors, Supervisors and Senior Management

DIRECTORS

Mr. Kong Dong, aged 59, graduated from Jiangxi Technology University majoring in mechanical engineering and is a senior economist. Mr. Kong was Deputy General Manager of China Ocean Helicopter Company, General Manager of Shenzhen Airport Group, Director-General in charge of the expansion project of the Beijing Capital International Airport, General Manager of China National Aviation Corporation and President of CNAC, and Vice Chairman and President of CNACG. After the restructuring of China's civil aviation industry in October 2002, he joined CNAHC as Deputy General Manager, a post he continues to hold since August 2004. He has been the acting Chairman since 2nd January 2008.

Mr. Wang Shixiang, aged 58, graduated from the China Civil Aviation Advanced School majoring in aviation and is a qualified First-Class Pilot. Mr. Wang was appointed as President of the Civil Aviation Flight Academy of China in 1995, and General Manager of China Southwest Airlines in 1999. After the restructuring of China's civil aviation industry in October 2002, he joined CNAHC as Deputy General Manager, a post he continues to hold.

Mr. Yao Weiting, aged 60, graduated from Zhejiang Institute of Economics and Management and the China Central Communist Party University majoring in industrial accounting and economic management, respectively. He is also a senior accountant and senior economist. Mr. Yao was appointed as Deputy Director of Economic Adjustment Bureau of China Metallurgical Ministry in 1997 and Assistant to the State Council Investigation Special Commissioner in 1998, and was the Chief Accountant of Air China International Corporation from 2000 to 2002. After the restructuring of China's civil aviation industry in October 2002, he joined CNAHC as Deputy General Manager, and assumed the position of Chief Accountant of CNAHC in December 2004, a post he continues to hold.

Mr. Ma Xulun, aged 43, graduated from Shanxi Finance University with a Bachelor's degree in Economics and is a certified public accountant. Mr. Ma was appointed as Deputy General Manager of China Commodities Storing and Transportation Corporation in 1995, Deputy Director General of Finance Department of the General Administration of Civil Aviation of China ("CAAC") in 1997, Vice President of Air China International Corporation in December 1998, and Deputy Director General of Air China International Corporation after the restructuring of China's civil aviation industry in 2002. From September 2004 to January 2007, he was the President of the Company. He has been serving as Deputy General Manger of CNAHC since February 2007.

Mr. Christopher Dale Pratt, aged 51, has been a non-executive director of the Company since June 2006. He was appointed as Chairman and a director of Cathay Pacific since February 2006. He is also Chairman of Swire Pacific Limited and John Swire & Sons (H.K.) Limited, and a Director of Swire Properties Limited. He joined John Swire & Sons Limited in 1978 and has worked with the group in Hong Kong, Australia and Papua New Guinea. He served as Executive Director of Swire Pacific Limited's Trading and Industrial Division from 2000 to 2005. He has an honours degree in modern history from Oxford University.

Mr. Chen Nan Lok, Philip, aged 52, has been a non-executive director of the Company since June 2007. He is currently Chairman of John Swire & Sons (China) Ltd., Vice Chairman of Cathay Pacific, and a director of John Swire & Sons (H.K.) Limited, Swire Pacific Limited and Swire Properties Limited. Mr. Chen Nan Lok joined the Swire Group in 1977 and in addition to Hong Kong has worked with the group in Mainland China and the Asia Pacific region. He holds an honours degree in Political Science and History from the University of Hong Kong.

Mr. Cai Jianjiang, aged 44, graduated from China Civil Aviation Institute majoring in aviation control. Mr. Cai was appointed General Manager of Shenzhen Airlines Company Limited in 1999. He joined Air China International Corporation in 2001 as Manager of its Shanghai Branch, and subsequently as Assistant to the President and Manager of the Marketing Department of Air China International Corporation. After the restructuring of China's civil aviation industry in October 2002, he was appointed as Vice President of Air China International Corporation, and has served as Vice President of Air China Limited since September 2004. In February 2007, he was promoted to President of the Company, a post he continues to hold.

Mr. Fan Cheng, aged 52, graduated from Nanjing Institute of Chemistry and Chemical Engineering with a major in organic fertilizer and graduated from Guanghua School of Management, Peking University in 2000 with an MBA degree. Mr. Fan is a senior accountant, senior engineer and certified public accountant. Mr. Fan was appointed as Deputy General Manager of China New Technology Venture Capital Company in 1996. He started his career in China's civil aviation industry in 2001, and served as General Manager of Corporate Management Department and Assets Management Department of CNAHC from October 2002 to October 2004. He has been the Chief Financial Officer of Air China Limited since September 2004. Since October 2006, he has been serving as the Vice President of the Company.

Mr. Hu Hung Lick, Henry, aged 88, is currently the president of Shue Yan University in Hong Kong. He graduated from the University of Paris with a Docteur-en-Droit degree. Mr. Hu was a member of Preparatory Committee and Selection Committee for the First Government of the Hong Kong Special Administrative Region, China, and was a member of the Standing Committee of the 8th and 9th Chinese People's Political Consultative Conference.

Mr. Wu Zhipan, aged 51, obtained a Bacheror's degree, then a Master's degree and a Doctor's degree in Law from School of Law, Peking University, in 1982, 1985 and 1988 respectively. He was a visiting scholar at Harvard Law School from 1991 to 1992. Mr. Wu is currently the Vice Chancellor of Peking University. He is also an expert consultant of the Supreme People's Court of China and Consultant of the Drafting Group of the Banking Law in China. Mr. Wu is also an independent non-executive director of China Minsheng Banking, Corp., Ltd., and Fortune SGAM Fund Management Co., Ltd., and an independent supervisor of PetroChina Company Limited.

Mr. Zhang Ke, aged 54, graduated from Renmin University of China in 1982 with a Bachelor's degree of economics. He is a certified public accountant and senior accountant. Mr. Zhang is currently Chairman and chief partner of Shine Wing Certified Public Accountants. Mr. Zhang is also the Vice Chairman of the Standing Council of CICPA, the Vice Chairman of Beijing Association of Forensic Examination and a member of CPA Examination Committee of the Ministry of Finance.

Mr. Jia Kang, aged 53, holds a Doctor's degree in Economics, and is a famous economist and a member of CPPCC National Committee. He is a researcher, a tutor of doctor and the head of Financial Science Research Institute of Ministry of Finance, and also the vice chairman and general-secretary of China Financial Association. Mr. Jia is also a visiting professor of Renmin University of China, State Administration Institute, Xiamen University, Southwest University of Finance and Economics, Guangdong University of Business Studies. Mr. Jia is also the winner of Sun Zhifang Economics Prize.

SUPERVISORS

Mr. Sun Yude, aged 53, graduated from China Civil Aviation Institute majoring in economic management. He started his career in China's civil aviation industry in 1972 and served as Deputy Head of CAAC Taiyuan Terminal and Head of Ningbo Terminal, as well as General Manager of CNAC Zhejiang Airlines. After the restructuring of China's civil aviation industry in October 2002, Mr. Sun joined Air China International Corporation as Vice President and General Manager of Zhejiang branch, and has been serving as Vice President of the Company since September 2004. Mr. Sun has been serving as Chairman and President of Shandong Aviation Group since December 2005, and as President of CNACG since March 2007.

Mr. Liao Wei, aged 43, graduated from China Southwest Finance University majoring in accounting and is a senior accountant. Mr. Liao served as the Deputy Director of CAAC's Finance Department, the Director of Human Resources Administration of Air Macau, Deputy General Manager and General Manager of CNACG's investment department. Mr. Liao joined CNAHC in December 2002 as Deputy General Manager of CNAHC's finance department and has been promoted to General Manager since September 2003.

Mr. Zhou Guoyou, aged 56, graduated from the China Central Communist Party University majoring in economic management and is a senior economist. Mr. Zhou started his career in China's civil aviation industry in 1970 and served in various positions in the Company such as Deputy Director of Beijing Ticketing Department, Manager of the Shanghai Business Division, General Manager of the Marketing and Sale Department of Beijing Business Division, Deputy Director of Quality Standard Department and Deputy Director of the Economic Efficiency Office. Mr. Zhou has been serving as Deputy General Manager of the Corporate Supervision Division of CNAHC since February 2004.

Mr. Liu Feng, aged 49, is the representative of the employees on the Supervisory Committee. Mr. Liu graduated from the China Central Communist Party University. He joined Air China International Corporation in 1992 as Secretary to the Labour Union. He was appointed as the Deputy Director of the Labour Union Office of Air China International Corporation in December 1995 and was promoted to Director in June 2007, a post he continues to hold.

Mr. Liu Guoqing, aged 45, is the representative of the employees on the Supervisory Committee and a committee member of the Labour Union. Mr. Liu graduated from the Beijing University of Technology majoring in automation in July 1984, and served as an assistant economist. He joined Air China International Corporation in December 1988 and worked in its Beijing ticketing and seat reservation centre until 1994, when he was transferred to the marketing department and market development department.

OTHER SENIOR MANAGEMENT PERSONNEL

Mr. Tan Zhihong, aged 57, graduated from Sichuan International Studies University with major in English. In August 1975, he joined the Beijing Administrative Bureau of CAAC. From April 1981 to September 1985, he worked at the London office of CAAC as the commercial officer and from September 1985 to March 1988, he served as the Deputy Director of the international passengers office of the passengers transportation department of the transportation division, and the Director of the scheduling and distribution division, of the Beijing Administrative Bureau of CAAC. From March 1988 to August 1998, he served in various positions such as Deputy Manager and Manager of Air China Transportation Services Company, Director of the passengers transportation division as well as the General Manager of the ground services department of Air China International Corporation. From August 1998 to September 2004, he was the General Manager of the Inner Mongolia Branch and Tianjin Branch of Air China International Corporation respectively. Since September 2004 to date, he has been serving as General Manager of Southwest Branch of the Company. Mr. Tan has been serving as Vice President of the Company since February 2007.

Mr. Song Zhiyong, aged 42, graduated from the Second Flying Academy of China Air Force with major in Flying Studies. Mr. Song started his career in the China's civil aviation industry in 1978 and was previously the pilot of the Third Group of the Chief Flight Team, Deputy Captain of the Chief Flight Team and Director of the Training Department of Air China International Corporation. Since September 2004, Mr. Song has been serving as the Assistant to President and Chief Captain of the Chief Flight Team of Air China Limited. Mr. Song has been serving as Vice President and Chief Captain of the Chief Flight Team of the Company since October 2006.

Mr. He Li, aged 56, holds a Master degree in Business Administration from China-Euro Management Institute. Mr. He started his career in the China's civil aviation industry in 1973 and was previously an engineer of Beijing Administrative Bureau of CAAC and General Manager of Aircraft Maintenance and Engineering Corporation, Beijing. Since November 2005, Mr. He has been serving as General Manager of the Engineering Technology (Branch) Company of the Company. Mr. He has been serving as Vice President of the Company since October 2006.

Ms. Yang Lihua, aged 52, graduated from Beijing Languages University majoring in French, and is a senior stewardess. She started her career in China's civil aviation industry in 1973 and had served in Air China International Corporation as Manager of Cabin Service Department, Deputy Chief of the Main Flight Team, and as General Manager of Passenger Service Department. Ms. Yang served as Vice President of Air China International Corporation after the restructuring of China's civil aviation industry in October 2002, and has been serving as Vice President of the Company since September 2004.

Mr. Li Huxiao, aged 57, graduated from Beijing Communist Party School and is a senior engineer. From July 1990 to November 2001, he served as Deputy General Manager and then General Manager of Inner Mongolia Branch of Air China International Corporation. He was Deputy General Manager of Cargo Branch of Air China International Corporation from November 2001 to October 2003 and was Deputy General Manager of Air China Cargo from October 2003 to September 2004. Mr. Li was appointed as Chairman of Air China Cargo in June 2006. He has been serving as Vice President of the Company since July 2007.

Ms. Zhang Lan, aged 52, graduated from Beijing Foreign Studies University majoring in English. Ms. Zhang started her career in the China's civil aviation industry in 1977 and had been seconded to work in various places including the United States and Switzerland. Ms. Zhang joined Air China International Corporation in 1988 and served at various positions, including General Manager of the Sales and Marketing Department. Since September 2004, Ms. Zhang has been serving as the Assistant to President and Chairman of the Commercial Committee of the Company. Ms. Zhang has been serving as Vice President of the Company and Director of the Commercial Committee since October 2006.

Mr. Gao Dianbang, aged 59, graduated from China Civil Aviation Advanced School and is a First-Class Pilot. He had served in Air China International Corporation as Captain, Deputy Commander, Deputy Chief and Chief of the Main Flight Team, and was appointed as Assistant to President of Air China International Corporation in 2001. After the restructuring of China's civil aviation industry in October 2002, Mr. Gao served as the Chief Pilot of Air China International Corporation, and has been serving as the Chief Pilot of the Company since September 2004.

Mr. Huang Bin, aged 44, graduated from China Civil Aviation Institution in 1983 majoring in financial planning. From 1998 to 2000, he studied Management and Engineering in Naning University of Aeronautics and Astronautics. He is a senior accountant. Mr Huang started his career in the civil aviation industry in 1983 and served as Section Chief, Deputy Director, Director and General Manager of Finance Department. In October 2002, Mr. Huang was appointed as Deputy General Manager and Chief Accountant of Southwest Branch of Air China International Corporation. After the establishment of the Company in September 2004, he served as Deputy General Manager and Chief Accountant of Southwest Branch of the Company. He has been serving as the Secretary of the Board since June 2007.

JOINT COMPANY SECRETARIES

Mr. Huang Bin, his biographical details are set out in the section headed "Other Senior Management Personnel" above.

Mr. Li Man Kit, aged 51, is a Joint Company Secretary of the Company. He has been the Company Secretary of CNAC and CNACG since December 2000. Mr. Li graduated from the University of East Asia, Macau in business administration and also holds both a Bachelor's degree in Chinese Law and a Master's degree in International Law from Peking University. He is an associate member of the Institute of Chartered Secretaries and Administrators, UK and the Hong Kong Institute of Chartered Secretaries. Prior to joining the CNAC Group, Mr. Li was the company secretary of a shipping group of companies whose shares were listed in both Hong Kong and London. Mr. Li has many years of experience in para-legal, corporate reorganisation, administrative and personnel management and company secretarial work.

QUALIFIED ACCOUNTANT

Mr. David Tze-kin Ng, aged 58, is a member of Hong Kong Institute of Certified Public Accountants. Mr. Ng graduated with Master of Commerce from Macquarie University in Australia, and has obtained various international professional accounting qualifications, including as a Chartered Accountant in Australia, Chartered Certified Accountant in the UK, fellow member of the Institute of Chartered Secretaries and Administrators, member of The Institute of Internal Auditors and member of the Association of International Accountants. Mr. Ng has 30 years of experience in the accounting profession. He had served in PricewaterhouseCoopers for eight years, responsible for auditing and taxation matters. Mr. Ng is currently the Managing Director and the Chief Accountant of Hong Kong Great Wall Certified Public Accountants Limited, and has been appointed by the Hong Kong Government as a committee member of the Insider Dealing Tribunal.

Independent Auditors' Report

ERNST & YOUNG

18th Floor
Two International Finance Centre
8 Finance Street, Central
Hong Kong
Phone: (852) 2846 9888
Fax: (852) 2868 4432
www.ey.com/china

To the shareholders of
Air China Limited
(Established in the People's Republic of China with limited liability)

We have audited the accompanying financial statements set out on pages 52 to 138 of Air China Limited (the "Company"), its subsidiaries and joint ventures (collectively the "Group"), which comprise the Company's balance sheet and the Group's consolidated balance sheet as at 31 December 2007, and the Group's consolidated income statement, consolidated statement of changes in equity and consolidated cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

DIRECTORS' RESPONSIBILITY FOR THE FINANCIAL STATEMENTS

The Company's Directors are responsible for the preparation and the true and fair presentation of these financial statements in accordance with International Financial Reporting Standards and the disclosure requirements of the Hong Kong Companies Ordinance. This responsibility includes designing, implementing and maintaining internal control relevant to the preparation and the true and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

AUDITORS' RESPONSIBILITY

Our responsibility is to express an opinion on these financial statements based on our audit. Our report is made solely to you, as a body, and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance as to whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditors consider internal control relevant to the entity's preparation and true and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the Company's Directors, as well as evaluating the overall financial statement presentation.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

OPINION

In our opinion, the financial statements give a true and fair view of the financial position of the Company and of the Group as at 31 December 2007, and of the financial performance and cash flows of the Group for the year then ended in accordance with International Financial Reporting Standards and have been properly prepared in accordance with the disclosure requirements of the Hong Kong Companies Ordinance.

Ernst & Young
Certified Public Accountants

Hong Kong
17 March 2008

Consolidated Income Statement

Year ended 31 December 2007

(Prepared under International Financial Reporting Standards)

	Notes	2007 RMB'000	2006 RMB'000
TURNOVER			
Air traffic revenue	4	**47,717,546**	41,606,130
Other operating revenue	5	**3,612,995**	3,330,476
		51,330,541	44,936,606
OPERATING EXPENSES			
Jet fuel costs		**(17,201,143)**	(15,716,174)
Take-off, landing and depot charges		**(5,537,907)**	(5,136,388)
Depreciation		**(5,554,443)**	(5,274,033)
Aircraft maintenance, repair and overhaul costs		**(2,076,119)**	(1,812,647)
Employee compensation costs	6	**(5,209,766)**	(4,313,883)
Air catering charges		**(1,473,543)**	(1,320,123)
Aircraft and engine operating lease expenses		**(2,239,359)**	(2,069,639)
Other operating lease expenses		**(311,262)**	(323,752)
Other flight operation expenses		**(4,232,726)**	(3,658,986)
Selling and marketing expenses		**(2,708,770)**	(2,026,728)
General and administrative expenses		**(951,376)**	(766,549)
		(47,496,414)	(42,418,902)
PROFIT FROM OPERATIONS	7	**3,834,127**	2,517,704
Finance revenue	8	**2,376,572**	1,177,871
Finance costs	8	**(1,969,326)**	(1,876,487)
Gain on disposal of an associate	9	**–**	1,592,633
Share of profits and losses of associates		**1,364,740**	517,500
PROFIT BEFORE TAX		**5,606,113**	3,929,221
Tax	12	**(1,484,613)**	(624,124)
PROFIT FOR THE YEAR		**4,121,500**	3,305,097
Attributable to:			
Equity holders of the Company		**4,228,997**	2,687,841
Minority interests		**(107,497)**	617,256
		4,121,500	3,305,097
Dividends:	14		
Interim		**–**	–
Proposed final		**837,987**	602,767
		837,987	602,767
Earnings per share attributable to equity holders of the Company:	15		
Basic		**35.6 cents**	26.2 cents
Diluted		**NA**	NA

Consolidated Balance Sheet

31 December 2007

(Prepared under International Financial Reporting Standards)

	Notes	**2007** **RMB'000**	2006 RMB'000
NON-CURRENT ASSETS			
Property, plant and equipment	16	**61,691,673**	54,767,664
Lease prepayments	17	**1,046,042**	1,013,529
Intangible asset	18	**75,194**	–
Interests in associates	21	**9,542,677**	9,255,474
Advance payments for aircraft and related equipment		**7,652,365**	6,976,054
Deposits for aircraft under operating leases		**257,505**	259,681
Long term receivable from ultimate holding company	22	**331,813**	431,813
Available-for-sale investments	23	**1,997**	6,704
Deferred tax assets	24	**626,645**	1,064,157
		81,225,911	73,775,076
CURRENT ASSETS			
Aircraft held for sale	25	**184,728**	–
Inventories	26	**1,142,050**	1,015,266
Accounts receivable	27	**2,794,280**	2,835,227
Bills receivable		**1,599**	–
Prepayments, deposits and other receivables	28	**1,318,062**	1,077,036
Derivative financial instruments	49(c)	**6,493**	99,935
Pledged deposits	29	**118,624**	211,504
Cash and cash equivalents	29	**3,906,520**	5,159,181
Due from ultimate holding company	30	**335,129**	289,933
Due from related companies	31	**22,881**	14,378
		9,830,366	10,702,460
TOTAL ASSETS		**91,056,277**	84,477,536
CURRENT LIABILITIES			
Air traffic liabilities		**(2,156,104)**	(1,530,484)
Accounts payable	32	**(5,930,800)**	(5,221,061)
Bills payable	33	**–**	(651,345)
Other payables and accruals	34	**(4,350,281)**	(4,192,887)
Derivative financial instruments	49(c)	**(14,826)**	(242,108)
Tax payable		**(1,111,404)**	(534,273)
Obligations under finance leases	35	**(2,216,680)**	(2,354,905)
Bank and other loans	36	**(10,978,835)**	(11,139,021)
Provision for major overhauls	37	**(83,907)**	(47,318)
Due to related companies	31	**(45,142)**	(39,989)
		(26,887,979)	(25,953,391)
NET CURRENT LIABILITIES		**(17,057,613)**	(15,250,931)
TOTAL ASSETS LESS CURRENT LIABILITIES		**64,168,298**	58,524,145

Consolidated Balance Sheet

31 December 2007

(Prepared under International Financial Reporting Standards)

	Notes	**2007** **RMB'000**	2006 RMB'000
NON-CURRENT LIABILITIES			
Obligations under finance leases	*35*	**(13,328,193)**	(11,247,855)
Bank loans, other loans and corporate bonds	*36*	**(16,615,291)**	(12,701,977)
Provision for major overhauls	*37*	**(1,190,415)**	(921,929)
Provision for early retirement benefits obligations		**(164,837)**	(201,199)
Long term payables	*38*	**(190,005)**	(252,591)
Deferred income	*39*	**(872,023)**	(948,966)
Deferred tax liabilities	*24*	**(300,181)**	(513,935)
		(32,660,945)	(26,788,452)
NET ASSETS		**31,507,353**	31,735,693
EQUITY ATTRIBUTABLE TO EQUITY HOLDERS OF THE COMPANY			
Issued share capital	*40*	**12,251,362**	12,251,362
Treasury shares	*41*	**(1,283,492)**	(1,246,955)
Reserves	*42*	**19,551,280**	18,117,084
Proposed final dividend	*14*	**837,987**	602,767
		31,357,137	29,724,258
MINORITY INTERESTS		**150,216**	2,011,435
TOTAL EQUITY		**31,507,353**	31,735,693

Cai Jianjiang
Director

Fan Cheng
Director

Consolidated Statement of Changes in Equity

Year ended 31 December 2007

(Prepared under International Financial Reporting Standards)

	Attributable to equity holders of the Company									
	Issued share capital	Treasury shares	Capital reserve	Reserve funds	Retained profits	Foreign exchange translation reserve	Proposed final dividend	Total	Minority interests	Total equity
	RMB'000	*RMB'000*	*RMB'000*	*RMB'000*	*RMB'000*	*RMB'000*	*RMB'000*	*RMB'000*	*RMB'000*	*RMB'000*
As at 1 January 2006	9,433,211	–	7,731,926	362,884	2,373,794	(34,367)	224,793	20,092,241	1,458,365	21,550,606
Profit for the year	–	–	–	–	2,687,841	–	–	2,687,841	617,256	3,305,097
Final 2005 dividend declared	–	–	–	–	–	–	(224,793)	(224,793)	–	(224,793)
Proposed final 2006 dividend *(note 14(a))*	–	–	–	–	(602,767)	–	602,767	–	–	–
Transfer to reserve funds *(note 14(b))*	–	–	–	405,514	(405,514)	–	–	–	–	–
Issue of new shares	2,818,151	–	5,897,294	–	–	–	–	8,715,445	–	8,715,445
Shares issue expenses	–	–	(145,097)	–	–	–	–	(145,097)	–	(145,097)
New capital contribution by a minority shareholder of a subsidiary	–	–	–	–	–	–	–	–	451	451
Dividends paid to minority shareholders by subsidiaries	–	–	–	–	–	–	–	–	(10,571)	(10,571)
Elimination for reciprocal shareholding *(note 41)*	–	(1,246,955)	–	–	–	–	–	(1,246,955)	–	(1,246,955)
Exchange realignment	–	–	–	–	–	(154,424)	–	(154,424)	(54,066)	(208,490)
As at 31 December 2006 and 1 January 2007	12,251,362	(1,246,955)	13,484,123*	768,398*	4,053,354*	(188,791)*	602,767	29,724,258	2,011,435	31,735,693
Profit for the year	–	–	–	–	4,228,997	–	–	4,228,997	(107,497)	4,121,500
Final 2006 dividend declared	–	–	–	–	–	–	(602,767)	(602,767)	–	(602,767)
Proposed final 2007 dividend *(note 14(a))*	–	–	–	–	(837,987)	–	837,987	–	–	–
Transfer to reserve funds *(note 14(b))*	–	–	–	582,602	(582,602)	–	–	–	–	–
Acquisition of minority interest of a subsidiary	–	–	(1,294,115)	–	–	–	–	(1,294,115)	(1,738,839)	(3,032,954)
Share of reserves of associates	–	–	138,272	–	–	–	–	138,272	–	138,272
Dividends paid to minority shareholders by subsidiaries	–	–	–	–	–	–	–	–	(1,077)	(1,077)
Elimination for reciprocal shareholding *(note 41)*	–	(36,537)	–	–	–	–	–	(36,537)	–	(36,537)
Exchange realignment	–	–	–	–	–	(800,971)	–	(800,971)	(13,806)	(814,777)
As at 31 December 2007	**12,251,362**	**(1,283,492)**	**12,328,280***	**1,351,000***	**6,861,762***	**(989,762)***	**837,987**	**31,357,137**	**150,216**	**31,507,353**

* The aggregate of these reserve accounts represents the consolidated reserves of RMB19,551,280,000 (2006: RMB18,117,084,000) in the consolidated balance sheet.

Consolidated Cash Flow Statement

Year ended 31 December 2007
(Prepared under International Financial Reporting Standards)

	Notes	2007 RMB'000	2006 RMB'000
CASH FLOWS FROM OPERATING ACTIVITIES			
Profit before tax		**5,606,113**	3,929,221
Adjustments for:			
Exchange gains, net		**(1,979,293)**	(980,849)
Gains on fuel derivatives, net	8	**(235,944)**	(113,225)
Dividend income from available-for-sale investments	8	**(224)**	(265)
Share of profits and losses of associates		**(1,364,740)**	(517,500)
Depreciation	16	**5,554,443**	5,274,033
Gains on disposal of property, plant and equipment, net	5	**(165,311)**	(17,353)
Loss on derecognition of property, plant and equipment	7	**37,138**	70,206
Amortisation of lease prepayments	17	**22,478**	21,495
Reversal of impairment of accounts receivable	7	**(1,411)**	(1,902)
Interest income	8	**(110,013)**	(80,689)
Interest expenses, net of interest capitalised	8	**1,969,326**	1,876,487
Gain on disposal of an associate		**–**	(1,592,633)
Impairment loss on available-for-sale investments	7	**4,481**	15,562
Impairment loss on aircraft held for sale	7	**142,800**	–
		9,479,843	7,882,588
Increase in inventories		**(126,784)**	(163,951)
Decrease/(increase) in accounts and bills receivable		**40,759**	(68,873)
Increase in prepayments, deposits and other receivables		**(215,065)**	(329,898)
Increase in deposits for aircraft under operating leases		**(37,645)**	(21,416)
Decrease in the amount due from ultimate holding company		**54,804**	284,283
Decrease/(increase) in amounts due from related companies		**(8,503)**	23,661
Increase in air traffic liabilities		**625,617**	53,865
Increase in accounts payable		**709,739**	619,697
Increase/(decrease) in bills payable		**(651,345)**	323,408
Increase in other payables and accruals		**184,826**	13,596
Increase/(decrease) in amounts due to related companies		**5,153**	(134,162)
Increase in provision for major overhauls		**305,075**	314,808
Increase/(decrease) in provision for early retirement benefits obligations		**(36,362)**	12,058
Recognition of deferred income		**(76,943)**	(76,943)
Cash generated from operations		**10,253,169**	8,732,721
Interest paid		**(2,267,801)**	(1,957,805)
Enterprise income tax paid in Mainland China		**(683,724)**	(562,779)
NET CASH INFLOW FROM OPERATING ACTIVITIES		**7,301,644**	6,212,137

Consolidated Cash Flow Statement

Year ended 31 December 2007

(Prepared under International Financial Reporting Standards)

	Notes	2007 RMB'000	2006 RMB'000
CASH FLOWS FROM INVESTING ACTIVITIES			
Purchases of property, plant and equipment		**(7,657,281)**	(7,127,790)
Acquisition of intangible asset		**(38,671)**	–
Proceeds from disposal of property, plant and equipment		**282,755**	337,751
Decrease/(increase) in lease prepayments		**(61,969)**	37,042
Decrease/(increase) of advance payments for aircraft and related equipment		**(676,311)**	353,268
Net cash settlements of fuel derivatives		**88,035**	381,266
Increase in amounts due from associates		**(38,310)**	(81,966)
Increase/(decrease) in amounts due to associates		**33,729**	(6,479)
Decrease/(increase) in non-pledged deposits with maturity of more than three months when acquired		**141,598**	(1,473,402)
Decrease/(increase) in pledged deposits		**92,880**	(34,929)
Interest received		**110,013**	80,689
Acquisition of minority interest of a subsidiary		**(3,032,954)**	–
Capital contributions to associates		**(2,938)**	(5,460,124)
Dividends received on long term investments		**224**	–
Dividends received from available-for-sale investments		**–**	265
Dividends received from associates		**546,832**	406,867
Receipts from the disposal of an associate		**–**	439,561
NET CASH OUTFLOW FROM INVESTING ACTIVITIES		**(10,212,368)**	(12,147,981)
NET CASH OUTFLOW BEFORE FINANCING ACTIVITIES		**(2,910,724)**	(5,935,844)
CASH FLOWS FROM FINANCING ACTIVITIES			
New bank loans, other loans and corporate bonds		**17,271,722**	14,476,780
Repayment of bank and other loans		**(12,404,754)**	(13,394,291)
Repayment of principals under finance lease obligations		**(2,361,068)**	(1,995,039)
Settlement of long term payables		**(62,586)**	(113,562)
Dividends paid to minority shareholders		**(1,077)**	(10,571)
Net proceeds from issuance of new shares		**–**	8,570,348
New capital contribution by a minority shareholder of a subsidiary		**–**	451
Dividends paid		**(602,767)**	(224,793)
NET CASH INFLOW FROM FINANCING ACTIVITIES		**1,839,470**	7,309,323
Effect of exchange rate changes on cash and cash equivalents		**(39,809)**	(33,461)
NET INCREASE/(DECREASE) IN CASH AND CASH EQUIVALENTS		**(1,111,063)**	1,340,018
Cash and cash equivalents at beginning of year		**3,588,404**	2,248,386
CASH AND CASH EQUIVALENTS AT END OF YEAR	29	**2,477,341**	3,588,404

Balance Sheet

31 December 2007

(Prepared under International Financial Reporting Standards)

	Notes	2007 RMB'000	2006 RMB'000
NON-CURRENT ASSETS			
Property, plant and equipment	16	**59,258,919**	52,021,875
Lease prepayments	17	**969,725**	991,884
Intangible asset	18	**75,194**	–
Interests in subsidiaries	19	**8,819,247**	5,736,360
Interests in joint ventures	20	**1,403,788**	1,403,788
Interests in associates	21	**933,246**	796,966
Advance payments for aircraft and related equipment		**7,652,365**	6,976,054
Deposits for aircraft under operating leases		**192,848**	186,407
Long term receivable from ultimate holding company	22	**331,813**	431,813
Available-for-sale investments	23	**3,516**	816
Deferred tax assets	24	**546,690**	997,633
		80,187,351	69,543,596
CURRENT ASSETS			
Inventories	26	**689,871**	640,888
Accounts receivable	27	**2,326,307**	2,371,867
Bills receivable		**1,599**	–
Prepayments, deposits and other receivables	28	**1,121,608**	842,699
Derivative financial instruments	49(c)	**6,493**	98,026
Pledged deposits	29	**2,486**	80,672
Cash and cash equivalents	29	**1,348,887**	2,921,900
Due from ultimate holding company	30	**350,377**	304,933
Due from related companies	31	**–**	21
		5,847,628	7,261,006
TOTAL ASSETS		**86,034,979**	76,804,602
CURRENT LIABILITIES			
Air traffic liabilities		**(2,013,038)**	(1,418,304)
Accounts payable	32	**(4,850,304)**	(4,156,278)
Bills payable	33	**–**	(610,545)
Other payables and accruals	34	**(3,663,181)**	(3,545,797)
Derivative financial instruments	49(c)	**(6,819)**	(242,108)
Tax payable		**(1,105,443)**	(530,720)
Obligations under finance leases	35	**(2,216,680)**	(2,354,905)
Bank and other loans	36	**(10,605,465)**	(10,737,064)
Provision for major overhauls	37	**(83,907)**	(47,318)
Due to related companies	31	**(27,730)**	(18,913)
		(24,572,567)	(23,661,952)
NET CURRENT LIABILITIES		**(18,724,939)**	(16,400,946)
TOTAL ASSETS LESS CURRENT LIABILITIES		**61,462,412**	53,142,650

Balance Sheet

31 December 2007

(Prepared under International Financial Reporting Standards)

	Notes	2007 RMB'000	2006 RMB'000
NON-CURRENT LIABILITIES			
Obligations under finance leases	35	**(13,328,193)**	(11,247,855)
Bank loans, other loans and corporate bonds	36	**(15,938,092)**	(12,130,330)
Provision for major overhauls	37	**(940,806)**	(696,828)
Provision for early retirement benefits obligations		**(97,015)**	(141,416)
Long term payables	38	**(158,050)**	(218,305)
Deferred income	39	**(872,023)**	(948,966)
Deferred tax liabilities	24	**(286,690)**	(502,633)
		(31,620,869)	(25,886,333)
NET ASSETS		**29,841,543**	27,256,317
EQUITY			
Issued share capital	40	**12,251,362**	12,251,362
Reserves	42	**16,752,194**	14,402,188
Proposed final dividend	14	**837,987**	602,767
TOTAL EQUITY		**29,841,543**	27,256,317

Cai Jianjiang
Director

Fan Cheng
Director

1 CORPORATE INFORMATION

Air China Limited (the "Company") was established as a joint stock limited company in Beijing, the People's Republic of China (the "PRC"), on 30 September 2004. The Company's H shares are listed on The Stock Exchange of Hong Kong Limited (the "HKSE") and the London Stock Exchange. In the opinion of the Directors, the Company's parent and ultimate holding company is China National Aviation Holding Company ("CNAHC"), a PRC state-owned enterprise under the supervision of the State Council.

On 18 August 2006, 1,639,000,000 A shares of the Company were issued at an offer price of RMB2.80 per share and listed on the Shanghai Stock Exchange. The net proceeds from the initial public offering of A shares, after deducting share issue expenses of RMB76,004,278, amounted to RMB4,513,195,722, of which RMB1,639,000,000 and RMB2,874,195,722 were credited to the Company's paid-up capital and capital reserve, respectively.

On 8 June 2006, the Company together with China National Aviation Company Limited ("CNAC", a 69%-owned subsidiary of the Company previously listed on the HKSE and was then privatised by the Company with effect from 24 January 2007), Cathay Pacific Airways Limited ("Cathay"), CITIC Pacific Limited ("CITIC") and Swire Pacific Limited ("SPAC") enter into a conditional agreement for the following transactions:

(i) sale of the Group's entire interest in Hong Kong Dragon Airlines Limited ("Dragonair") held by CNAC to Cathay for 288,596,335 shares issued by Cathay at a price of HK$13.5 per share and cash consideration of approximately HK$433 million;

(ii) acquisition of 359,170,636 shares and 40,128,292 shares in Cathay by the Company from CITIC and SPAC, respectively, at a price of HK$13.5 per share;

(iii) payment of a special interim dividend by Cathay of HK$0.32 per share after completion of the above transactions; and

(iv) issue of 1,179,151,364 H shares of the Company to Cathay at a price of HK$3.45 per H share.

The above transactions became unconditional and were completed on 28 September 2006 except for the issue of 1,179,151,364 H shares of the Company to Cathay which was completed on 27 September 2006. After completion of the above transactions, the Company has acquired, through its subsidiaries, an aggregate of 687,895,263 shares or 17.5% equity interest in Cathay which has been accounted for as an associate in the Group's consolidated financial statements since 28 September 2006.

On 24 January 2007, the Company privatised CNAC by way of a scheme of arrangement (the "Scheme") under Section 166 of the Hong Kong Companies Ordinance that comprised the following arrangements:

(i) purchase from the minority shareholders of CNAC of an aggregate of 1,048,052,000 shares in CNAC for cancellation at a price of HK$2.8 per share or at an aggregate consideration of approximately HK$2,935 million; and

(ii) purchase of an aggregate of 66,252,000 outstanding share options granted under the share option scheme of CNAC for cancellation at a price of HK$1.66 for each option or at an aggregate consideration of approximately HK$110 million with the remaining 38,126,000 share options granted under the share option scheme of CNAC forfeited by the respective option holders.

The Scheme became effective on 24 January 2007 and the listing of CNAC on the HKSE was then officially withdrawn.

The principal activities of the Company, its subsidiaries and joint ventures (collectively the "Group") and associates consist of the provision of airline, airline-related services, including aircraft engineering services, air catering services and airport ground handling services, mainly in Mainland China, Hong Kong and Macau.

The registered office of the Company is located at 9th Floor, Blue Sky Mansion, 28 Tianzhu Road, Zone A, Tianzhu Airport Industrial Zone, Shunyi District, Beijing 101312, the PRC.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of preparation

These financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRSs", which comprise standards and interpretations approved by the International Accounting Standards Board, and International Accounting Standards ("IAS") and Standing Interpretations Committee interpretations approved by the International Accounting Standards Committee that remain in effect) and the disclosure requirements of the Hong Kong Companies Ordinance. These financial statements are presented in Renminbi ("RMB") and all values are rounded to the nearest thousand (RMB'000) except when otherwise indicated.

These financial statements have been prepared on a historical cost basis, except for derivative financial instruments which have been measured at fair value and aircraft held for sale which have been stated at the lower of their carrying amounts and fair values less costs to sell.

Impact of new and revised IFRSs

The Group has adopted the following new and revised IFRSs for the first time for the current year's financial statements. Except for in certain cases, giving rise to new and revised accounting policies and additional disclosures, the adoption of these new and revised standards and interpretations has had no material effect on these financial statements.

IFRS 7	Financial Instruments: Disclosures
IAS 1 Amendment	Capital Disclosures
IFRIC-Int 8	Scope of IFRS 2
IFRIC-Int 9	Reassessment of Embedded Derivatives
IFRIC-Int 10	Interim Financial Reporting and Impairment

(a) *IFRS 7 Financial Instruments: Disclosures*

This standard requires disclosures that enable users of the financial statements to evaluate the significance of the Group's financial instruments and the nature and extent of risks arising from those financial instruments. The new disclosures are included throughout the financial statements. While there has been no effect on the financial position or results of operations of the Group, comparative information has been included where appropriate.

(b) *Amendment to IAS 1 Presentation of Financial Statements – Capital Disclosures*

This amendment requires the Group to make disclosures that enable users of the financial statements to evaluate the Group's objectives, policies and procedures for managing capital. These new disclosures are shown in note 49 to the financial statements.

(c) *IFRIC-Int 8 Scope of IFRS 2*

This interpretation requires IFRS 2 to be applied to any arrangement in which the Group cannot identify specifically some or all of the goods or services received, for which equity instruments are granted or liabilities (based on a value of the Company's equity instruments) are incurred by the Group for a consideration, and which appears to be less than the fair value of the equity instruments granted or liabilities incurred. As the Company has not issued any equity instruments to its employees and only incurred liabilities to its employees for identified services provided in accordance with its share appreciation right arrangement, the interpretation has had no effect on these financial statements.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Impact of new and revised IFRSs (Continued)

(d) IFRIC-Int 9 Reassessment of Embedded Derivatives

This interpretation requires that the date to assess whether an embedded derivative is required to be separated from the host contract and accounted for as a derivative is the date that the Group first becomes a party to the contract, with reassessment only if there is a change to the contract that significantly modifies the cash flows. As the Group has no embedded derivative requiring separation from the host contract, the interpretation has had no impact on the financial position or results of operations of the Group.

(e) IFRIC-Int 10 Interim Financial Reporting and Impairment

The Group has adopted IFRIC Interpretation 10 as at 1 January 2007, which requires that an impairment loss recognised in a previous interim period in respect of goodwill or an investment in either an equity instrument classified as available-for-sale or a financial asset carried at cost is not subsequently reversed. As the Group had no impairment losses previously reversed in respect of such assets, the interpretation has had no impact on the financial position or results of operations of the Group.

Impact of issued but not yet effective IFRSs

The Group has not applied the following new and revised IFRSs, which have been issued but are not yet effective, in these financial statements:

IFRS 2 Amendment	Share-based Payments – Vesting Conditions and Cancellations
IFRS 3 (Revised)	Business Combinations
IFRS 8	Operating Segments
IAS 1 (Revised)	Presentation of Financial Statements
IAS 1 Amendment	Puttable Financial Instruments
IAS 23 (Revised)	Borrowing Costs
IAS 27 (Revised)	Consolidated and Separate Financial Statements
IAS 32 Amendment	Puttable Financial Instruments
IFRIC-Int 11	IFRS 2 – Group and Treasury Share Transactions
IFRIC-Int 12	Service Concession Arrangements
IFRIC-Int 13	Customer Loyalty Programmes
IFRIC-Int 14	IAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction

(a) Amendment to IFRS 2 Share-based Payments – Vesting Conditions and Cancellations

This amendment will become effective for annual periods beginning on or after 1 January 2009. This amendment restricts the definition of "vesting condition" to a condition that includes an explicit or implicit requirement to provide services. Any other conditions are non-vesting conditions, which have to be taken into account to determine the fair value of the equity instruments granted. In the case that such award does not vest as the result of a failure to meet a non-vesting condition that is within the control of either the entity or the counterparty, this must be accounted for as a cancellation.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Impact of issued but not yet effective IFRSs (Continued)

(b) IFRS 3 (Revised) Business Combinations

The revised standard will become effective for annual periods beginning on or after 1 July 2009. The revised standard introduces a number of changes in the accounting for business combinations that will impact the amount of goodwill recognised, the reported results in the period that an acquisition occurs and future reported results. The changes introduced by the revised standard must be applied prospectively and will affect future acquisitions and transactions with minority interest.

(c) IFRS 8 Operating Segments

This standard will become effective for annual periods beginning on or after 1 January 2009. The standard specifies how an entity should report information about its operating segments, based on information about the components of the entity that is available to the chief operating decision maker for the purpose of allocating resources to the segments and assessing their performance. The standard also requires the disclosure of information about the products and services provided by the segments, the geographical areas in which the Group operates, and revenue from the Group's major customers. The Group expects to adopt IFRS 8 from 1 January 2009.

(d) IAS 1 (Revised) Presentation of Financial Statements

The revised standard will become effective for annual periods beginning on or after 1 January 2009. The revised standard separates owners and non-owner changes in equity. The statement of changes in equity will include only details of transactions with owners, with all non-owner changes in equity presented as a single line. In addition, the revised standard introduces the statement of comprehensive income which presents all items of income and expense recognised in profit or loss, together with all other items of recognised income and expenses, either in one single statement or in two linked statements.

(e) Amendment to IAS 1 Puttable Financial Instruments

The amendment was issued in February 2008 and will become effective for annual periods beginning on or after 1 January 2009. The amendment requires disclosure of certain information relating to puttable instruments classified as equity.

(f) IAS 23 (Revised) Borrowing Costs

The revised standard will become effective for annual periods beginning on or after 1 January 2009 and requires capitalisation of borrowing costs when such costs are directly attributable to the acquisition, construction or production of a qualifying asset.

(g) IAS 27 (Revised) Consolidated and Separate Financial Statements

The revised standard will become effective for annual periods beginning on or after 1 July 2009. The revised standard requires that a change in the ownership interest of a subsidiary be accounted for as an equity transaction. Therefore, such a change will have no impact on goodwill, nor will it give raise to a gain or loss. Furthermore, the revised standard changes the accounting for losses incurred by subsidiaries as well as the loss of control of a subsidiary. The changes introduced by the revised standard must be applied prospectively and will affect future acquisitions and transactions with minority interest.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Impact of issued but not yet effective IFRSs (Continued)

(h) *Amendment to IAS 32 Puttable Financial Instruments*

The amendment will become effective for annual periods beginning on or after 1 January 2009. The amendment requires certain puttable financial instruments and obligations arising on liquidation to be classified as equity if certain criteria are met.

(i) *IFRIC-Int 11 IFRS 2 – Group and Treasury Share Transactions*

This interpretation will become effective for annual periods beginning on or after 1 March 2007. This interpretation requires arrangements whereby an employee is granted rights to the Group's equity instruments, to be accounted for as an equity-settled scheme, even if the Group acquires the instruments from another party, or the shareholders provide the equity instruments needed. The interpretation also addresses the accounting for share-based payment transactions involving two or more entities within the Group.

(j) *IFRIC-Int 12 Service Concession Arrangements*

This interpretation will become effective for annual periods beginning on or after 1 January 2008. The interpretation requires an operator under public-to-private service concession arrangements to recognise the consideration received or receivables in exchange for the construction services as a financial asset and/or an intangible asset, based on the terms of the contractual arrangements. The interpretation also address how an operator shall apply existing IFRSs to account for the obligations and the rights arising from service concession arrangements by which a government or a public sector entity grants a contract for the construction of infrastructure used to provide public services and/or for the supply of public service.

(k) *IFRIC-Int 13 Customer Loyalty Programmes*

This interpretation will become effective for annual periods beginning on or after 1 July 2008. This interpretation requires that the loyalty award credits granted to customers as part of a sales transaction are accounted for as a separate component of the sales transaction. The consideration received in the sales transaction is allocated between the loyalty award credits and the other components of the sale. The amount allocated to the loyalty award credits is determined by reference to their fair value and is deferred until the awards are redeemed or the liability is otherwise extinguished.

(l) *IFRIC-Int 14 IAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction*

This interpretation will become effective for annual periods beginning on or after 1 January 2008. This interpretation provides guidance on how to assess the limit under IAS 19 Employee Benefits, on the amount of a refund or a reduction in future contributions in relation to a defined benefit scheme that can be recognised as an asset, in particular, when a minimum funding requirement exists.

The Group is in the process of making an assessment of the impact of these new and revised IFRSs upon initial application. So far, the impact of these new and revised IFRSs cannot be reasonably estimated except for the adoption of IFRS 8 may result in new or amended disclosure and the adoption of IFRIC-Int 13 may result in a change in accounting policy.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Basis of consolidation

The consolidated financial statements comprise the financial statements of the Company, its subsidiaries and joint ventures for the year ended 31 December 2007. The financial statements of the subsidiaries and joint ventures are prepared for the same reporting year as the Company. Adjustments are made to bring into line any dissimilar accounting policies that may exist.

Subsidiaries are fully consolidated from the date on which control is transferred to the Group and cease to be consolidated from the date on which control is transferred out of the Group. Joint ventures are proportionally consolidated from the date on which joint control is transferred to the Group and cease to be proportionally consolidated from the date on which joint control is transferred out of the Group. All significant intercompany transactions and balances within the Group are eliminated on consolidation.

Minority interests represent the interests of outside shareholders not held by the Group in the results and net assets of the Company's subsidiaries and are presented in the consolidated balance sheet separately from the shareholders' equity within equity. An acquisition of minority interests is accounted for using the entity concept method whereby the difference between the consideration and the book value of the share of the net assets acquired is recognised as an equity transaction.

Foreign currency translation

These financial statements are presented in RMB, which is the Company's functional and presentation currency. Each entity in the Group determines its own functional currency and items included in the financial statements of each entity are measured using that functional currency. Transactions in foreign currencies are initially recorded in the functional currency rates ruling at the date of the transactions. Monetary assets and liabilities denominated in foreign currencies are retranslated at the functional currency rates of exchange ruling at the balance sheet date. All differences are taken to the income statement. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates as at the dates of the initial transactions. Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined.

The functional currencies of certain overseas subsidiaries and associates are currencies other than RMB. As at the balance sheet date, the assets and liabilities of these entities are translated into RMB at the rates of exchange ruling at the balance sheet date and their income statements are translated into RMB at the weighted average exchange rates for the year. The exchange differences arising on the translation are included in the foreign exchange translation reserve within equity. On disposal of a foreign entity, the deferred cumulative amount recognised in equity relating to that particular foreign entity is recognised in the income statement.

For the purpose of the consolidated cash flow statement, the cash flows of overseas subsidiaries are translated into RMB at the exchange rates ruling at the dates of the cash flows. Frequently recurring cash flows of overseas subsidiaries which arise throughout the year are translated into RMB at the weighted average exchange rates for the year.

Subsidiaries

A subsidiary is a company whose financial and operating policies the Company controls, directly or indirectly, so as to obtain benefits from its activities.

The results of subsidiaries are included in the Company's income statement to the extent of dividends received and receivable. In the Company's balance sheet, the Company's interests in subsidiaries are stated at cost less any impairment losses.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Interests in joint ventures

The Group has interests in certain joint ventures which are considered as jointly-controlled entities. A joint venture is an entity set up by contractual arrangement whereby two or more parties undertake an economic activity that is subject to joint control. A jointly-controlled entity is a joint venture that is subject to joint control, resulting in none of the participating parties having unilateral control over the economic activity of the jointly-controlled entity.

The Group recognises its interests in joint ventures through proportionate consolidation. The Group combines its share of each of the assets, liabilities, income and expenses of the joint ventures with the similar items, line by line, in its consolidated financial statements. The financial statements of the joint ventures are prepared for the same reporting year as the Company. Adjustments are made to bring into line any dissimilar accounting policies that may exist.

Unrealised gains and losses resulting from transactions between the Group and its jointly-controlled entities are eliminated to the extent of the Group's interests in the jointly-controlled entities, except where unrealised losses provide evidence of an impairment of the asset transferred.

The results of joint ventures are included in the Company's income statement to the extent of dividends received and receivable. The Company's investments in joint ventures are treated as non-current assets and are stated at cost less any impairment losses.

Interests in associates

The Group's interests in its associates are accounted for under the equity method of accounting. An associate is an entity in which the Group has significant influence and which is neither a subsidiary nor a joint venture of the Group.

Under the equity method, the interests in associates are carried in the consolidated balance sheet at cost plus post-acquisition changes in the Group's share of net assets of the associates, less any impairment losses. Goodwill relating to the associates is included in the carrying amounts of the investments and is not amortised. The Group's share of the post-acquisition results and reserves of associates is included in the consolidated income statement and consolidated reserves, respectively. Unrealised gains and losses resulting from transactions between the Group and its associates are eliminated to the extent of the Group's interests in the associates, except where unrealised losses provide evidence of an impairment of the asset transferred.

The financial statements of the associates are prepared for the same reporting year as the Company. Adjustments are made to bring into line any dissimilar accounting policies that may exist.

The results of associates are included in the Company's income statement to the extent of dividends received and receivable. The Company's interests in associates are treated as non-current assets and are stated at cost less any impairment losses.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Goodwill

Goodwill arising on the acquisition of subsidiaries, associates and jointly-controlled entities represents the excess of the cost of the business combination over the Group's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities as at the date of acquisition. Following initial recognition, goodwill is measured at cost less any accumulated impairment losses. In the case of associates and joint ventures, goodwill is included in the carrying amount thereof, rather than as a separately identified asset on the consolidated balance sheet. Goodwill is reviewed for impairment annually or more frequently if events or changes in circumstances indicate that the carrying amount may be impaired.

For the purpose of impairment testing, goodwill acquired in a business combination is, from the acquisition date, allocated to each of the Group's cash-generating units, or groups of cash-generating units, that are expected to benefit from the synergies of the combination, irrespective of whether other assets or liabilities of the Group are assigned to those units or groups of units.

Impairment is determined by assessing the recoverable amount of the cash-generating unit (group of cash-generating units), to which the goodwill relates. Where the recoverable amount of the cash-generating unit (group of cash-generating units) is less than the carrying amount, an impairment loss is recognised. An impairment loss recognised for goodwill is not reversed in a subsequent period. Where goodwill forms part of a cash-generating unit (group of cash-generating units) and part of the operation within that unit is disposed of, the goodwill associated with the operation disposed of is included in the carrying amount of the operation when determining the gain or loss on disposal of the operation. Goodwill disposed of in this circumstance is measured based on the relative values of the operation disposed of and the portion of the cash-generating unit retained.

Related parties

A party is considered to be related to the Group if:

(a) the party, directly or indirectly through one or more intermediaries, (i) controls, is controlled by, or is under common control with, the Group; (ii) has an interest in the Group that gives it significant influence over the Group; or (iii) has joint control over the Group;

(b) the party is an associate;

(c) the party is a jointly-controlled entity;

(d) the party is a member of the key management personnel of the Group or its parent;

(e) the party is a close member of the family of any individual referred to in (a) or (d); or

(f) the party is an entity that is controlled, jointly controlled or significantly influenced by or for which significant voting power in such entity resides with, directly or indirectly, any individual referred to in (d) or (e).

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Property, plant and equipment and depreciation

Property, plant and equipment other than construction in progress are stated at cost less accumulated depreciation and any impairment losses. When an item of property, plant and equipment is classified as held for sale or when it is part of a disposal group classified as held for sale, it is not depreciated and is accounted for in accordance with IFRS 5, as further explained in the accounting policy for "non-current assets and disposal groups held for sale". The cost of an item of property, plant and equipment comprises its purchase price and any directly attributable costs of bringing the asset to its working condition and location for its intended use. Expenditure incurred after items of property, plant and equipment have been put into operation, such as repairs and maintenance, is normally charged to the income statement in the period in which it is incurred. In situations where it can be clearly demonstrated that the expenditure has resulted in an increase in the future economic benefits expected to be obtained from the use of an item of property, plant and equipment, and where the cost of the item can be measured reliably, the expenditure is capitalised as an additional cost of that asset or as a replacement.

When each major overhaul is performed, its cost is recognised in the carrying amount of the property, plant and equipment as a replacement if the recognition criteria are satisfied. Any remaining carrying amount of the cost of the previous inspection (as distinct from physical pacts) is derecognised.

Depreciation is calculated on the straight-line basis to write off the cost of each item of property, plant and equipment to its residual value over its estimated useful life. The principal estimated useful lives and residual values used for this purpose are as follows:

	Estimated useful life	Residual value
Aircraft and flight equipment	2 to 20 years	Nil to 5%
Buildings	15 to 35 years	5%
Machinery, transportation equipment and office equipment	4 to 20 years	5%

Where parts of an item of property, plant and equipment have different useful lives, the cost of that item is allocated on a reasonable basis among the parts and each part is depreciated separately.

The assets' residual values, useful lives and depreciation method are reviewed, and adjusted if appropriate, at each year end.

Construction in progress represents buildings or various infrastructure projects under construction, and equipment pending installation in aircraft which is stated at cost less any impairment losses and is not depreciated. Costs of construction in progress comprise the direct costs of construction, the cost of equipment as well as capitalised borrowing costs on related borrowed funds during the construction or installation period. Construction in progress is reclassified to the appropriate category of property, plant and equipment when completed and ready for use.

An item of property, plant and equipment is derecognised upon disposal or when no future economic benefits are expected from its use or disposal. Any gain or loss arising on derecognition of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the asset) is included in the income statement in the year the asset is derecognised.

The carrying amounts of property, plant and equipment are reviewed for impairment when events or changes in circumstances indicate that the carrying amounts may not be recoverable.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Non-current assets and disposal groups held for sale

Non-current assets and disposal groups are classified as held for sale if their carrying amounts will be recovered principally through a sale transaction rather than through continuing use. For this to be the case, the asset or disposal group must be available for immediate sale in its present condition subject only to terms that are usual and customary for the sale of such assets or disposal groups and its sale must be highly probable.

Non-current assets and disposal groups classified as held for sale are measured at the lower of their carrying amounts and fair values less costs to sell.

Lease prepayments

Lease prepayments represent acquisition costs of land use rights less accumulated amortisation and any impairment losses. The prepaid land lease payments are amortised on the straight-line basis over the lease terms.

Intangible assets

The useful lives of intangible assets are assessed to be either finite or indefinite. Intangible assets with finite lives are amortised over the useful economic life and assessed for impairment whenever there is an indication that the intangible asset may be impaired. The amortisation period and the amortisation method for an intangible asset with a finite useful life are reviewed at least at each balance sheet date.

Intangible assets with indefinite useful lives are tested for impairment annually either individually or at the cash-generating unit level. Such intangible assets are not amortised. The useful life of an intangible asset with an indefinite life is reviewed annually to determine whether indefinite life assessment continues to be supportable. If not, the change in the useful life assessment from indefinite to finite is accounted for on a prospective basis.

Leases

The determination of whether an arrangement is, or contains, a lease is based on the substance of the arrangement and requires an assessment of whether the fulfilment of the arrangement is dependent on the use of a specific asset or assets and the arrangement conveys a right to use the asset.

Finance leases, which transfer to the Group substantially all the risks and benefits incidental to ownership of the leased item, are capitalised at the inception of the lease at the fair value of the leased asset or, if lower, at the present value of the minimum lease payments. Minimum lease payments are apportioned between the finance charges and reduction in the outstanding liability so as to achieve a constant periodical rate of interest on the remaining balance of the liability. Finance charges are charged to the income statement.

Capitalised leased assets are depreciated over the shorter of the estimated useful life of the asset and the lease term, if there is no reasonable certainty that the Group will obtain ownership by the end of the lease term.

Leases where the lessor retains substantially all the risks and benefits of ownership of the asset are classified as operating leases. Where the Group is the lessee, rentals payable under operating leases are charged to the income statement on the straight-line basis over the lease terms.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Advance payments for aircraft and related equipment

Advance contract payments to aircraft manufacturers to secure deliveries of aircraft and related equipment in future years, including attributable finance costs, are included in assets. The advances are accounted for as part of the costs of property, plant and equipment upon delivery of the aircraft and related equipment.

Impairment of non-financial assets other than goodwill

The Group assesses at each reporting date whether there is an indication that an asset may be impaired. Indefinite life intangible assets are tested for impairment annually and at other times when such indictor exists. Other non-financial assets are tested for impairment when there are indicators that the carrying amounts may not be recoverable. If any such indication exists, or when annual impairment testing for an asset is required, the Group makes an estimate of the asset's recoverable amount. An asset's recoverable amount is the higher of an asset's or cash-generating unit's fair value less cost to sell and its value in use, and is determined for an individual asset, unless the asset does not generate cash inflows that are largely independent of those from other assets or groups of assets, in which case, the recoverable amount is determined for the cash-generating unit to which the asset belongs. Where the carrying amount of an asset exceeds its recoverable amount, the asset is considered impaired and is written down to its recoverable amount. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. Impairment losses of continuing operations are recognised in the income statement in the period in which it arises in those expense categories consistent with the function of the impaired asset.

An assessment is made at each reporting date as to whether there is any indication that previously recognised impairment losses may no longer exist or may have decreased. If such indication exists, the recoverable amount is estimated. A previously recognised impairment loss of an asset other than goodwill is reversed only if there has been a change in the estimates used to determine the asset's recoverable amount since the last impairment loss was recognised. If that is the case, the carrying amount of the asset is increased to its recoverable amount. That increased amount cannot exceed the carrying amount that would have been determined, net of depreciation, had no impairment loss been recognised for the asset in prior years. Such reversal is recognised in the income statement.

Investments and other financial assets

Financial assets in the scope of IAS 39 are classified as financial assets at fair value through profit or loss, loans and receivables, held-to-maturity investments and available-for-sale financial assets, as appropriate. When financial assets are recognised initially, they are measured at fair value, plus, in the case of investments not at fair value through profit or loss, directly attributable transactions costs. The Group assesses whether a contract contains an embedded derivative when the Group first becomes a party to it and assesses whether an embedded derivatives is required to be separated from the host contract when the analysis shows that the economic characteristics and risks of the embedded derivative are not closely related to those of the host contract. Reassessment only occurs if there is a change in the terms of the contract that significantly modifies the cash flows that would otherwise be required under the contract.

The Group determines the classification of its financial assets after initial recognition and, where allowed and appropriate, re-evaluates this designation at the balance sheet date.

All regular way purchases and sales of financial assets are recognised on the trade date, that is, the date that the Group commits to purchase or sell the asset. Regular way purchases or sales are purchases or sales of financial assets that require delivery of assets within the period generally established by regulation or convention in the marketplace.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Investments and other financial assets (Continued)

Financial assets at fair value through profit or loss

Financial assets at fair value through profit or loss include financial assets held for trading and financial assets designated upon initial recognition as at fair value through profit or loss. Financial assets are classified as held for trading if they are acquired for the purpose of selling in the near term. Derivatives, including separated embedded derivatives, are also classified as held for trading unless they are designated as effective hedging instruments or financial guarantee contracts. Gains or losses on investments held for trading are recognised in the income statement. The net fair value gain or loss recognised in the income statement does not include any dividends on these financial assets, which are recognised in accordance with the policies set out for "Revenue recognition" below.

Financial assets may be designated upon initial recognition as at fair value through profit or loss if the following criteria are met: (i) the designation eliminates or significantly reduces the inconsistent treatment that would otherwise arise from measuring the assets or recognising gains or losses on them on a different basis; (ii) the assets are part of a group of financial assets which are managed and their performance evaluated on a fair value basis, in accordance with a documented risk management strategy; or (iii) the financial asset contains an embedded derivative that would need to be separately recorded.

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Such assets are subsequently carried at amortised cost using the effective interest method less any allowance for impairment. Amortised cost is calculated taking into account any discount or premium on acquisition and includes fees that are an integral part of the effective interest rate and transaction costs. Gains and losses are recognised in the income statement when the loans and receivables are derecognised or impaired, as well as through the amortisation process.

Held-to-maturity investments

Non-derivative financial assets with fixed or determinable payments and fixed maturity are classified as held-to-maturity when the Group has the positive intention and ability to hold to maturity. Held-to-maturity investments are subsequently measured at amortised cost less any allowance for impairment. This amortised cost is computed as the amount initially recognised minus principal repayments, plus or minus the cumulative amortisation using the effective interest method of any difference between the initially recognised amount and the maturity amount.

Available-for-sale financial assets

Available-for-sale financial assets are those non-derivative financial assets in listed and unlisted equity securities that are designated as available for sale or are not classified as financial assets at fair value through profit or loss, held-to-maturity investments and loans and receivables. After initial recognition, available-for-sale financial assets are measured at fair value with gains or losses being recognised as a separate component of equity until the investment is derecognised or until the investment is determined to be impaired, at which time the cumulative gain or loss previously reported in equity is included in the income statement. Interest and dividends earned are reported as interest income and dividend income, respectively and are recognised in the income statement in accordance with the policies set out for "Revenue recognition" below. Losses arising from the impairment of such investments are recognised in the income statement as "Impairment losses on available-for-sale financial assets" and are transferred from the available-for-sale investment revaluation reserve.

When the fair value of unlisted equity securities cannot be reliably measured because (a) the variability in the range of reasonable fair value estimates is significant for that investment or (b) the probabilities of the various estimates within the range cannot be reasonably assessed and used in estimating fair value, such securities are stated at cost less any impairment losses.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Investments and other financial assets (Continued)

Fair value

The fair value of investments that are actively traded in organised financial markets is determined by reference to quoted market bid prices at the close of business on the balance sheet date. For investments where there is no active market, fair value is determined using valuation techniques. Such techniques include using recent arm's length market transactions, reference to the current market value of another instrument, which is substantially the same, discounted cash flow analysis and option pricing models.

Impairment of financial assets

The Group assesses at each balance sheet date whether a financial asset or group of financial assets is impaired.

Assets carried at amortised cost

If there is objective evidence that an impairment loss on loans and receivables carried at amortised cost has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate (i.e., the effective interest rate computed at initial recognition). The carrying amount of the asset is reduced either directly or through the use of an allowance account. The amount of the impairment loss is recognised in the income statement. Loans and receivables together with any associated allowance are written off when there is no realistic prospect of future recovery and all collateral has been realised or has been transferred to the Group.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed by adjusting the allowance account. Any subsequent reversal of an impairment loss is recognised in the income statement, to the extent that the carrying value of the asset does not exceed its amortised cost at the reversal date.

In relation to accounts receivable and other receivables, a provision for impairment is made when there is objective evidence (such as the probability of insolvency or significant financial difficulties of the debtor and significant changes in the technological, market economic or legal environment that have an adverse effect on the debtor) that the Group will not be able to collect all of the amounts due under the original terms of an invoice. The carrying amount of the receivables is reduced through the use of an allowance account. Impaired debts are derecognised when they are assessed as uncollectible.

Assets carried at cost

If there is objective evidence that an impairment loss has been incurred on an unquoted equity instrument that is not carried at fair value because its fair value cannot be reliably measured, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the current market rate of return for a similar financial asset. Impairment losses on these assets are not reversed.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Impairment of financial assets (Continued)

Available-for-sale financial assets

If an available-for-sale asset is impaired, an amount comprising the difference between its cost (net of any principal payment and amortisation) and its current fair value, less any impairment loss previously recognised in the income statement, is transferred from equity to the income statement. A provision for impairment is made for available-for-sale equity investments when there has been a significant or prolonged decline in the fair value below its cost or where other objective evidence of impairment exists. The determination of what is "significant" or "prolonged" requires judgement. In addition, the Group evaluates other factors, such as the share price volatility. Reversals of impairment loss in respect of equity instruments classified as available-for-sale are not recognised in the income statement. Reversals of impairment losses on debt instruments are reversed through the income statement, if the increase in fair value of the instruments can be objectively related to an event occurring after the impairment loss was recognised in the income statement.

Derecognition of financial assets and liabilities

Financial assets

A financial asset (or, where applicable a part of a financial asset or part of a group of similar financial assets) is derecognised where:

- the rights to receive cash flows from the asset have expired;
- the Group retains the right to receive cash flows from the asset, but has assumed an obligation to pay them in full without material delay to a third party under a "pass-through" arrangement; or
- the Group has transferred its rights to receive cash flows from the asset and either (a) has transferred substantially all the risks and rewards of the asset, or (b) has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

Where the Group has transferred its rights to receive cash flows from an asset and has neither transferred nor retained substantially all the risks and rewards of the asset nor transferred control of the asset, the asset is recognised to the extent of the Group's continuing involvement in the asset. Continuing involvement that takes the form of a guarantee over the transferred asset is measured at the lower of the original carrying amount of the asset and the maximum amount of consideration that the Group could be required to repay.

Where continuing involvement takes the form of a written and/or purchased option (including a cash-settled option or similar provision) on the transferred asset, the extent of the Group's continuing involvement is the amount of the transferred asset that the Group may repurchase, except that in the case of a written put option (including a cash-settled option or similar provision) on an asset measured at fair value, the extent of the Group's continuing involvement is limited to the lower of the fair value of the transferred asset and the option exercise price.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Derecognition of financial assets and liabilities (Continued)

Financial liabilities

A financial liability is derecognised when the obligation under the liability is discharged or cancelled or expires.

Where an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a derecognition of the original liability and the recognition of a new liability, and the difference in the respective carrying amounts is recognised in the income statement.

Financial liabilities at amortised cost (including interest-bearing loans and borrowings)

Financial liabilities including air traffic liabilities, accounts payable, other payables and accruals, bills payable, amounts due to related companies and interest-bearing loans and borrowings are initially stated at fair value less directly attributable transaction costs and are subsequently measured at amortised cost, using the effective interest method unless the effect of discounting would be immaterial, in which case they are stated at cost.

Gains and losses are recognised in the income statement when the liabilities are derecognised as well as through the amortisation process.

Financial liabilities at fair value through profit or loss

Financial liabilities at fair value through profit or loss include financial liabilities held for trading and financial liabilities designated upon initial recognition as at fair value through profit or loss.

Financial liabilities are classified as held for trading if they are acquired for the purpose of sale in the near term. Derivatives, including separated embedded derivatives, are also classified as held for trading unless they are designated as effective hedging instruments. Gains or losses on liabilities held for trading are recognised in the income statement. The net fair value gain or loss recognised in the income statement does not include any interest charged on these financial liabilities.

Where a contract contains one or more embedded derivatives, the entire hybrid contract may be designated as a financial liability at fair value through profit or loss, except where the embedded derivative does not significantly modify the cash flows or it is clear that separation of the embedded derivative is prohibited.

Financial liabilities may be designated upon initial recognition as at fair value through profit or loss if the following criteria are met: (i) the designation eliminates or significantly reduces the inconsistent treatment that would otherwise arise from measuring the liabilities or recognising gains or losses on them on a different basis; (ii) the liabilities are part of a group of financial liabilities which are managed and their performance evaluated on a fair value basis, in accordance with a documented risk management strategy; or (iii) the financial liability contains an embedded derivative that would need to be separately recorded.

Financial guarantee contracts

Financial guarantee contracts in the scope of IAS 39 are accounted for as financial liabilities. A financial guarantee contract is recognised initially at its fair value less transaction costs that are directly attributable to the acquisition or issue of the financial guarantee contract, except when such contract is recognised at fair value through profit or loss. Subsequent to initial recognition, the Group measures the financial guarantee contract at the higher of: (i) the amount determined in accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets;* and (ii) the amount initially recognised less, when appropriate, cumulative amortisation recognised in accordance with IAS 18 Revenue.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Derivative financial instruments and hedging

The Group uses derivative financial instruments to hedge its exposure to jet fuel prices. Such derivative financial instruments are initially recognised at fair value on the date on which a derivative contract is entered into and are subsequently re-measured at fair value. Derivatives are carried as assets when the fair value is positive and as liabilities when the fair value is negative.

Any gains or losses arising from changes in fair value on derivatives that do not qualify for hedge accounting are taken directly to the income statement for the year.

The fair value of such derivatives financial instruments is determined by reference to market values for similar instruments.

Treasury shares

Own equity instruments which are reacquired (treasury shares) are deducted from equity. No gain or loss is recognised in the income statement on the purchase, sale, issue or cancellation of the Group's own equity instruments.

Inventories

Inventories, which consist primarily of expendable spare parts and supplies, are stated at lower of cost and net realisable value. Cost is determined on the weighted average basis, and in the case of work in progress, comprises direct material costs, labour costs and overhead costs capitalised for the provision of aircraft engineering services. Net realisable value is determined on the basis of anticipated sales proceeds less estimated costs to be incurred to completion and disposal.

Cash and cash equivalents

Cash and cash equivalents in the balance sheets comprise cash at banks and on hand and short term deposits with an original maturity of three months or less, which are not restricted as to use.

For the purpose of the consolidated cash flow statement, cash and cash equivalents consist of cash and cash equivalents as defined above.

Manufacturers' credits

In connection with the acquisition of certain aircraft and related equipment, the Group receives various credits from the manufacturers. Such credits are deferred until the aircraft and related equipment are delivered, at which time they are applied as a reduction in the cost of acquiring the aircraft and related equipment.

Provisions

Provisions are recognised when the Group has a present obligation (legal or constructive) as a result of a past event and it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. The expense relating to any provision is recognised in the income statement. If the effect of the time value of money is material, provisions are discounted using a current pre-tax rate that reflects, where appropriate, the risks specific to the liability. Where discounting is used, the increase in the provision due to the passage of time is recognised as a finance cost.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Employee benefits

(a) *Pension obligations*

The full-time employees of the Group are covered by various government-sponsored pension plans under which the employees are entitled to a monthly pension based on certain formulae. Certain government agencies are responsible for the pension liability to these retired employees. The Group contributes on a monthly basis to these pension plans. Under these plans, the Group has no legal or constructive obligation for retirement benefits beyond the contributions made. Contributions to these plans are expensed as incurred.

(b) *Termination and early retirement benefits*

Termination benefits are payable whenever an employee's employment is voluntarily terminated before the normal retirement date or whenever an employee accepts voluntary redundancy in exchange for these benefits. The Group recognises termination benefits when it is demonstrably committed to either terminating the employment of current employees according to a detailed formal plan without possibility of withdrawal or providing termination benefits as a result of an offer made to encourage voluntary redundancy.

(c) *Housing benefits*

In prior years, the Group sold staff quarters to its employees, subject to a number of eligibility requirements, at below market prices. When staff quarters are identified as being subject to sale under these arrangements, the carrying value of the staff quarters is written down to the net recoverable amount. Upon sale, any difference between sales proceeds and the carrying amount of the staff quarters is charged to the income statement. The above staff quarters' allocation scheme was phased out before the incorporation of the Company in accordance with the policies of the PRC government.

In 1998, the State Council of the PRC issued a circular, which stipulated that the sale of quarters to employees at preferential prices should be withdrawn. In 2000, the State Council further issued a circular stating that cash subsidies should be made to the employees following the withdrawal of allocation of the staff quarters. However, the specific timetable and procedures to implement these policies are to be determined by the individual provincial or municipal government based on the particular situation of the province or municipality.

Based on the relevant detailed local government regulations promulgated, certain entities within the Group have adopted cash housing subsidy plans, whereby, for those eligible employees who have not been allocated with any quarters or who have not been allocated with quarters up to the prescribed standards before the staff quarters' allocation scheme was terminated, the Group will pay them one-off cash housing subsidies based on their years of service, position and other criteria. These cash housing subsidies are charged to the income statement in the year in which it was determined that the payment of such subsidies is probable and the amounts can be reasonably estimated.

In addition, all full-time employees of the Group are entitled to participate in various government-sponsored housing funds. The Group contributes on a monthly basis to these funds based on certain percentages of the salaries of the employees. The Group's liability in respect of these funds is limited to the contributions payable in each year.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Employee benefits (Continued)

(d) Share-based payment transactions

The Company operates a Share Appropriation Rights ("SARs") plan for the purpose of providing incentives and rewards to eligible participants who contribute to the success of the Group's operations. Employees (including directors) of the Group are entitled to a future cash payment (rather than an equity instrument) ("cash-settled transactions"), based on the increase in the entity's share price from a specified level over a specified period of time. The Company recognises the services received, and a liability to pay for those services, as the employees render service.

The cost of cash-settled transactions with employees is measured initially at fair value at the grant date using a binomial model. The liability is remeasured at each reporting date up to and including the settlement date, with any changes in fair value recognised in profit or loss for the period.

Maintenance and overhaul costs

In respect of aircraft and engines under operating leases, the Group has the responsibility to fulfil certain return conditions under the relevant operating leases. In order to fulfil these return conditions, major overhauls are required to be conducted on a regular basis. Accordingly, estimated costs of major overhauls for aircraft and engines under operating leases are accrued and charged to the income statement over the estimated period between overhauls using the ratios of actual flying hours/cycles and estimated flying hours/cycles between overhauls. The costs of major overhauls comprise mainly labour and materials. Differences between the estimated costs and the actual costs of overhauls are included in the income statement in the period of overhaul.

In respect of aircraft and engines owned by the Group or held under finance leases, costs of major overhauls are recognised in the carrying amount of the property, plant and equipment as a replacement if the recognition criteria are satisfied.

All other routine repair and maintenance costs incurred in restoring such aircraft and engines to their normal working condition are charged to the income statement as and when incurred.

Frequent flyer programme

For Air China Companion Club member accounts that have sufficient mileage credits to claim the lowest level of free travel, the Group records a liability for the estimated incremental costs associated with providing travel awards that are expected to be redeemed. Incremental costs include the costs of incremental fuel, meals and insurance but do not include any costs for aircraft ownership, maintenance, labour or overhead allocation. The liability is adjusted periodically based on awards earned, awards redeemed, changes in the incremental costs and changes in the Air China Companion Club programme, and is included in the balance sheet as a current liability.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Revenue recognition

Revenue is recognised to the extent that it is probable that the economic benefits will flow to the Group and the revenue can be reliably measured. The following specific recognition criteria must also be met before revenue is recognised:

(a) Provision of airline and airline-related services

Passenger revenue is recognised either when transportation services are provided or when a ticket expires unused rather than when a ticket is sold. Unused tickets generally expire one year from the date the ticket was sold, or for partially used tickets, the date of first flight. Ticket sales for transportation not yet provided are included in current liabilities as air traffic liabilities. In addition, the Group has code-sharing agreements with other airlines under which a carrier's flights can be marketed under the two-letter airline designator code of another carrier. Revenue earned under these arrangements are allocated between the code-sharing partners based on existing contractual agreements and airline industry standard pro-ratio formulae and are recognised as passenger revenue when the transportation services are provided.

Cargo and mail revenue is recognised when transportation services are provided.

Revenue from airline-related services is recognised when the relevant services are rendered.

Revenue is stated net of business tax.

(b) Sale of goods

Revenue is recognised when the significant risks and rewards of ownership of the goods have been passed to the buyer.

(c) Interest income

Revenue is recognised on a time proportion basis taking into account the principal outstanding and the effective rate of interest applicable.

(d) Dividend income

Revenue is recognised when the Group's right to receive payments is established.

(e) Rental income and aircraft and related equipment lease income

Revenue is recognised on a time proportion basis over the terms of the respective leases.

Government grants

Government grants are recognised where there is reasonable assurance that the grant will be received and all attaching conditions will be complied with. When the grant relates to an expense item, it is recognised as income over the period necessary to match the grant on a systematic basis to the costs that it is intended to compensate. Where the grant relates to an asset, the fair value is credited to a deferred income account and is released to the income statement over the expected useful life of the relevant asset by equal annual instalments.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Income tax

Current tax

Current tax assets and liabilities for the current and prior periods are measured at the amounts expected to be recovered from or paid to the taxation authorities. The tax rates and tax laws used to compute the amount are those that are enacted or substantively enacted by the balance sheet date.

Deferred tax

Deferred tax is provided, using the liability method on temporary differences at the balance sheet date between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes.

Deferred tax liabilities are recognised for all taxable temporary differences, except:

- where the deferred tax liability arises from the initial recognition of goodwill or an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and

- in respect of taxable temporary differences associated with investments in subsidiaries, associates and interests in joint ventures, where the timing of the reversal of the temporary differences can be controlled and it is probable that the temporary differences will not reverse in the foreseeable future.

Deferred tax assets are recognised for all deductible temporary differences, carry-forward of unused tax assets and unused tax losses, to the extent that it is probable that taxable profit will be available against which the deductible temporary differences, and the carry-forward of unused tax credits and unused tax losses can be utilised, except:

- where the deferred tax asset relating to the deductible temporary difference arises from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and

- in respect of deductible temporary differences associated with investments in subsidiaries, associates and interests in joint ventures, deferred tax assets are recognised only to the extent that it is probable that the temporary differences will reverse in the foreseeable future and taxable profit will be available against which the temporary differences can be utilised.

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred tax asset to be utilised. Unrecognised deferred tax assets are reassessed at each balance sheet date and are recognised to the extent that it has become probable that future taxable profit will be available to allow the deferred tax asset to be utilised .

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply to the period when the asset is realised or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted at the balance sheet date.

Current tax and deferred tax shall be charged or credited to equity if the tax relates to items that are credited or charged, in the same or a different period, directly to equity.

Deferred tax assets and deferred tax liabilities are offset if a legally enforceable right exists to set off current tax assets against current tax liabilities and the deferred taxes relate to the same taxable entity and the same taxation authority.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Borrowing costs

Borrowing costs directly attributable to the acquisition of aircraft, construction or production of qualifying assets, that is, assets that necessarily take a substantial period of time to get ready for their intended use, are capitalised as part of the costs of those assets. The capitalisation of aircraft borrowing costs ceases when the aircraft is placed into revenue earning services and the capitalisation of other assets' borrowing costs ceases when the assets are substantially ready for their intended use or sale. Investment income earned on the temporary investment of specific borrowings pending their expenditure on qualifying assets is deducted from the borrowing cost capitalised.

Where funds have been borrowed generally, and used for the purpose of obtaining qualifying assets, a capitalisation rate ranging between 4.5% and 5.9% (2006: ranging between 4.5% and 6.0%) has been applied to the expenditure on the individual assets.

All other borrowing costs are recognised as expenses when incurred.

Dividends

Final dividends proposed by the directors are classified as a separate allocation of retained profits within the equity section of the balance sheet, until they have been approved by the shareholders in a general meeting. When these dividends have been approved by the shareholders and declared, they are recognised as a liability.

Interim dividends are recognised immediately as a liability when they are proposed and declared.

Significant accounting judgements and estimates

The preparation of the Group's financial statements requires management to make judgements, estimates and assumptions that affect the reported amounts of revenue, expenses, assets and liabilities, and the disclosure of contingent liabilities, at the reporting date. However, uncertainty about these assumptions and estimates could result in outcomes that could require a material adjustment to the carrying amounts of the assets or liabilities affected in the future.

The key assumptions concerning the future and other key sources of judgments and estimation uncertainty at the balance sheet date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below.

(a) Deferred tax assets

Deferred tax assets are recognised for all unused tax losses to the extent that it is probable that taxable profit will be available against which the losses can be utilised. Significant management judgement is required to determine the amount of deferred tax assets that can be recognised, based upon the likely timing and level of future taxable profits together with future tax planning strategies. The carrying value of deferred tax assets relating to recognised tax losses as at 31 December 2007 was RMB13 million (2006: RMB16 million). The amount of unrecognised tax losses as at 31 December 2007 was RMB9 million (2006: RMB8 million). Further details are contained in note 24 and note 12 to the financial statements.

(b) Overhaul costs

Cost of overhauls for aircraft and engines under operating leases are accrued and charged to the income statement over the estimated period. This requires an estimation of the expected flying hours/cycles, overhaul costs and overhaul cycles, which are largely based on past experience of overhauls of the same or similar models of aircraft and engines. Different judgements or estimates could significantly affect the estimated overhaul provision and materially impact the results of operations.

3 SEGMENT INFORMATION

Segment information of the Group is presented by way of two segment formats: (i) on a primary segment reporting basis, by business segment; and (ii) on a secondary segment reporting basis, by geographical segment.

The Group's operating businesses are structured and managed separately, according to the nature of their operations and the services they provide. Each of the Group's business segments represents a strategic business unit that offers services which are subject to risks and returns that are different from those of the other business segments. Summary details of the business segments are as follows:

(a) the airline operations segment comprises the provision of air passenger and air cargo services;

(b) the engineering services segment comprises the provision of aircraft engineering services, including aircraft maintenance, repair and overhaul services;

(c) the airport terminal services segment comprises the provision of ground services, including check-in service, boarding service, premium class lounge service, ramp service, luggage handling service, loading and unloading services, cabin cleaning and transit services; and

(d) the "others" segment comprises the provision of air catering services and other airline-related services.

The profit before tax of a segment represents revenue less expenses directly attributable to a segment and the relevant portion of enterprise revenue less expenses that can be allocated on a reasonable basis to a segment, whether from external transactions or from transactions with other segments of the Group.

Segment assets and liabilities mainly comprise operating assets and liabilities that are directly attributable to the segment or can be allocated to the segment on a reasonable basis.

In determining the Group's geographical segments, revenue is attributed to the segments based on the origin and destination of each flight segment. Assets, which consist principally of aircraft and ground equipment, supporting the entire worldwide transportation system of the Group, are mainly located in Mainland China. An analysis of assets and capital expenditure of the Group by geographical distribution has therefore not been included.

Intersegment sales and transfers are transacted with reference to the selling prices used for sales made to third parties at the then prevailing market prices.

3 SEGMENT INFORMATION (Continued)

Business segments

The following tables present revenue, profit and certain asset, liability and expenditure information for the Group's business segments for the years ended 31 December 2007 and 2006:

Year ended 31 December 2007

	Airline operations *RMB'000*	Engineering services *RMB'000*	Airport terminal services *RMB'000*	Others *RMB'000*	Eliminations *RMB'000*	Total *RMB'000*
REVENUE						
Sales to external customers	50,028,849	487,710	509,450	304,532	–	51,330,541
Intersegment sales	–	674,123	–	190,758	(864,881)	–
Total revenue	50,028,849	1,161,833	509,450	495,290	(864,881)	51,330,541
PROFIT FROM OPERATIONS						
Segment results	3,695,437	686,601	111,793	205,177	(864,881)	3,834,127
Finance revenue	2,328,035	21,791	–	26,746	–	2,376,572
Finance costs	(1,954,476)	(13,400)	–	(1,450)	–	(1,969,326)
Share of profits and losses of associates	1,214,190	5,189	117,808	27,553		1,364,740
Profit before tax	5,283,186	700,181	229,601	258,026	(864,881)	5,606,113
Tax						(1,484,613)
Minority interests						107,497
Profit attributable to equity holders of the Company						4,228,997
ASSETS						
Segment assets	79,308,581	1,441,639	371,119	1,096,601	(1,330,985)	80,886,955
Interests in associates	9,013,689	153,911	119,317	255,760	–	9,542,677
Unallocated assets						626,645
Total assets						91,056,277
LIABILITIES						
Segment liabilities	(57,141,527)	(827,806)	(608,978)	(890,013)	1,330,985	(58,137,339)
Unallocated liabilities						(1,411,585)
Total liabilities						(59,548,924)
OTHER SEGMENT INFORMATION						
Capital expenditure (including additions to property, plant and equipment and advance payments for aircraft, and related equipment)	20,591,633	215,990	134,954	3,852	–	20,946,429
Depreciation of property, plant and equipment	5,447,151	38,594	66,324	2,374	–	5,554,443
Amortisation of lease prepayments	22,478	–	–	–	–	22,478
Impairment loss on aircraft held for sale	142,800	–	–	–	–	142,800
Impairment loss on available-for-sale investments	–	–	–	4,481	–	4,481
Decrease in fair value of derivative financial instruments	133,840	–	–	–	–	133,840
Reversal of impairment of accounts receivable	(435)	(884)	–	(92)	–	(1,411)
Recognition of deferred income	76,943	–	–	–	–	76,943

3 SEGMENT INFORMATION (Continued)

Business segments (Continued)

Year ended 31 December 2006

	Airline operations *RMB'000*	Engineering services *RMB'000*	Airport terminal services *RMB'000*	Others *RMB'000*	Eliminations *RMB'000*	Total *RMB'000*
REVENUE						
Sales to external customers	43,708,683	481,021	496,741	250,161	–	44,936,606
Intersegment sales	–	620,302	–	186,000	(806,302)	–
Total revenue	43,708,683	1,101,323	496,741	436,161	(806,302)	44,936,606
PROFIT FROM OPERATIONS						
Segment results	2,281,754	655,137	175,445	211,670	(806,302)	2,517,704
Finance revenue	1,161,287	9,456	–	7,128	–	1,177,871
Finance costs	(1,863,002)	(11,606)	–	(1,879)	–	(1,876,487)
Gain on disposal of an associate	1,592,633	–	–	–	–	1,592,633
Share of profits and losses of associates	365,639	4,797	135,169	11,895	–	517,500
Profit before tax	3,538,311	657,784	310,614	228,814	(806,302)	3,929,221
Tax						(624,124)
Minority interests						(617,256)
Profit attributable to equity holders of the Company						2,687,841
ASSETS						
Segment assets	72,975,757	1,239,259	306,758	1,182,531	(1,546,400)	74,157,905
Interests in associates	8,663,367	112,336	170,115	309,656	–	9,255,474
Unallocated assets						1,064,157
Total assets						84,477,536
LIABILITIES						
Segment liabilities	(51,130,149)	(639,936)	(475,015)	(994,935)	1,546,400	(51,693,635)
Unallocated liabilities						(1,048,208)
Total liabilities						(52,741,843)
OTHER SEGMENT INFORMATION						
Capital expenditure (including additions to property, plant and equipment and advance payments for aircraft and related equipment)	16,440,786	89,754	27,521	28,191	–	16,586,252
Depreciation of property, plant and equipment	5,168,367	41,834	56,088	7,744	–	5,274,033
Amortisation of lease prepayments	21,495	–	–	–	–	21,495
Impairment loss on available-for-sale investments	–	–	–	15,562	–	15,562
Decrease in fair value of derivative financial instruments	268,041	–	–	–	–	268,041
Impairment/(reversal of impairment) of accounts receivable	3,536	(3,579)	–	(1,859)	–	(1,902)
Recognition of deferred income	76,943	–	–	–	–	76,943

3 SEGMENT INFORMATION (Continued)

Geographical segments

The following tables present the Group's consolidated revenue by geographical segment for the years ended 31 December 2007 and 2006:

Year ended 31 December 2007

	Mainland China *RMB'000*	Hong Kong and Macau *RMB'000*	Europe *RMB'000*	North America *RMB'000*	Japan and Korea *RMB'000*	Asia Pacific and others *RMB'000*	Total *RMB'000*
Sales to external customers and total revenue	**27,702,479**	**2,848,675**	**7,616,370**	**4,678,276**	**4,475,578**	**4,009,163**	**51,330,541**

Year ended 31 December 2006

	Mainland China *RMB'000*	Hong Kong and Macau *RMB'000*	Europe *RMB'000*	North America *RMB'000*	Japan and Korea *RMB'000*	Asia Pacific and others *RMB'000*	Total *RMB'000*
Sales to external customers and total revenue	23,868,328	2,770,579	6,203,536	3,806,678	4,256,753	4,030,732	44,936,606

4 AIR TRAFFIC REVENUE

Air traffic revenue comprises revenue from the airline operations business and is stated net of business tax. An analysis of the Group's air traffic revenue during the year is as follows:

	Group	
	2007 *RMB'000*	2006 *RMB'000*
Passenger	**43,632,090**	37,564,903
Cargo and mail	**4,085,456**	4,041,227
	47,717,546	41,606,130

Pursuant to the relevant business tax rules and regulations in Mainland China, air traffic revenue for all domestic and outbound international flights is subject to business tax at a rate of 3%. All inbound international, Hong Kong and Macau regional flights are exempted from business tax. Business tax incurred and set off against air traffic revenue for the years ended 31 December 2007 amounted to approximately RMB1,224 million (2006: RMB1,039 million).

31 December 2007
(Prepared under International Financial Reporting Standards)

5 OTHER OPERATING REVENUE

	Group	
	2007	2006
	RMB'000	*RMB'000*
Bellyhold income from a joint venture *(note 50)*	**1,579,185**	1,518,925
Aircraft engineering income	**487,710**	481,021
Ground service income	**509,450**	496,741
Air catering income	**162,886**	136,581
Government grants:		
Recognition of deferred income *(note 39)*	**76,943**	76,943
Others	**131,136**	124,420
Service charges on return of unused flight tickets	**152,107**	110,825
Cargo handling service income	**62,466**	63,938
Sale of materials	**12,648**	15,055
Import and export service income	**7,850**	10,676
Training service income	**20,837**	17,839
Aircraft and related equipment lease income	**12,688**	1,323
Gain on disposal of property, plant and equipment, net	**165,311**	17,353
Others	**231,778**	258,836
	3,612,995	3,330,476

6 EMPLOYEE COMPENSATION COSTS

An analysis of the Group's employee compensation costs, including the emoluments of Directors and Supervisors, is as follows:

	Group	
	2007	2006
	RMB'000	*RMB'000*
Wages, salaries and social security costs	**4,817,539**	4,037,553
Retirement benefit costs *(note 11)*	**368,241**	276,330
Share-based benefits *(note 43)*	**23,986**	–
	5,209,766	4,313,883

7 PROFIT FROM OPERATIONS

The Group's profit from operations is arrived at after charging/(crediting):

	Group 2007 RMB'000	Group 2006 RMB'000
Auditors' remuneration	**14,261**	10,658
Depreciation *(note 16)*	**5,554,443**	5,274,033
Gains on disposal of property, plant and equipment, net	**(165,311)**	(17,353)
Loss on derecognition of property, plant and equipment	**37,138**	70,206
Amortisation of lease prepayments *(note 17)*	**22,478**	21,495
Minimum lease payments under operating leases:		
Aircraft and engines	**2,239,359**	2,069,639
Land, buildings and others	**311,262**	323,752
Impairment loss on available-for-sale investments	**4,481**	15,562
Impairment loss on aircraft held for sale *(note 25)*	**142,800**	–
Reversal of impairment of accounts receivable	**(1,411)**	(1,902)

8 FINANCE REVENUE AND FINANCE COSTS

An analysis of the Group's finance revenue and finance costs during the year is as follows:

Finance revenue

	Group 2007 RMB'000	Group 2006 RMB'000
Exchange gains, net	**2,030,391**	983,692
Interest income	**110,013**	80,689
Gains on fuel derivatives, net	**235,944**	113,225
Dividend income from available-for-sale investments	**224**	265
	2,376,572	1,177,871

Finance costs

	Group 2007 RMB'000	Group 2006 RMB'000
Interest on bank loans, other loans and corporate bonds	**1,572,793**	1,380,781
Interest on finance leases	**650,613**	601,153
Total interest	**2,223,406**	1,981,934
Less: Interest capitalised	**(254,080)**	(105,447)
	1,969,326	1,876,487

The interest capitalisation rates ranging from 4.5% to 5.9% (2006: 4.5% to 6.0%) per annum represent the cost of related borrowings during the year.

9 GAIN ON DISPOSAL OF AN ASSOCIATE

The gain on disposal of an associate in 2006 relates to the sale of the Group's equity interest in Dragonair to Cathay.

10 REMUNERATION OF DIRECTORS, SUPERVISORS AND FIVE HIGHEST PAID EMPLOYEES

Remuneration of the Company's Directors and Supervisors for the year disclosed pursuant to the Rules Governing the Listing of Securities on the Hong Kong Stock Exchange and Section 161 of the Hong Kong Companies Ordinance is as follows:

	Group	
	2007	2006
	RMB'000	*RMB'000*
Fees	**200**	179
Basic salaries, housing benefits, other allowances and benefits in kind	**1,289**	4,561
Discretionary bonuses	**1,795**	1,674
Retirement benefits	**105**	94
	3,389	6,508

10 REMUNERATION OF DIRECTORS, SUPERVISORS AND FIVE HIGHEST PAID EMPLOYEES (Continued)

	Fees RMB'000	Basic salaries, housing benefits, other allowances and benefits in kind RMB'000	Discretionary bonuses RMB'000	Retirement benefits RMB'000	Total RMB'000
Year ended 31 December 2007					
Directors					
Li Jiaxiang	–	–	–	–	–
Kong Dong	–	196	–	–	196
Wang Shixiang	–	–	–	–	–
Yao Weiting	–	–	–	–	–
Christopher Dale Pratt	–	–	–	–	–
Chen Nan Lok Philip	–	–	–	–	–
Ma Xulun	–	250	552	21	823
Cai Jianjiang	–	250	552	21	823
Fan Cheng	–	228	497	21	746
Hu Hung Lick, Henry	50	15	–	–	65
Wu Zhipan	50	–	–	–	50
Zhang Ke	50	–	–	–	50
Jia Kang	50	–	–	–	50
	200	939	1,601	63	2,803
Supervisors					
Zhang Xianlin	–	163	–	–	163
Sun Yude	–	–	–	–	–
Liao Wei	–	–	–	–	–
Zhang Huilan	–	–	–	–	–
Zhou Guoyou	–	–	–	–	–
Liu Feng	–	115	137	21	273
Liu Guoqing	–	72	57	21	150
	–	350	194	42	586
	200	1,289	1,795	105	3,389

10 REMUNERATION OF DIRECTORS, SUPERVISORS AND FIVE HIGHEST PAID EMPLOYEES (Continued)

	Fees *RMB'000*	Basic salaries, housing benefits, other allowances and benefits in kind *RMB'000*	Discretionary bonuses *RMB'000*	Retirement benefits *RMB'000*	Total *RMB'000*
Year ended 31 December 2006					
Directors					
Li Jiaxiang	–	–	–	–	–
Kong Dong	–	2,095	–	–	2,095
Wang Shixiang	–	–	–	–	–
Yao Weiting	–	–	–	–	–
Christopher Dale Pratt	–	–	–	–	–
Ma Xulun	–	121	543	19	683
Cai Jianjiang	–	121	504	19	644
Fan Cheng	–	113	441	19	573
Hu Hung Lick, Henry	50	138	–	–	188
Wu Zhipan	50	–	–	–	50
Zhang Ke	50	–	–	–	50
Jia Kang	29	–	–	–	29
	179	2,588	1,488	57	4,312
Supervisors					
Zhang Xianlin	–	1,739	–	–	1,739
Liao Wei	–	–	–	–	–
Zhang Huilan	–	–	–	–	–
Liu Feng	–	157	141	19	317
Liu Guoqing	–	77	45	18	140
	–	1,973	186	37	2,196
	179	4,561	1,674	94	6,508

Fees of RMB200,000 (2006: RMB179,000) were paid or payable to the Company's Independent Non-Executive Directors during the year. Except for allowances of RMB15,000 (2006: RMB138,000) paid to Dr. Hu Hung Lick, Henry, there were no other emolument payable to other Independent Non-Executive Directors during the year.

In addition to the above, certain Directors have been granted SARs in respect of their services to the Group, further details of which are set out in note 43 to the financial statements. The fair value of these SARs recognised in the income statement for the year ended 31 December 2007 was RMB3,339,000.

An analysis of the five highest paid employees within the Group is as follows:

	Group	
	2007 ***Number of individuals***	2006 *Number of individuals*
Directors	**1**	1
Supervisor	**–**	1
Employees	**4**	3

10 REMUNERATION OF DIRECTORS, SUPERVISORS AND FIVE HIGHEST PAID EMPLOYEES (Continued)

The emoluments paid to the four (2006: three) non-director, non-supervisor highest paid employees are as follows:

	Group	
	2007	2006
	RMB'000	*RMB'000*
Basic salaries, housing benefits, other allowances and benefits in kind	**4,688**	4,274
Retirement benefits *(note 6)*	**54**	428
	4,742	4,702

The number of these four (2006: three) non-director, non-supervisor highest paid employees whose remuneration for the year fell within the following bands:

	Group	
	2007	2006
	Number of individuals	*Number of individuals*
HK$1,000,001 to HK$1,500,000 (equivalent to 2007: RMB970,551 to RMB1,455,825; 2006: RMB1,022,501 to RMB1,533,750)	**1**	2
HK$1,500,001 to HK$2,000,000 (equivalent to 2007: RMB1,455,826 to RMB1,941,100; 2006: RMB1,533,751 to RMB2,045,000)	**3**	1
	4	3

There was no arrangement under which a Director or a Supervisor waived or agreed to waive any remuneration during the year (2006: Nil).

11 RETIREMENT BENEFIT COSTS

All of the Group's full-time employees in Mainland China are covered by a government-regulated defined contribution retirement scheme, and are entitled to an annual pension determined by their basic salaries upon their retirement. The PRC government is responsible for the pension liabilities to these retired employees. The Group is required to make annual contributions to the government-regulated defined contribution retirement scheme at rates ranging from 15% to 20% (2006: 15% to 20%) of the employees' basic salaries during the year and has no further obligation for post-retirement benefits in respect of the above. The related pension costs are expensed as incurred. Contributions to other defined contribution retirement schemes operated by the Group are charged to the income statement in the year which the contributions relate to.

The Group also implements an early retirement plan for certain employees in addition to the benefits under the government-regulated defined contribution retirement scheme described above. The benefits of the early retirement plan are calculated based on factors including the remaining number of years of services from the date of early retirement to the normal retirement date and the salary amount on the date of early retirement of the employees. The costs of early retirement benefits are recognised in the period when employees opt for early retirement. Where the effect of discounting is material, the amount recognised for early retirement benefits is the present value at the balance sheet date of the future cash flows expected to be required to settle the obligation. The increase in the discounted present value amount arising from the passage of time is included in finance costs in the income statement.

The retirement benefit costs in relation to the defined contribution retirement scheme and the early retirement benefits are as follows:

	Group	
	2007	2006
	RMB'000	*RMB'000*
Contributions to defined contribution retirement scheme	**332,411**	264,274
Early retirement benefit	**35,830**	12,056
Total retirement benefit costs *(note 6)*	**368,241**	276,330

No forfeited contributions were utilised during the year (2006: RMB1,407,000). As at 31 December 2007, no forfeited contributions were available to reduce its contributions to the defined contribution retirement schemes operated by the Group in future years (2006: RMB164,000).

12 TAX

According to the Enterprise Income Tax Law in Mainland China (the "Old CIT Law"), the Company, its subsidiaries, joint ventures and associates established in Mainland China are subject to enterprise income tax at rates ranging from 12% to 33% (2006: 12% to 33%) on their taxable income.

Hong Kong profits tax has been provided at a rate of 17.5% (2006: 17.5%) on the estimated assessable profits arising in Hong Kong during the year.

In accordance with the Old CIT Law and an approval document issued by the relevant tax bureau on 28 November 2005 (the "Approval Document"), Air China Cargo Co., Ltd. ("Air China Cargo") was subject to a state enterprise income tax rate of 24% and was fully exempted from state enterprise income tax for the year ended 31 December 2005, followed by a 3-year 50% reduction in state enterprise income tax during the period between 1 January 2006 and 31 December 2008. In addition, pursuant to the Approval Document, Air China Cargo has been granted a 4-year local enterprise income tax exemption during the period between 1 January 2005 and 31 December 2008, followed by a 5-year 50% reduction in local enterprise income tax during the period between 1 January 2009 and 31 December 2013.

12 TAX (Continued)

During the 5th Session of the 10th National People's Congress, which was concluded on 16 March 2007, the People's Republic of China Corporate Income Tax Law (the "New CIT Law") was approved and became effective on 1 January 2008. The New CIT Law introduces a wide range of changes which include, but are not limited to, the unification of the corporate income tax rate for both domestic enterprises and foreign-invested enterprises at 25%. The New CIT Law also lays down principles for transitional arrangements relating to tax incentives (reduced tax and tax holidays) enjoyed by enterprises under the Old CIT Law. Therefore, deferred tax assets and liabilities of the Group are measured at the 25% tax rate or other applicable tax rates that are expected to apply to annual periods beginning on or after 1 January 2008 when the deferred tax asset is realised or the deferred tax liability is settled.

The determination of current and deferred income tax was based on enacted tax rates. Major components of income tax charge are as follows:

	Group	
	2007	2006
	RMB'000	*RMB'000*
Current income tax – Mainland China	**1,260,855**	675,975
Deferred income tax – origination and reversal of temporary differences *(note 24)*	**223,758**	(51,851)
Income tax charge for the year	**1,484,613**	624,124

The share of tax attributable to associates amounting to RMB193,915,329 (2006: RMB113,577,000) is included in the "Share of profits and losses of associates" on the face of the consolidated income statement.

A reconciliation of income tax expense applicable to profit before tax at the statutory income tax rate in Mainland China to income tax expense at the Group's effective income tax rate, and a reconciliation of the applicable rate (i.e., the statutory tax rate) to the effective tax rate are as follows:

	Group			
	2007		2006	
	RMB'000	***%***	*RMB'000*	%
Profit before tax	**5,606,113**		3,929,221	
At statutory income tax rate of 33%	**1,850,017**	**33.0**	1,296,643	33.0
Tax effect of share of profits and losses of associates, net	**(450,364)**	**(8.0)**	(170,775)	(4.3)
Lower income tax rates of other territories	**54,074**	**0.9**	(20,718)	(0.5)
Income not subject to tax	**(27,716)**	**(0.5)**	(614,323)	(15.6)
Expenses not deductible for tax purposes	**(27,247)**	**(0.5)**	125,004	3.2
Tax losses not recognised	**8,844**	**0.2**	8,293	0.2
Effect on opening deferred income tax due to a decrease in income tax rates	**77,005**	**1.4**	–	–
At the Group's effective income tax rate	**1,484,613**	**26.5**	624,124	16.0

As at 31 December 2007, there was no significant unrecognised deferred tax liability (2006: Nil) for taxes that would be payable on the unremitted earnings of certain of the Group's subsidiaries and joint ventures as the Directors of the Company have no intention to request remittance of any significant amount of earnings to the Company in the foreseeable future.

There are no income tax consequences attaching to the payment of dividends by the Company to its shareholders.

13 PROFIT ATTRIBUTABLE TO EQUITY HOLDERS OF THE COMPANY

The consolidated profit attributable to the equity holders of the Company for the year ended 31 December 2007 includes a profit of approximately RMB3,097 million (2006: RMB1,226 million), which was arrived at after deducting dividend income received from subsidiaries, joint ventures and associates aggregating approximately RMB91 million (2006: RMB39 million) from the Company's profit of approximately RMB3,188 million (2006: RMB1,265 million) that has been dealt with in the financial statements of the Company (note 42).

14 APPROPRIATIONS

	Company	
	2007	2006
	RMB'000	*RMB'000*
Proposed final dividend – RMB0.684 (2006: RMB0.492) per 10 shares	**837,987**	602,767

(a) The proposed final dividend of RMB0.684 (2006: RMB0.492) per 10 shares for the year is subject to the approval of the Company's shareholders at the forthcoming annual general meeting.

Cash dividends to shareholders in Hong Kong will be paid in Hong Kong dollars.

(b) Under the Company Law and the Company's articles of association in Mainland China, profit after tax as reported in the PRC statutory financial statements can only be distributed as dividends after allowance has been made for the following:

(i) making up prior years' cumulative losses, if any;

(ii) allocations to the statutory common reserve fund of at least 10% of after-tax profit, until the fund aggregates 50% of the Company's registered capital. For the purpose of calculating the transfer to reserves, the profit after tax shall be the amount determined under China Accounting Standards ("CAS"). The transfer to this reserve must be made before any distribution of dividends to shareholders.

The statutory common reserve fund can be used to offset previous years' losses, if any, and part of the statutory common reserve fund can be capitalised as the Company's share capital provided that the amount of such reserve remaining after the capitalisation shall not be less than 25% of the share capital of the Company;

(iii) in the prior year, allocations of 5% to 10% of after-tax profit, as determined under Accounting Standards for Business Enterprises and Accounting Regulations for Business Enterprises, to the Company's statutory public welfare fund. Pursuant to the relevant PRC regulations, the appropriation of public welfare fund was discontinued with effect from 1 January 2006. The balance brought forward from prior years was then transferred to the statutory common reserve; and

(iv) Allocations to the discretionary common reserve if approved by the shareholders.

The above reserves cannot be used for purposes other than those for which they are created and are not distributable as cash dividends.

In accordance with the articles of association of the Company, the profit after tax of the Company for the purpose of dividend payment is based on the lesser of (i) the profit determined in accordance with CAS; and (ii) the profit determined in accordance with IFRSs.

15 EARNINGS PER SHARE ATTRIBUTABLE TO EQUITY HOLDERS OF THE COMPANY

The calculation of basic earnings per share for the year ended 31 December 2007 is based on the profit attributable to equity holders of the Company for the year ended 31 December 2007 of approximately RMB4,229 million, and the weighted average number of 11,878,992,909 ordinary shares in issue during the year, as adjusted to reflect the weighted average number of treasury shares held by Cathay through reciprocal shareholding.

The calculation of basic earnings per share for the year ended 31 December 2006 is based on the profit attributable to equity holders of the Company for the year ended 31 December 2006 of approximately RMB2,688 million, and the weighted average number of 10,256,259,793 ordinary shares in issue during the year, as adjusted to reflect the weighted average number of treasury shares held by Cathay through reciprocal shareholding.

Diluted earnings per share for the years ended 31 December 2007 and 2006 have not been disclosed because no diluting events existed during both years.

16 PROPERTY, PLANT AND EQUIPMENT

Group

	Aircraft and flight equipment *RMB'000*	Buildings *RMB'000*	Machinery *RMB'000*	Transportation equipment *RMB'000*	Office equipment *RMB'000*	Construction in progress *RMB'000*	Total *RMB'000*
As at 1 January 2006, net of accumulated depreciation	41,767,629	2,572,551	982,540	318,936	122,985	1,426,087	47,190,728
Additions	10,507,612	20,333	96,578	117,456	54,354	2,453,470	13,249,803
Disposals	(335,251)	(30,208)	(12,416)	(10,393)	(2,336)	–	(390,604)
Transfer from construction in progress	1,241,246	222,893	65,434	131,257	296	(1,661,126)	–
Depreciation charge for the year	(4,837,545)	(125,234)	(176,362)	(92,940)	(41,952)	–	(5,274,033)
Exchange adjustment	(5,846)	(1,608)	–	(776)	–	–	(8,230)
As at 31 December 2006 and 1 January 2007, net of accumulated depreciation	48,337,845	2,658,727	955,774	463,540	133,347	2,218,431	54,767,664
Additions	9,231,312	6,036	112,445	172,058	60,635	3,711,578	13,294,064
Disposals	(383,744)	(74,636)	(2,941)	(6,038)	(811)	–	(468,170)
Transfer from construction in progress	1,964,974	239,364	86,429	91,694	1,070	(2,383,531)	–
Reclassified to current assets held for sale *(note 25)*	(327,528)	–	–	–	–	–	(327,528)
Depreciation charge for the year	(5,058,427)	(125,237)	(193,679)	(132,714)	(44,386)	–	(5,554,443)
Exchange adjustment	(13,269)	(4,574)	–	(2,071)	–	–	(19,914)
As at 31 December 2007, net of accumulated depreciation	**53,751,163**	**2,699,680**	**958,028**	**586,469**	**149,855**	**3,546,478**	**61,691,673**
As at 31 December 2006 and 1 January 2007							
Cost	81,308,583	3,873,170	2,310,773	1,265,628	318,382	2,218,431	91,294,967
Accumulated depreciation	(32,970,738)	(1,214,443)	(1,354,999)	(802,088)	(185,035)	–	(36,527,303)
Net book value	48,337,845	2,658,727	955,774	463,540	133,347	2,218,431	54,767,664
As at 31 December 2007							
Cost	**89,419,255**	**4,007,940**	**2,493,040**	**1,489,509**	**374,775**	**3,546,478**	**101,330,997**
Accumulated depreciation	**(35,668,092)**	**(1,308,260)**	**(1,535,012)**	**(903,040)**	**(224,920)**	**–**	**(39,639,324)**
Net book value	**53,751,163**	**2,699,680**	**958,028**	**586,469**	**149,855**	**3,546,478**	**61,691,673**

16 PROPERTY, PLANT AND EQUIPMENT (Continued)

Company

	Aircraft and flight equipment RMB'000	Buildings RMB'000	Machinery RMB'000	Transportation equipment RMB'000	Office equipment RMB'000	Construction in progress RMB'000	Total RMB'000
As at 1 January 2006, net of accumulated depreciation	40,608,439	1,951,581	779,068	203,944	96,215	1,386,216	45,025,463
Additions	9,792,550	12,631	60,439	82,326	43,139	2,358,575	12,349,660
Disposals	(328,114)	(27,310)	(3,134)	(3,303)	(2,133)	–	(363,994)
Transfer from construction in progress	1,231,652	168,976	57,168	122,504	296	(1,580,596)	–
Depreciation charge for the year	(4,664,092)	(90,451)	(137,759)	(62,901)	(34,051)	–	(4,989,254)
As at 31 December 2006 and 1 January 2007, net of accumulated depreciation	46,640,435	2,015,427	755,782	342,570	103,466	2,164,195	52,021,875
Additions	9,176,250	–	67,933	135,469	46,700	3,401,865	12,828,217
Disposals	(337,853)	(9,735)	(736)	(2,459)	(292)	–	(351,075)
Transfer from construction in progress	1,964,974	234,732	81,927	91,694	1,070	(2,374,397)	–
Depreciation charge for the year	(4,843,730)	(93,745)	(160,706)	(107,665)	(34,252)	–	(5,240,098)
As at 31 December 2007, net of accumulated depreciation	**52,600,076**	**2,146,679**	**744,200**	**459,609**	**116,692**	**3,191,663**	**59,258,919**
As at 31 December 2006 and 1 January 2007							
Cost	77,931,225	2,961,806	1,749,995	993,787	205,304	2,164,195	86,006,312
Accumulated depreciation	(31,290,790)	(946,379)	(994,213)	(651,217)	(101,838)	–	(33,984,437)
Net book value	46,640,435	2,015,427	755,782	342,570	103,466	2,164,195	52,021,875
As at 31 December 2007							
Cost	**88,146,626**	**3,183,536**	**1,891,739**	**1,193,658**	**250,943**	**3,191,663**	**97,858,165**
Accumulated depreciation	**(35,546,550)**	**(1,036,857)**	**(1,147,539)**	**(734,049)**	**(134,251)**	**–**	**(38,599,246)**
Net book value	**52,600,076**	**2,146,679**	**744,200**	**459,609**	**116,692**	**3,191,663**	**59,258,919**

As at 31 December 2007, certain of the Group's aircraft and buildings with an aggregate net book value of approximately RMB12,255 million (2006: RMB17,625 million) were pledged to secure certain bank loans of the Group (note 36(a)).

The aggregate net book value of aircraft held under finance leases included in the property, plant and equipment of the Group amounted to RMB21,948 million (2006: RMB16,589 million) (note 35(a)).

As at 31 December 2007, the Group was in the process of applying for the title certificates of certain of its buildings with an aggregate net book value of approximately RMB114 million (2006: RMB131 million) transferred from Air China International Corporation, the predecessor of the Company, upon incorporation. The Group was also in the process of applying for title certificates of certain buildings acquired by the Group after incorporation with an aggregate net book value of approximately RMB384 million (2006: RMB178 million). The Directors of the Company are of the view that the Group is entitled to lawfully and validly occupy and use the above-mentioned buildings. The Directors of the Company are also of the opinion that the aforesaid matter did not have any significant impact on the Group's financial position as at 31 December 2007.

17 LEASE PREPAYMENTS

	Group		Company	
	2007	2006	**2007**	2006
	RMB'000	*RMB'000*	***RMB'000***	*RMB'000*
Cost				
As at 1 January	**1,056,558**	1,096,715	**1,034,219**	1,076,850
Additions	**61,969**	57,334	**5,162**	54,860
Disposal	**(7,302)**	(97,491)	**(7,302)**	(97,491)
As at 31 December	**1,111,225**	1,056,558	**1,032,079**	1,034,219
Accumulated amortisation				
As at 1 January	**(43,029)**	(24,649)	**(42,335)**	(24,357)
Amortisation for the year	**(22,478)**	(21,495)	**(20,343)**	(21,093)
Disposal	**324**	3,115	**324**	3,115
As at 31 December	**(65,183)**	(43,029)	**(62,354)**	(42,335)
Net book value				
As at 31 December	**1,046,042**	1,013,529	**969,725**	991,884

As at 31 December 2007, certain of the Group's land use rights, which are accounted for as lease prepayments in the Group's consolidated financial statements, with an aggregate net book value of approximately RMB37 million (2006: RMB37 million) were pledged to secure certain of the Group's bank loans (note 36(a)).

As at 31 December 2007, the Group was in the process of applying for the title certificates of certain land use rights acquired by the Group after incorporation with an aggregate net book value of approximately RMB5 million (2006: RMB51 million). The Directors of the Company are of the view that the Group is entitled to lawfully and validly occupy and use the above-mentioned land use rights. The Directors of the Company are also of the opinion that the aforesaid matter did not have any significant impact on the Group's financial position as at 31 December 2007.

Notes to Financial Statements

31 December 2007

(Prepared under International Financial Reporting Standards)

18 INTANGIBLE ASSET

	Group		Company	
	2007	2006	**2007**	2006
	RMB'000	*RMB'000*	***RMB'000***	*RMB'000*
Addition during the year and balance as at 31 December	**75,194**	–	**75,194**	–

The Group's intangible asset represents admission rights to Star Alliance which is stated at cost and has an indefinite useful life.

19 INTERESTS IN SUBSIDIARIES

	Company	
	2007	2006
	RMB'000	*RMB'000*
Listed shares in Hong Kong, at cost	**–**	579,472
Unlisted investments, at cost	**9,205,299**	5,600,895
Due from subsidiaries	**65,367**	55,080
Due to subsidiaries	**(451,419)**	(499,087)
	8,819,247	5,736,360
Market value of listed shares	**–**	6,325,255

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

19 INTERESTS IN SUBSIDIARIES (Continued)

Particulars of the principal subsidiaries at 31 December 2007 are as follows:

Company name	Place of incorporation/ registration and operations	Legal status	Nominal value of paid-up capital (in thousands)	Percentage of equity interests attributable to the Company Direct (%)	Indirect (%)	Principal activities
CNAC (中航興業有限公司)	Hong Kong	Limited liability company	HK$331,268	69	31	Investment holding
Air Macau Company Limited ("Air Macau") (澳門航空股份有限公司)	Macau	Limited liability company	MOP400,000	–	51	Airline operator
Air China Group Import and Export Trading Co. ("AIE") (國航集團進出口貿易公司)	PRC/ Mainland China	Limited liability company	RMB95,081	100	–	Import and export trading
Zhejiang Air Services Co., Ltd.# (浙江航空服務有限公司)	PRC/ Mainland China	Limited liability company	RMB20,000	100	–	Provision of airline catering and shuttle bus services
Air China Shantou Industrial Development Company (中國國際航空汕頭實業發展公司)	PRC/ Mainland China	Limited liability company	RMB18,000	51	–	Manufacture and retail of aircraft supplies
Air China Development Corporation (Hong Kong) Limited (國航香港發展有限公司)	Hong Kong	Limited liability company	HK$9,379	95	–	Provision of air ticketing services
Shanghai Air China Aviation Service Co., Ltd.# (formerly "Shanghai Air China Base Development Center") (上海國航航空服務有限公司，前稱「上海國航基地開發中心」)	PRC/ Mainland China	Limited liability company	RMB2,000	100	–	Provision of ground handling service, air passenger, cargo and consultancy services
Total Transform Group Limited (國航海外控股有限公司)	British Virgin Islands/ Hong Kong	Limited liability company	HK$8,427,047	99.9	0.1	Investment holding
Angel Paradise Limited	British Virgin Islands/ Hong Kong	Limited liability company	US$10	–	100	Investment holding

\# The English names of these companies are direct translations of the Chinese names.

The above table lists the subsidiaries of the Company which, in the opinion of the Directors, principally affected the results for the year ended 31 December 2007 or formed a substantial portion of the net assets of the Group at 31 December 2007. To give details of other subsidiaries would, in the opinion of the Directors, result in particulars of excessive length.

20 INTERESTS IN JOINT VENTURES

	Company 2007 RMB'000	Company 2006 RMB'000
Unlisted investments, at cost	**1,403,788**	1,403,788

Particulars of the joint ventures of the Group at 31 December 2007 are as follows:

Company name	Nominal value of paid-up capital (in thousands)	Place of incorporation/ registration and operations	Percentage of (%) Ownership interest	Voting power	Profit sharing	Principal activities
Aircraft Maintenance and Engineering Corporation, Beijing (北京飛機維修工程有限公司)	US$162,533	PRC/ Mainland China	60	57.1	60	Provision of aircraft overhaul and maintenance services
Air China Cargo (中國國際貨運航空有限公司)	RMB2,200,000	PRC/ Mainland China	51	55.6	51	Provision of cargo carriage services
Beijing Air Catering Co., Ltd.* (北京航空食品有限公司)	US$26,000	PRC/ Mainland China	60	60	60	Provision of airline catering services
Southwest Air Catering Co., Ltd.* (西南航空食品有限公司)	RMB70,000	PRC/ Mainland China	60	60	60	Provision of airline catering services
Macau Asia Express Ltd.*	MOP100,000	Macau	68	68	68	Airline Operator
SkyWork Capital Asia Ltd.*	HK0.03	Hong Kong	33	33	33	Provision of financial services

* The equity interest of these joint ventures are held indirectly through certain subsidiaries of the Company.

20 INTERESTS IN JOINT VENTURES (Continued)

As at the balance sheet date and for the two years ended 31 December 2007, the Group's proportionate share of the assets, liabilities, and the Group's proportionate share of the revenue and expenses of the joint ventures are as follows:

	Group	
	2007	2006
	RMB'000	*RMB'000*
Current assets	**1,489,241**	1,647,132
Non-current assets	**2,618,253**	2,835,754
Total assets	**4,107,494**	4,482,886
Current liabilities	**(1,393,529)**	(1,546,322)
Non-current liabilities	**(762,336)**	(571,646)
Net assets attributable to the Group	**1,951,629**	2,364,918
Revenue	**4,977,977**	5,001,632
Operating expenses	**(5,169,310)**	(4,798,109)
Finance revenue	**58,037**	25,876
Finance costs	**(48,898)**	(44,121)
Profit/(loss) before tax	**(182,194)**	185,278
Tax	**(30,245)**	(80,541)
Profit/(loss) attributable to the Group	**(212,439)**	104,737

21 INTERESTS IN ASSOCIATES

	Group		Company	
	2007	2006	**2007**	2006
	RMB'000	*RMB'000*	***RMB'000***	*RMB'000*
Listed shares in Mainland China, at cost	**–**	–	**163,477**	163,477
Unlisted investments, at cost	**–**	–	**847,982**	717,523
Share of net assets	**7,854,720**	7,569,781	**–**	–
Goodwill	**1,627,888**	1,630,205	**–**	–
Due from associates	**183,224**	144,914	**40,555**	21,784
Due to associates	**(123,155)**	(89,426)	**(118,768)**	(105,818)
	9,542,677	9,255,474	**933,246**	796,966
Market value of listed shares			**640,224**	185,136

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

As at 31 December 2007, certain number of listed shares in an associate of the Group with an aggregate market value of approximately RMB7,609 million (2006: RMB7,695 million) were pledged to secure certain bank loans of the Group (note 36(b)).

Notes to Financial Statements

31 December 2007
(Prepared under International Financial Reporting Standards)

21 INTERESTS IN ASSOCIATES (Continued)

As at 31 December 2007, the Group was in the process of completing the registration of its equity interests in certain associates with an aggregate investment cost of approximately RMB200 million (2006: RMB96 million) and carrying amount of approximately RMB564 million (2006: RMB395 million) transferred from Air China International Corporation upon incorporation. The Directors of the Company are of the view that the aforesaid matter did not have any significant impact on the Group's ownership in those equity interests and hence the Group's financial position as at 31 December 2007.

Particulars of the principal associates as at 31 December 2007 are as follows:

Company name	Place of incorporation/ registration and operations	Nominal value of registered/ issued share capital	Percentage of equity interests attributable to the Group (%)	Principal activities
Cathay*# (國泰航空有限公司)	Hong Kong	HK$787,139,514	17.5	Airline operator
Shenzhen Airlines Co., Ltd.# (深圳航空有限責任公司)	PRC/ Mainland China	RMB300,000,000	25	Airline operator
Shandong Aviation Group Corporation ("Shandong Aviation") (山東航空集團有限公司)	PRC/ Mainland China	RMB580,000,000	49.4	Investment holding
Shandong Airlines Co., Ltd. ("Shandong Airlines") (山東航空股份有限公司)	PRC/ Mainland China	RMB400,000,000	22.8	Airline operator
Sichuan SNECMA Aeroengine Maintenance Co., Ltd. ("SNECMA") (四川斯拉克瑪航空發動機維修有限公司)	PRC/ Mainland China	US$31,900,000	43.6	Provision of maintenance and repair service for aircraft engines
Chengdu Falcon Aircraft Engineering Service Co., Ltd. (成都富凱飛機工程服務有限公司)	PRC/ Mainland China	RMB16,474,293	35.6	Provision of maintenance and repair service for aircraft engines
Yunnan Airport Aircraft Maintenance Services Co., Ltd. (雲南空港飛機維修服務公司)	PRC/ Mainland China	RMB10,000,000	40	Provision of maintenance and repair service
Jardine Airport Services Limited* (怡中航空服務有限公司)	Hong Kong	HK$10,000	50	Provision of airport ground handling service
Menzies Macau Airport Services Limited* (明捷澳門機場服務有限公司)	Macau	MOP10,000,000	33.7	Provision of airport ground handling service

21 INTERESTS IN ASSOCIATES (Continued)

Company name	Place of incorporation/ registration and operations	Nominal value of registered/ issued share capital	Percentage of equity interests attributable to the Group (%)	Principal activities
Guangzhou Baiyun International Airport Ground Handling Service Company Limited (廣州白雲國際機場地勤服務有限公司)	PRC/ Mainland China	RMB100,000,000	21	Provision of airport ground handling service
Sanya World Trade Development Company Limited***## (三亞世貿發展有限公司)	PRC/ Mainland China	RMB5,000,000	40	Provision of airport ground handling service
CAAC Cares Chongqing Co., Ltd. (重慶民航凱亞信息技術有限公司)	PRC/ Mainland China	RMB9,800,000	24.5	Provision of airline-related information system service
Chengdu CAAC Southwest Cares Co., Ltd.## (成都民航西南凱亞有限責任公司)	PRC/ Mainland China	RMB2,000,000	35	Provision of airline-related information system service
Tradeport Hong Kong Limited* (香港商貿港有限公司)	Hong Kong	HK$400	25	Development and operation of a logistics centre
LSG Lufthansa Service Hong Kong Limited ("LSGHK")* (德國漢莎航空膳食服務(香港)有限公司)	Hong Kong	HK$501	20.2	Provision of airline catering services
China National Aviation Finance Co., Ltd. ("CNAF")** (中國航空集團財務有限責任公司)	PRC/ Mainland China	RMB 505,269,500	23.5	Provision of financial services
Shanghai Guocheng Aviation Travel Services Co., Ltd.## (上海國程航空旅行社有限公司)	PRC/ Mainland China	RMB 1,000,000	49	Provision of airline tickets services

* The equity interests of these associates are held indirectly through certain subsidiaries of the Company.

** 19.3% of the Group's equity interest in CNAF is held directly by the Company, and the remaining 4.2% is held indirectly through subsidiaries of the Company.

*** This associate became dormant during the current year and was in the process of deregistration as at 31 December 2007.

\# Not audited by Ernst & Young Hong Kong or other member firm of the Ernst & Young global network.

\#\# The English names of these companies are direct translations of the Chinese names.

The above table lists the associates of the Group which, in the opinion of the Directors, principally affected the result for the year ended 31 December 2007 or formed a substantial portion at the net assets of the Group at 31 December 2007. To give details of other associates would, in the opinion of the Directors, result in particulars of excessive length.

21 INTERESTS IN ASSOCIATES (Continued)

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

	Group	
	2007	2006
	RMB'000	*RMB'000*
Aggregate of associates' financial position:		
Total assets	**138,516,852**	129,330,489
Total liabilities	**(86,527,778)**	(79,777,602)
Aggregate of associates' results:		
Revenue	**89,211,451**	35,150,157
Net profit	**7,791,767**	2,102,744

Movements of goodwill are as follows:

	Group	
	2007	2006
	RMB'000	*RMB'000*
As at 1 January	**1,630,205**	1,444,367
Additions	**1,283**	1,393,370
Disposal	**–**	(1,205,390)
Exchange realignment	**(3,600)**	(2,142)
As at 31 December	**1,627,888**	1,630,205

22 LONG TERM RECEIVABLE FROM ULTIMATE HOLDING COMPANY

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

23 AVAILABLE-FOR-SALE INVESTMENTS

Available-for-sale investments consist of unlisted equity investments measured at cost.

24 DEFERRED TAX ASSETS/LIABILITIES

The movements in deferred tax during the year are as follows:

	Group		Company	
	2007	2006	**2007**	2006
	RMB'000	*RMB'000*	***RMB'000***	*RMB'000*
Balance at beginning of year	**550,222**	498,371	**495,000**	391,000
Charge for the year *(note 12)*	**(223,758)**	51,851	**(235,000)**	104,000
Balance at end of year	**326,464**	550,222	**260,000**	495,000

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

	Group		Company	
	2007	2006	**2007**	2006
	RMB'000	*RMB'000*	***RMB'000***	*RMB'000*
Deferred tax liabilities:				
Accelerated depreciation for tax purposes	**(299,181)**	(455,935)	**(285,690)**	(444,633)
Other deferred tax liabilities	**(1,000)**	(58,000)	**(1,000)**	(58,000)
Gross deferred tax liabilities	**(300,181)**	(513,935)	**(286,690)**	(502,633)
Deferred tax assets:				
Additional tax deduction on revaluation surplus arising from the Restructuring	**148,790**	351,946	**105,329**	312,946
Provisions and accruals	**362,620**	507,309	**339,361**	495,687
Losses available for offset against future taxable income	**13,235**	15,902	**–**	–
Other deferred tax assets	**102,000**	189,000	**102,000**	189,000
Gross deferred tax assets	**626,645**	1,064,157	**546,690**	997,633
Net deferred tax assets	**326,464**	550,222	**260,000**	495,000

There was no material unprovided deferred tax during the year (2006: Nil).

There are no income tax consequences attaching to the payment of dividends by the Company to its shareholders.

25 AIRCRAFT HELD FOR SALE

	Group 2007 RMB'000	Group 2006 RMB'000
Reclassified from property, plant and equipment during the year end at 31 December 2007 *(note 16)*	**327,528**	–
Impairment *(note 7)*	**(142,800)**	–
	184,728	–

Aircraft held for sale represent aircraft to retire in the next 12 month and are measured at the lower of their carrying amounts and fair values less costs to sell.

26 INVENTORIES

An analysis of the inventories as at the balance sheet date is as follows:

	Group		Company	
	2007 RMB'000	2006 RMB'000	**2007 RMB'000**	2006 RMB'000
Flight equipment spare parts	**932,517**	894,678	**658,955**	612,457
Work in progress	**179,302**	88,419	**6,034**	1,499
Catering supplies	**30,231**	32,169	**24,882**	26,932
	1,142,050	1,015,266	**689,871**	640,888

27 ACCOUNTS RECEIVABLE

	Group		Company	
	2007 RMB'000	2006 RMB'000	**2007 RMB'000**	2006 RMB'000
Accounts receivable	**2,839,785**	2,882,143	**2,362,573**	2,408,237
Impairment	**(45,505)**	(46,916)	**(36,266)**	(36,370)
	2,794,280	2,835,227	**2,326,307**	2,371,867

27 ACCOUNTS RECEIVABLE (Continued)

The Group normally allows a credit period ranging from 30 to 90 days to its sales agents and other customers. An aged analysis of the accounts receivable as at the balance sheet date, net of provision for impairment, is as follows:

	Group		Company	
	2007	2006	**2007**	2006
	RMB'000	*RMB'000*	***RMB'000***	*RMB'000*
Within 30 days	**2,246,288**	2,169,345	**1,873,381**	1,718,214
31 to 60 days	**279,497**	361,524	**244,015**	377,219
61 to 90 days	**136,078**	129,790	**157,763**	194,719
Over 90 days	**132,417**	174,568	**51,148**	81,715
	2,794,280	2,835,227	**2,326,307**	2,371,867

Included in the accounts receivable as at the balance sheet date is the following amount due from a joint venture:

	Group		Company	
	2007	2006	**2007**	2006
	RMB'000	*RMB'000*	***RMB'000***	*RMB'000*
Joint venture	**306,831**	332,811	**585,703**	679,206

The movements in provision for impairment of accounts receivable are as follows:

	Group		Company	
	2007	2006	**2007**	2006
	RMB'000	*RMB'000*	***RMB'000***	*RMB'000*
As at 1 January	**46,916**	48,795	**36,370**	32,485
Impairment losses recognised	**–**	4,654	**–**	3,885
Amount written off as uncollectible	**(1,411)**	(6,533)	**(104)**	–
As at 31 December	**45,505**	46,916	**36,266**	36,370

As at 31 December 2007, accounts receivable with an aggregate nominal value of RMB15,170,307 (2006: RMB14,430,850) were impaired and fully provided for. The remaining individually impaired accounts receivable relate to customers that were in financial difficulties and only a portion of the receivables is expected to be recovered. The Group does not hold any collateral or other credit enhancements over these balances.

27 ACCOUNTS RECEIVABLE (Continued)

An aged analysis of the accounts receivable that are not considered to be impaired is as follows:

	Group		Company	
	2007	2006	**2007**	2006
	RMB'000	*RMB'000*	***RMB'000***	*RMB'000*
Neither past due nor impaired	**1,595,986**	1,576,058	**1,805,696**	1,805,087
Less than 1 month past due	**10,417**	20,506	**10,417**	20,506
	1,606,403	1,596,564	**1,816,113**	1,825,593

Receivables that were neither past due nor impaired relate to a large number of diversified customers for whom there was no recent history of default.

Receivables that were past due but not impaired relate to a number of independent customers that have a good track record with the Group. Based on past experience, the Directors of the Company are of the opinion that no provision for impairment is necessary in respect of these balances as there has not been a significant change in credit quality and the balances are still considered fully recoverable. The Group does not hold any collateral or other credit enhancements over these balances.

28 PREPAYMENTS, DEPOSITS AND OTHER RECEIVABLES

An analysis of the prepayments, deposits and other receivables as at the balance sheet date is as follows:

	Group		Company	
	2007	2006	**2007**	2006
	RMB'000	*RMB'000*	***RMB'000***	*RMB'000*
Prepayments				
Advances and others	**743,946**	620,323	**604,508**	457,736
Manufacturers' credits on aircraft acquisition receivables	**55,741**	109,296	**30,516**	48,235
Prepaid aircraft operating lease rentals	**195,970**	163,059	**195,970**	163,059
	995,657	892,678	**830,994**	669,030
Deposits and other receivables				
Receivables from the sale of staff quarters	**–**	2,269	**–**	–
Miscellaneous deposits	**322,405**	182,089	**290,614**	173,669
	322,405	184,358	**290,614**	173,669
Total	**1,318,062**	1,077,036	**1,121,608**	842,699

29 DEPOSITS AND CASH AND CASH EQUIVALENTS

	Group		Company	
	2007	2006	**2007**	2006
	RMB'000	*RMB'000*	***RMB'000***	*RMB'000*
Cash and bank balances	**1,586,380**	1,280,406	**530,374**	394,880
Cash placed with CNAF	**387,962**	200,242	**357,016**	129,516
	1,974,342	1,480,648	**887,390**	524,396
Time deposits placed with banks	**2,050,802**	3,890,037	**463,983**	2,478,176
Less: Pledged deposits against:				
Bank loans *(note 36(c))*	**–**	(78,195)	**–**	(78,195)
Aircraft operating leases and financial derivatives	**(118,624)**	(133,309)	**(2,486)**	(2,477)
	(118,624)	(211,504)	**(2,486)**	(80,672)
Cash and cash equivalents	**3,906,520**	5,159,181	**1,348,887**	2,921,900
Less: Non-pledged deposits with maturity of more than three months when acquired	**(1,429,179)**	(1,570,777)	**(22,974)**	(421,498)
	2,477,341	3,588,404	**1,325,913**	2,500,402

As at the balance sheet date, the cash and cash equivalents of the Group denominated in RMB amounted to RMB1,290,571,594 (2006: RMB3,043,395,230). The RMB is not freely convertible into other currencies, however, under Mainland China's Foreign Exchange Control Regulations and Administration of Settlement, Sale and Payment of Foreign Exchange Regulations, the Group is permitted to exchange RMB for other currencies through banks authorised to conduct foreign exchange business.

Cash at banks earns interest at floating rates based on daily bank deposit rates. Time deposits are placed for vesting periods of up to one year, depending on the cash requirements of the Group and the Company, and earn interest at the respective time deposit rates. The bank balances and pledged deposits are deposited with creditworthy banks with no recent history of default. The carrying amounts of the deposits and cash and cash equivalents approximate to their fair value.

30 DUE FROM ULTIMATE HOLDING COMPANY

The amount due from the Company's ultimate holding company for the year mainly arose from transactions as set out in notes 22 and 50 to the financial statements. The amount is unsecured, interest-free and is repayable within one year.

31 BALANCES WITH RELATED COMPANIES

The balances with related companies are unsecured, interest-free and are repayable within one year or have no fixed terms of repayment.

Notes to Financial Statements

31 December 2007
(Prepared under International Financial Reporting Standards)

32 ACCOUNTS PAYABLE

An aged analysis of the accounts payable as at the balance sheet date is as follows:

	Group		Company	
	2007	2006	**2007**	2006
	RMB'000	*RMB'000*	***RMB'000***	*RMB'000*
Within 30 days	**4,249,353**	3,660,639	**3,623,987**	3,069,452
31 to 60 days	**788,374**	869,108	**584,583**	579,156
61 to 90 days	**412,435**	304,730	**334,575**	235,421
Over 90 days	**480,638**	386,584	**307,159**	272,249
	5,930,800	5,221,061	**4,850,304**	4,156,278

Included in the accounts payable as at the balance sheet date is the following amount due to joint ventures:

	Group		Company	
	2007	2006	**2007**	2006
	RMB'000	*RMB'000*	***RMB'000***	*RMB'000*
Joint ventures	**141,419**	136,455	**334,047**	316,482

33 BILLS PAYABLE

An aged analysis of the bills payable as at the balance sheet date is as follows:

	Group		Company	
	2007	2006	**2007**	2006
	RMB'000	*RMB'000*	***RMB'000***	*RMB'000*
Within 30 days	**–**	191,330	**–**	191,330
Over 90 days	**–**	460,015	**–**	419,215
	–	651,345	**–**	610,545

Included in the bills payable as at the balance sheet date is the following amount due to an associate:

	Group and Company	
	2007	2006
	RMB'000	*RMB'000*
CNAF *(note 50(e))*	**–**	95,733

34 OTHER PAYABLES AND ACCRUALS

An analysis of the other payables and accruals as at the balance sheet date is as follows:

	Group		Company	
	2007	2006	**2007**	2006
	RMB'000	*RMB'000*	***RMB'000***	*RMB'000*
Provision for staff housing benefits	**23,038**	24,791	**17,921**	19,401
Accrued salaries, wages and benefits	**1,213,017**	870,743	**1,050,627**	706,847
Interest payable	**287,886**	332,281	**286,765**	321,630
Custom duties and levies payable	**1,066,387**	1,309,984	**984,649**	1,232,679
Current portion of long term payables *(note 38)*	**55,155**	86,945	**55,155**	86,945
Current portion of deferred income *(note 39)*	**76,944**	76,944	**76,944**	76,944
Deposits received from sales agents	**404,796**	306,893	**291,641**	212,353
Accrued operating expenses	**725,303**	749,202	**604,464**	674,267
Others	**497,755**	435,104	**295,015**	214,731
	4,350,281	4,192,887	**3,663,181**	3,545,797

35 OBLIGATIONS UNDER FINANCE LEASES

The Group and the Company have obligations under finance lease agreements expiring during the years from 2008 to 2017 (2006: 2007 to 2016) in respect of aircraft. An analysis of the future minimum lease payments under these finance leases as at the balance sheet date, together with the present value of the net minimum lease payments which are principally denominated in foreign currencies, are as follows:

	Group and Company			
	Minimum lease payments 2007	**Present value of minimum lease payments 2007**	Minimum lease payments 2006	Present value of minimum lease payments 2006
	RMB'000	***RMB'000***	*RMB'000*	*RMB'000*
Amounts repayable:				
Within one year	**2,839,608**	**2,216,680**	2,964,933	2,354,905
In the second year	**3,372,767**	**2,821,518**	2,492,368	1,996,954
In the third to fifth years, inclusive	**6,429,660**	**5,484,352**	7,046,163	6,061,709
Over five years	**5,521,634**	**5,022,323**	3,619,853	3,189,192
Total minimum finance lease payments	**18,163,669**	**15,544,873**	16,123,317	13,602,760
Less: Amounts representing finance charges	**(2,618,796)**		(2,520,557)	
Present value of minimum lease payments	**15,544,873**		13,602,760	
Less: Portion classified as current liabilities	**(2,216,680)**		(2,354,905)	
Non-current portion	**13,328,193**		11,247,855	

35 OBLIGATIONS UNDER FINANCE LEASES (Continued)

Certain financial lease arrangements comprise finance leases between the Company and certain of its subsidiaries, and the corresponding borrowings between such subsidiaries and commercial banks. The Company has guaranteed the subsidiaries' obligations under those bank borrowing arrangements and, accordingly, the relevant assets and obligations are recorded in the Company's balance sheet to reflect the substance of the transactions. The future payments under these finance leases have therefore been presented by the Company and the Group in the amounts that reflect the payments under the bank borrowing arrangements between the subsidiaries and commercial banks.

As at 31 December 2007, there were 43 (2006: 32) aircraft under finance lease agreements. Under the terms of the leases, the Company has the option to purchase, at the end of or during the lease terms, certain aircraft at market value and others at either market value or the price as stipulated in the finance lease agreements. The effective borrowing rates during the current year ranged from 2.36% to 9.84% (2006: 1.64% to 9.84%).

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

(a) mortgages over certain of the Group's and the Company's aircraft, which had an aggregate net book value of approximately RMB21,948 million as at 31 December 2007 (2006: RMB16,589 million) (note 16); and

(b) guarantees by certain commercial banks in an aggregate amount of approximately RMB6,925 million (2006: RMB9,386 million).

As at 31 December 2007, certain PRC state-owned banks have provided counter-guarantees in an aggregate amount of RMB1,274 million (2006: RMB1,910 million) in respect of the above-mentioned commercial bank guarantee arrangements.

36 BANK LOANS, OTHER LOANS AND CORPORATE BONDS

	Group		Company	
	2007	2006	**2007**	2006
	RMB'000	*RMB'000*	***RMB'000***	*RMB'000*
Bank loans:				
Secured	**10,086,265**	10,419,442	**9,551,478**	9,791,644
Unsecured	**14,283,542**	10,328,590	**13,869,976**	10,040,806
	24,369,807	20,748,032	**23,421,454**	19,832,450
Other loans:				
Secured	**19,613**	34,944	**19,613**	34,944
Unsecured	**204,706**	58,022	**102,490**	–
	224,319	92,966	**122,103**	34,944
Corporate bonds – unsecured	**3,000,000**	3,000,000	**3,000,000**	3,000,000
	27,594,126	23,840,998	**26,543,557**	22,867,394
Bank loans repayable:				
Within one year	**10,904,944**	11,067,021	**10,592,390**	10,723,086
In the second year	**4,032,991**	2,635,719	**3,980,463**	2,579,565
In the third to fifth years, inclusive	**8,038,098**	5,574,198	**7,726,976**	5,405,741
Over five years	**1,393,774**	1,471,094	**1,121,625**	1,124,058
	24,369,807	20,748,032	**23,421,454**	19,832,450
Other loans repayable:				
Within one year	**73,891**	72,000	**13,075**	13,978
In the second year	**6,538**	13,978	**6,538**	13,978
In the third to fifth years, inclusive	**143,890**	6,988	**102,490**	6,988
	224,319	92,966	**122,103**	34,944
Corporate bonds – over five years	**3,000,000**	3,000,000	**3,000,000**	3,000,000
Total bank loans, other loans and corporate bonds	**27,594,126**	23,840,998	**26,543,557**	22,867,394
Less: Portion classified as current liabilities	**(10,978,835)**	(11,139,021)	**(10,605,465)**	(10,737,064)
Non-current portion	**16,615,291**	12,701,977	**15,938,092**	12,130,330

36 BANK LOANS, OTHER LOANS AND CORPORATE BONDS (Continued)

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

Nature	Interest rate and final maturity	Group 2007 RMB'000	Group 2006 RMB'000	Company 2007 RMB'000	Company 2006 RMB'000
RMB denominated loans and corporate bonds:					
Loans for purchases of aircraft and related equipment	Floating interest rates ranging from 6.08% to 6.64% and 5.18% to 5.75% per annum as at 31 December 2007 and 2006, respectively, with maturities up to 2016	**2,007,520**	2,844,000	**2,007,520**	2,844,000
Loans for construction in process	Fixed interest rate of 5.51% per annum as at 31 December 2007 with maturities up to 2010	**40,000**	–	**40,000**	–
Loans for construction in process	Floating interest rate ranging from 5.67% to 6.80% per annum as at 31 December 2007, with maturities up to 2012	**617,030**	–	**344,690**	–
Loans for working capital	Fixed interest rates ranging from 4.23% to 5.43% and 3.70% to 5.81% per annum as at 31 December 2007 and 2006, respectively, with maturities up to 2010	**1,743,000**	2,817,934	**1,730,000**	2,730,000
Loans for working capital	Floating interest rates ranging from 5.43% to 5.83% and 5.42% per annum as at 31 December 2007 and 2006, respectively, with maturities up to 2009	**232,480**	335,230	**223,480**	335,230
Corporate bonds for purchases of aircraft and related equipment	Fixed interest rate of 4.50% per annum as at 31 December 2007 and 2006, with maturity in September 2015	**3,000,000**	3,000,000	**3,000,000**	3,000,000
		7,640,030	8,997,164	**7,345,690**	8,909,230
United States dollars denominated loans:					
Loans for purchases of aircraft and related equipment	Fixed interest rates ranging from 5.34% to 8.28% and 5.40% to 8.33% per annum as at 31 December 2007 and 2006, respectively, with maturities up to 2012	**3,321,072**	4,519,846	**3,321,072**	4,519,846
Loans for purchases of aircraft and related equipment	Floating interest rate of six months LIBOR+0.40% to 0.70% per annum as at 31 December 2007 and 2006 with maturities up to 2018	**5,101,110**	2,629,310	**4,566,324**	2,001,510
Loans for working capital	Floating interest rate of six months LIBOR+0.27% to 0.50% and LIBOR + 0.40% to 0.70% per annum as at 31 December 2007 and 2006, respectively, with maturities up to 2010	**8,220,550**	6,372,630	**8,013,146**	6,129,830
		16,642,732	13,521,786	**15,900,542**	12,651,186

36 BANK LOANS, OTHER LOANS AND CORPORATE BONDS (Continued)

Nature	Interest rate and final maturity	Group 2007 RMB'000	Group 2006 RMB'000	Company 2007 RMB'000	Company 2006 RMB'000
Hong Kong dollars denominated loans:					
Loans for working capital	Floating interest rate of three months HIBOR +1.15% per annum as at 31 December 2007 and 2006 with maturities up to 2008	**14,039**	15,070	**–**	–
Loans for capital investment	Floating interest rate of three months HIBOR +0.45% per annum as at 31 December 2007 and 2006 with maturities up to 2013	**3,015,208**	1,208,654	**3,015,208**	1,208,654
		3,029,247	1,223,724	**3,015,208**	1,208,654
Euros denominated loans:					
Loans for purchase of related equipment	Fixed interest rates of 3.88% and 4.38% per annum as at 31 December 2007 and 2006, respectively, with maturities up to 2013	**282,117**	98,324	**282,117**	98,324
		282,117	98,324	**282,117**	98,324
		27,594,126	23,840,998	**26,543,557**	22,867,394
Less: Loans falling due within one year and classified as current liabilities		**(10,978,835)**	(11,139,021)	**(10,605,465)**	(10,737,064)
Non-current portion		**16,615,291**	12,701,977	**15,938,092**	12,130,330

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

The Group's and the Company's bank and other loans of approximately RMB13,106 million as at 31 December 2007 (2006: RMB13,454 million) were secured or guaranteed by:

(a) mortgages over certain of the Group's aircraft and buildings with an aggregate net book value of approximately RMB12,255 million as at 31 December 2007 (2006: RMB17,625 million) (note 16); and land use rights with an aggregate carrying amount of approximately RMB37 million as at 31 December 2007 (2006: RMB37 million) (note 17);

(b) pledge of certain number of listed shares in an associate of the Group with an aggregate market value of approximately RMB7,609 million as at 31 December 2007 (2006: RMB7,695 million) (note 21);

(c) pledge of certain of the Group's bank deposits amounting to approximately RMB78 million as at 31 December 2006 (note 29); and

(d) guarantees by certain commercial banks amounting to approximately RMB3,896 million as at 31 December 2007 (2006: RMB8,281 million).

As at 31 December 2007, certain PRC state-owned banks provided counter-guarantees in an aggregate amount of approximately RMB2,872 million (2006: RMB3,811 million) to one of the above-mentioned commercial banks.

37 PROVISION FOR MAJOR OVERHAULS

Details of the movements of provision for major overhauls in respect of aircraft and engines under operating leases for each of the two years ended 31 December 2007 and 2006 are as follows:

	Group		Company	
	2007	2006	**2007**	2006
	RMB'000	*RMB'000*	***RMB'000***	*RMB'000*
At beginning of year	**969,247**	654,439	**744,146**	493,292
Provision for the year	**800,463**	654,572	**588,858**	521,032
Utilised during the year	**(495,388)**	(339,764)	**(308,291)**	(270,178)
At end of year	**1,274,322**	969,247	**1,024,713**	744,146
Less: Portion classified as current liabilities	**(83,907)**	(47,318)	**(83,907)**	(47,318)
Non-current portion	**1,190,415**	921,929	**940,806**	696,828

38 LONG TERM PAYABLES

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

	Group		Company	
	2007	2006	**2007**	2006
	RMB'000	*RMB'000*	***RMB'000***	*RMB'000*
Customs duties and value-added tax payable	**213,205**	305,250	**213,205**	305,250
Others	**31,955**	34,286	**–**	–
	245,160	339,536	**213,205**	305,250
Less: Portion classified as current liabilities *(note 34)*	**(55,155)**	(86,945)	**(55,155)**	(86,945)
Non-current portion	**190,005**	252,591	**158,050**	218,305

39 DEFERRED INCOME

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

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

	Group		Company	
	2007	2006	**2007**	2006
	RMB'000	*RMB'000*	***RMB'000***	*RMB'000*
Deferred income:				
At beginning of year and end of year	**1,462,667**	1,462,667	**1,462,667**	1,462,667
Accumulated income recognised as other operating revenue:				
At beginning of year	**(436,757)**	(359,814)	**(436,757)**	(359,814)
Credit during the year *(note 5)*	**(76,943)**	(76,943)	**(76,943)**	(76,943)
At end of year	**(513,700)**	(436,757)	**(513,700)**	(436,757)
Net carrying amounts	**948,967**	1,025,910	**948,967**	1,025,910
Less: Portion classified as current liabilities *(note 34)*	**(76,944)**	(76,944)	**(76,944)**	(76,944)
Non-current portion	**872,023**	948,966	**872,023**	948,966

40 SHARE CAPITAL

	Number of shares 2007	**Nominal value 2007** *RMB'000*	Number of shares 2006	Nominal value 2006 *RMB'000*
Registered, issued and fully paid:				
State legal person shares of RMB1.00 each	**4,826,195,989**	**4,826,196**	4,826,195,989	4,826,196
Non-H foreign shares of RMB1.00 each	**1,380,482,920**	**1,380,483**	1,380,482,920	1,380,483
H shares of RMB1.00 each	**4,405,683,364**	**4,405,683**	4,405,683,364	4,405,683
A shares of RMB1.00 each	**1,639,000,000**	**1,639,000**	1,639,000,000	1,639,000
	12,251,362,273	**12,251,362**	12,251,362,273	12,251,362

A summary of the movements in the Company's issued share capital for the years ended 31 December 2007 and 31 December 2006 is as follows:

	Number of shares	**Nominal value** *RMB'000*
As at 1 January 2006	9,433,210,909	9,433,211
Public offer of A shares	1,639,000,000	1,639,000
Placement of H shares to Cathay	1,179,151,364	1,179,151
As at 31 December 2006, 1 January 2007 and 31 December 2007	12,251,362,273	12,251,362

The H shares and A shares rank pari passu, in all material respects, with the state legal person shares and non-H foreign shares of the Company.

41 TREASURY SHARES

As at 31 December 2007, the Group owned a 17.5% equity interest in Cathay, which in turn owned a 17.64% equity interest in the Company. Accordingly, the 17.5% of Cathay's shareholding in the Company should be recorded in the Group's consolidated financial statements as treasury shares through deduction from equity.

42 RESERVES

Group

The amounts of the Group's reserves and the movements therein for each of the two years ended 31 December 2007 are presented in the consolidated statement of changes in equity.

Company

	Capital reserve *RMB'000*	Reserve funds *RMB'000*	Retained profits *RMB'000*	Total *RMB'000*
As at I January 2006	5,212,261	304,816	2,470,607	7,987,684
Profit for the year	–	–	1,265,074	1,265,074
Proposed final 2006 dividend *(note 14(a))*	–	–	(602,767)	(602,767)
Transfer to reserve funds *(note 14(b))*	–	402,206	(402,206)	–
Issue of new shares	5,897,294	–	–	5,897,294
Share issue expenses	(145,097)	–	–	(145,097)
As at 31 December 2006 and 1 January 2007	10,964,458	707,022	2,730,708	14,402,188
Profit for the year	–	–	3,187,993	3,187,993
Proposed final 2007 dividend *(note 14(a))*	–	–	(837,987)	(837,987)
Transfer to reserve funds *(note 14(b))*	–	582,602	(582,602)	–
As at 31 December 2007	**10,964,458**	**1,289,624**	**4,498,112**	**16,752,194**

43 SHARE APPRECIATION RIGHTS

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

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

The exercise period of all SARs commences after a vesting period and ends on a date which is not later than five years from the date of grant of the SARs. The exercise price of the SARs will be equal to the average closing price of the Company's H shares on the HKSE for the five consecutive trading days immediately preceding the date of the grant. On 15 June 2007, 14,939,900 SARs were granted to a total of 109 individuals at an exercise price of HK$2.98 per share. As at each of the last days of the second, third and fourth anniversaries of the date of grant, the total number of SARs exercisable will not exceed 30%, 70% and 100%, respectively, of the total SARs granted to the respective eligible participants. As at 31 December 2007, all SARs granted remained unexercised.

43 SHARE APPRECIATION RIGHTS (Continued)

As at 31 December 2007, the fair value of the SARs granted during the year was RMB23,986,200, of which the Group recognised as employee compensation expense (note 6) during the year then ended.

The fair value of the SARs was estimated as at the date of grant using a binomial model, taking into account the terms and conditions upon which the SARs were granted. The following table lists the inputs to the model used:

Dividend yield *(%)*	0.64%
Expected volatility *(%)*	45.96%
Risk-free interest rate *(%)*	3.75%
Expected life of options *(year)*	1.5-4.5
Weighted average share price *(RMB)*	10.88

The expected life of the SARs is based on the estimation of the management and is not necessarily indicative of the exercise patterns that may occur. The expected volatility reflects the assumption that the historical volatility is indicative of future trends, which may also not necessarily be the actual outcome.

44 DISTRIBUTABLE RESERVES

As at 31 December 2007, in accordance with the Company Law in Mainland China, an amount of approximately RMB14,281 million (2006: RMB14,279 million as restated under CAS) standing to the credit of the Company's capital reserve account, and an amount of approximately RMB1,290 million (2006: RMB707 million) standing to the credit of the Company's reserve funds, as determined in accordance with CAS, were available for distribution by way of a future capitalisation issue. In addition, the Company had retained earnings of approximately RMB3,686 million (2006: RMB2,224 million as restated under CAS), as determined in accordance with CAS and being the lesser amount of the retained profits determined in accordance with CAS and IFRSs, available for distribution as dividend.

45 MAJOR NON-CASH TRANSACTION

During the year, the Group entered into finance lease arrangements in respect of property, plant and equipment with a total capital value at the inception of the leases of approximately RMB5,112 million (2006: RMB6,017 million).

46 CONTINGENT LIABILITIES

As at 31 December 2007, the Group had the following contingent liabilities:

(a) Pursuant to the restructuring of CNAHC, in preparation for the listing of the Company's H shares on the HKSE and the London Stock Exchange, the Company entered into a restructuring agreement with CNAHC and China National Aviation Corporation (Group) Limited ("CNACG", a wholly-owned subsidiary of CNAHC incorporated in Hong Kong) on 20 November 2004 (the "Restructuring Agreement"). According to the Restructuring Agreement, except for liabilities constituting or arising out of or relating to business undertaken by the Company after the restructuring, no liabilities were assumed by the Company and the Company is not liable, whether severally, or jointly and severally, for debts and obligations incurred prior to the restructuring by CNAHC and CNACG. The Company has also undertaken to indemnify CNAHC and CNACG against any damage suffered or incurred by CNAHC and CNACG as a result of any breach by the Company of any provision of the Restructuring Agreement.

46 CONTINGENT LIABILITIES (Continued)

(b) On 15 April 2002, Flight CA129 crashed on approach to Gimhae International Airport, South Korea. There were 129 fatalities including 121 passengers and 8 crew members aboard the crashed aircraft. An investigation was conducted by the Chinese and the Korean civil aviation authorities, but the investigation has yet to be finished at the date of approval of these financial statements. Certain injured passengers and families of the deceased passengers and crew members have commenced proceedings in Korean courts seeking damages against Air China International Corporation, the predecessor of the Company. The Group cannot predict the timing of the courts' judgements or the possible outcome of the lawsuits nor any possible appeal actions. Up to 31 December 2007, the Company, Air China International Corporation and the Company's insurer had paid an aggregate amount of approximately RMB220 million (2006: RMB218 million) in respect of passenger liability and other auxiliary costs. Included in the RMB220 million (2006: RMB218 million) is an amount of approximately RMB213 million (2006: RMB199 million) borne by the Company's insurer. As part of the above-mentioned restructuring, CNAHC has agreed to indemnify the Group against any liabilities relating to the crash of Flight CA129, excluding the compensation already paid up to 30 September 2004 (being the date of incorporation of the Company). The Directors of the Company believe that there will not be any material adverse impact on the Group's financial position.

(c) On 26 February 2007, the Eastern District Court of New York of the Federal Judiciary of the United States filed a civil summon against the Company and Air China Cargo, claiming that they, together with a number of other airlines, have violated certain anti-trust regulations in respect of their air cargo operations in the United States by acting in concert in imposing excessive surcharges to impede the offering of discounts and allocating revenue and customers so as to increase, maintain and stabilise air cargo prices. The status of the proceedings is still in the preliminary stage and therefore the Directors of the Company are of the view that it is not possible to estimate the eventual outcome of the claim with reasonable certainty and therefore no provision for this claim has been made at this stage.

(d) The Group and the Company have issued guarantees to banks in respect of the bank loans granted to the following parties:

	Group		Company	
	2007	2006	**2007**	2006
	RMB'000	*RMB'000*	***RMB'000***	*RMB'000*
Joint venture	**–**	32,250	**–**	–
Associates	**132,857**	143,199	**114,129**	123,105
	132,857	175,449	**114,129**	123,105

47 COMMITMENTS

(a) Capital commitments

The Group and the Company had the following amounts of contractual commitments for the acquisition and construction of plant, property and equipment as at the balance sheet date:

	Group		Company	
	2007	2006	**2007**	2006
	RMB'000	*RMB'000*	***RMB'000***	*RMB'000*
Contracted, but not provided for:				
Aircraft and flight equipment	**53,897,381**	39,663,862	**53,897,381**	39,594,216
Buildings	**1,026,747**	950,817	**573,112**	563,112
Others	**248,388**	44,886	**241,500**	44,886
	55,172,516	40,659,565	**54,711,993**	40,202,214
Authorised, but not contracted for:				
Aircraft and flight equipment	**226,874**	–	**–**	–
Buildings	**3,006,501**	2,183,678	**2,971,164**	2,180,090
Others	**471,907**	100,673	**460,337**	–
	3,705,282	2,284,351	**3,431,501**	2,180,090
Total capital commitments	**58,877,798**	42,943,916	**58,143,494**	42,382,304

(b) Investment commitments

The Group and the Company had the following amounts of investment commitments as at the balance sheet date:

	Group		Company	
	2007	2006	**2007**	2006
	RMB'000	*RMB'000*	***RMB'000***	*RMB'000*
Contracted, but not provided for:				
Joint venture	**–**	–	**109,569**	239,114
Associate	**54,165**	59,277	**54,165**	59,277
Minority shareholders of CNAC	**–**	3,122,420	**–**	3,122,420
Total investment commitments	**54,165**	3,181,697	**163,734**	3,420,811

Details of the acquisition of minority interests of CNAC are set out in note 1 to the financial statements.

(c) Operating lease commitments

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

At the balance sheet date, the Group and the Company had the following future minimum lease payments under non-cancellable operating leases:

	Group		Company	
	2007	2006	**2007**	2006
	RMB'000	*RMB'000*	***RMB'000***	*RMB'000*
Within one year	**2,349,599**	2,301,491	**1,819,561**	1,716,993
In the second to fifth years, inclusive	**6,599,485**	6,276,717	**5,372,798**	4,813,863
Over five years	**3,860,049**	3,126,336	**3,379,761**	2,575,453
	12,809,133	11,704,544	**10,572,120**	9,106,309

48 FINANCIAL INSTRUMENTS BY CATEGORY

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

Market price has been used to determine the fair value of assets held for sale. The fair value of bank loans and other borrowings has been calculated by discounting the expected future cash flows at prevailing interest rates. The fair value of long term deposits and other financial assets has been discounted to present value after calculation based on market interest rates.

The carrying amounts of each of the categories of financial instruments as at the balance sheet date are as follows:

Group

2007

Financial assets

	Financial assets at fair value through profit or loss designated as such upon initial recognition *RMB'000*	Loans and receivables *RMB'000*	Available for-sale financial assets *RMB'000*	Total *RMB'000*
Interests in associates *(note 21)*	–	183,224	–	183,224
Deposits for aircraft under operating leases	–	257,505	–	257,505
Long term receivable from ultimate holding company	–	331,813	–	331,813
Available-for-sale investments	–	–	1,997	1,997
Accounts and bills receivable	–	2,795,879	–	2,795,879
Deposits and other receivables *(note 28)*	–	322,405	–	322,405
Derivative financial instruments	6,493	–	–	6,493
Pledged deposits	–	118,624	–	118,624
Non-pledged deposits *(note 29)*	–	1,429,179	–	1,429,179
Cash and cash equivalents *(note 29)*	–	2,477,341	–	2,477,341
Due from ultimate holding company	–	335,129	–	335,129
Due from related companies	–	22,881	–	22,881
	6,493	8,273,980	1,997	8,282,470

Financial liabilities

	Financial liabilities at fair value through profit or loss designated as such upon initial recognition *RMB'000*	Financial liabilities at amortised cost *RMB'000*	Total *RMB'000*
Interests in associates *(note 21)*	–	(123,155)	(123,155)
Air traffic liabilities	–	(2,156,104)	(2,156,104)
Accounts and bills payable	–	(5,930,800)	(5,930,800)
Other payables and accruals	–	(4,350,281)	(4,350,281)
Derivative financial instruments	(14,826)	–	(14,826)
Obligations under finance leases *(note 35)*	–	(15,544,873)	(15,544,873)
Bank loans, other loans and corporate bonds *(note 36)*	–	(27,594,126)	(27,594,126)
Due to related companies	–	(45,142)	(45,142)
Provision for early retirement benefits obligations	–	(164,837)	(164,837)
Long term payables	–	(190,005)	(190,005)
	(14,826)	(56,099,323)	(56,114,149)

48 FINANCIAL INSTRUMENTS BY CATEGORY (Continued)

Group

2006

Financial assets

	Financial assets at fair value through profit or loss designated as such upon initial recognition *RMB'000*	Loans and receivables *RMB'000*	Available-for-sale financial assets *RMB'000*	Total *RMB'000*
Interests in associates *(note 21)*	–	144,914	–	144,914
Deposits for aircraft under operating leases	–	259,681	–	259,681
Long term receivable from ultimate holding company	–	431,813	–	431,813
Available-for-sale investments	–	–	6,704	6,704
Accounts and bills receivable	–	2,835,227	–	2,835,227
Deposits and other receivables *(note 28)*	–	184,358	–	184,358
Derivative financial instruments	99,935	–	–	99,935
Pledged deposits	–	211,504	–	211,504
Non-pledged deposits *(note 29)*		1,570,777		1,570,777
Cash and cash equivalents *(note 29)*	–	3,588,404	–	3,588,404
Due from ultimate holding company	–	289,933	–	289,933
Due from related companies	–	14,378	–	14,378
	99,935	9,530,989	6,704	9,637,628

Financial liabilities

	Financial liabilities at fair value through profit or loss designated as such upon initial recognition *RMB'000*	Financial liabilities at amortised cost *RMB'000*	Total *RMB'000*
Interests in associates *(note 21)*	–	(89,426)	(89,426)
Air traffic liabilities	–	(1,530,484)	(1,530,484)
Accounts and bills payable	–	(5,872,406)	(5,872,406)
Other payables and accruals	–	(4,192,887)	(4,192,887)
Derivative financial instruments	(242,108)	–	(242,108)
Obligations under finance leases *(note 35)*	–	(13,602,760)	(13,602,760)
Bank loans, other loans and corporate bonds *(note 36)*	–	(23,840,998)	(23,840,998)
Due to related companies	–	(39,989)	(39,989)
Provision for early retirement benefits obligations	–	(201,199)	(201,199)
Long term payables	–	(252,591)	(252,591)
	(242,108)	(49,622,740)	(49,864,848)

48 FINANCIAL INSTRUMENTS BY CATEGORY (Continued)

Company

Financial assets

2007

	Financial assets at fair value through profit or loss designated as such upon initial recognition RMB'000	Loans and receivables RMB'000	Available-for-sale financial assets RMB'000	Total RMB'000
Interests in subsidiaries *(note 19)*	–	65,367	–	65,367
Interests in associates *(note 21)*	–	40,555	–	40,555
Deposits for aircraft under operating leases	–	192,848	–	192,848
Long term receivable from ultimate holding company	–	331,813	–	331,813
Available-for-sale investments	–	–	3,516	3,516
Accounts and bills receivable	–	2,327,906	–	2,327,906
Deposits and other receivables *(note 28)*	–	290,614	–	290,614
Derivative financial instruments	6,493	–	–	6,493
Pledged deposits	–	2,486	–	2,486
Non-pledged deposits	–	22,974	–	22,974
Cash and cash equivalents	–	1,325,913	–	1,325,913
Due from ultimate holding company	–	350,377	–	350,377
	6,493	4,950,853	3,516	4,960,862

2006

	Financial assets at fair value through profit or loss designated as such upon initial recognition RMB'000	Loans and receivables RMB'000	Available for-sale financial assets RMB'000	Total RMB'000
Interests in subsidiaries *(note 19)*	–	55,080	–	55,080
Interests in associates *(note 21)*	–	21,784	–	21,784
Deposits for aircraft under operating leases	–	186,407	–	186,407
Long term receivable from ultimate holding company	–	431,813	–	431,813
Available-for-sale investments	–	–	816	816
Accounts and bills receivable	–	2,371,867	–	2,371,867
Deposits and other receivables *(note 28)*	–	173,669	–	173,669
Derivative financial instruments	98,026	–	–	98,026
Pledged deposits	–	80,672	–	80,672
Non-pledged deposits *(note 29)*	–	421,498	–	421,498
Cash and cash equivalents *(note 29)*	–	2,500,402	–	2,500,402
Due from ultimate holding company	–	304,933	–	304,933
Due from related companies	–	21	–	21
	98,026	6,548,146	816	6,646,988

48 FINANCIAL INSTRUMENTS BY CATEGORY (Continued)

Company

Financial liabilities

2007

	Financial assets at fair value through profit or loss designated as such upon initial recognition *RMB'000*	Financial liabilities at amortised cost *RMB'000*	Total *RMB'000*
Interests in subsidiaries *(note 19)*	–	**(451,419)**	**(451,419)**
Interests in associates *(note 21)*	–	**(118,768)**	**(118,768)**
Air traffic liabilities	–	**(2,013,038)**	**(2,013,038)**
Accounts and bills payable	–	**(4,850,304)**	**(4,850,304)**
Other payables and accruals *(note 34)*	–	**(3,663,181)**	**(3,663,181)**
Derivative financial instruments	**(6,819)**	–	**(6,819)**
Obligations under finance leases *(note 35)*	–	**(15,544,873)**	**(15,544,873)**
Bank loans, other loans and corporate bonds *(note 36)*	–	**(26,543,557)**	**(26,543,557)**
Due to related companies	–	**(27,730)**	**(27,730)**
Provision for early retirement benefits obligations	–	**(97,015)**	**(97,015)**
Long term payables	–	**(158,050)**	**(158,050)**
	(6,819)	**(53,467,935)**	**(53,474,754)**

2006

	Financial assets at fair value through profit or loss designated as such upon initial recognition *RMB'000*	Financial liabilities at amortised cost *RMB'000*	Total *RMB'000*
Interests in subsidiaries *(note 19)*	–	(499,087)	(499,087)
Interests in associates *(note 21)*	–	(105,818)	(105,818)
Air traffic liabilities	–	(1,418,304)	(1,418,304)
Accounts and bills payable	–	(4,766,823)	(4,766,823)
Other payables and accruals *(note 34)*	–	(3,545,797)	(3,545,797)
Derivative financial instruments	(242,108)	–	(242,108)
Obligations under finance leases *(note 35)*	–	(13,602,760)	(13,602,760)
Bank loans, other loans and corporate bonds *(note 36)*	–	(22,867,394)	(22,867,394)
Due to related companies	–	(18,913)	(18,913)
Provision for early retirement benefits obligations	–	(141,416)	(141,416)
Long term payables	–	(218,305)	(218,305)
	(242,108)	(47,184,617)	(47,426,725)

49 FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES

The Group's principal financial instruments, other than derivatives, comprise bank and other loans and corporate bonds, obligations under finance leases, cash and cash equivalents and pledged deposits. The main purpose of these financial instruments is to raise finance for the Group's operations. The Group has various other financial assets and liabilities such as accounts receivable and accounts payable, which arise directly from its operations.

The Group also enters into derivative transactions, including principally swaps and collars contracts. The purpose is to manage the jet fuel price risk arising from the Group's operations.

It is, and has been, throughout the year under review, the Group's policy that no trading in financial instruments shall be undertaken.

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

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

(a) Business risk

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

(b) Liquidity risk

The Group's net current liabilities amounted to approximately RMB17,058 million as at 31 December 2007 (2006: RMB15,251 million). The Group recorded a net cash inflow from operating activities of approximately RMB7,302 million for the year ended 31 December 2007 (2006: RMB6,212 million). For the same period, the Group had a net cash outflow from investing activities of approximately RMB10,212 million (2006: RMB12,148 million). The Group also recorded a net cash inflow from financing activities of approximately RMB1,839 million for the year ended 31 December 2007 (2006: RMB7,309 million). The Group has recorded a decrease in cash and cash equivalents of approximately RMB1,111 million and an increase in cash and cash equivalents of approximately RMB1,340 million for the years ended 31 December 2007 and 2006, respectively.

Starting from 2007, the liquidity of the Group is primarily dependent on its ability to maintain adequate cash inflows from operations to meet its debt obligations as they fall due, and its ability to obtain external financing to meet its committed future capital expenditure. With regard to its future capital commitments and other financing requirements, the Company has already obtained several banking facilities with several PRC banks of up to an amount of RMB80,172 million as at 31 December 2007, of which an amount of approximately RMB32,639 million was utilised.

The Directors of the Company have carried out a detailed review of the cash flow forecast of the Group for the year ending 31 December 2008. Based on such forecast, the Directors have determined that adequate liquidity exists to finance the working capital and capital expenditure requirements of the Group during 2008. In preparing the cash flow forecast, the Directors have considered historical cash requirements of the Group as well as other key factors, including the availability of the above-mentioned loan financing which may impact the operations of the Group prior to the end of 2008. The Directors are of the opinion that the assumptions and sensitivities which are included in the cash flow forecast are reasonable. However, these are subject to inherent limitations and uncertainties and some or all of these assumptions may not be realised.

49 FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (Continued)

(b) Liquidity risk (Continued)

The maturity profile of the Group's financial liabilities as at the balance sheet date, based on the contracted undiscounted payments, was as follows:

Group

2007

	On demand *RMB'000*	**Within one year** *RMB'000*	**1 to 5 years** *RMB'000*	**Over 5 years** *RMB'000*	**Total** *RMB'000*
Interests in associates *(note 21)*	**34,434**	**88,721**	**–**	**–**	**123,155**
Air traffic liabilities	**2,156,104**	**–**	**–**	**–**	**2,156,104**
Accounts and bills payable	**480,639**	**5,450,161**	**–**	**–**	**5,930,800**
Other payables and accruals	**1,885,387**	**2,426,846**	**38,048**	**–**	**4,350,281**
Derivative financial instruments	**–**	**14,271**	**555**	**–**	**14,826**
Obligations under finance leases *(note 35)*	**–**	**2,216,680**	**8,305,870**	**5,022,323**	**15,544,873**
Bank loans, other loans and corporate bonds *(note 36)*	**–**	**10,978,835**	**12,221,517**	**4,393,774**	**27,594,126**
Due to related companies	**–**	**45,142**	**–**	**–**	**45,142**
Provision for early retirement benefits obligations	**–**	**–**	**123,751**	**41,086**	**164,837**
Long term payables	**–**	**–**	**190,005**	**–**	**190,005**
	4,556,564	**21,220,656**	**20,879,746**	**9,457,183**	**56,114,149**

2006

	On demand *RMB'000*	Within one year *RMB'000*	1 to 5 years *RMB'000*	Over 5 years *RMB'000*	Total *RMB'000*
Interests in associates *(note 21)*	–	89,426	–	–	89,426
Air traffic liabilities	1,530,484	–	–	–	1,530,484
Accounts and bills payable	386,584	5,485,822	–	–	5,872,406
Other payables and accruals	2,076,210	2,116,677	–	–	4,192,887
Derivative financial instruments	–	9,301	232,807	–	242,108
Obligations under finance leases *(note 35)*	–	2,354,905	8,058,663	3,189,192	13,602,760
Bank loans, other loans and corporate bonds *(note 36)*	–	11,139,021	8,230,883	4,471,094	23,840,998
Due to related companies	–	39,989	–	–	39,989
Provision for early retirement benefits obligations	–	35,221	134,522	31,456	201,199
Long term payables	–	–	252,591	–	252,591
	3,993,278	21,270,362	16,909,466	7,691,742	49,864,848

49 FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (Continued)

(b) Liquidity risk (Continued)

The maturity profile of the Company's financial liabilities as at the balance sheet date, based on the contracted undiscounted payments, was as follows:

Company

2007

	On demand *RMB'000*	Within one year *RMB'000*	1 to 5 years *RMB'000*	Over 5 years *RMB'000*	Total *RMB'000*
Interests in subsidiaries *(note 19)*	**–**	**451,419**	**–**	**–**	**451,419**
Interests in associates *(note 21)*	**34,434**	**84,334**	**–**	**–**	**118,768**
Air traffic liabilities	**2,013,038**	**–**	**–**	**–**	**2,013,038**
Accounts and bills payable	**307,159**	**4,543,145**	**–**	**–**	**4,850,304**
Other payables and accruals	**1,658,673**	**1,966,460**	**38,048**	**–**	**3,663,181**
Derivative financial instruments	**–**	**6,264**	**555**	**–**	**6,819**
Obligations under finance leases *(note 35)*	**–**	**2,216,680**	**8,305,870**	**5,022,323**	**15,544,873**
Bank loans, other loans and corporate bonds *(note 36)*	**–**	**10,605,465**	**11,816,467**	**4,121,625**	**26,543,557**
Due to related companies	**–**	**27,730**	**–**	**–**	**27,730**
Provision for early retirement benefits obligations	**–**	**–**	**76,139**	**20,876**	**97,015**
Long term payables	**–**	**–**	**158,050**	**–**	**158,050**
	4,013,304	**19,901,497**	**20,395,129**	**9,164,824**	**53,474,754**

2006

	On demand *RMB'000*	Within one year *RMB'000*	1 to 5 years *RMB'000*	Over 5 years *RMB'000*	Total *RMB'000*
Interests in subsidiaries *(note 19)*	–	499,087	–	–	499,087
Interests in associates *(note 21)*	–	105,818	–	–	105,818
Air traffic liabilities	1,418,304	–	–	–	1,418,304
Accounts and bills payables	272,249	4,494,574	–	–	4,766,823
Other payables and accruals	1,863,433	1,682,364	–	–	3,545,797
Derivative financial instruments	–	9,301	232,807	–	242,108
Obligations under finance leases *(note 35)*	–	2,354,905	8,058,663	3,189,192	13,602,760
Bank loans, other loans and corporate bonds *(note 36)*	–	10,737,064	8,006,272	4,124,058	22,867,394
Due to related companies	–	18,913	–	–	18,913
Provision for early retirement benefits obligations	–	23,739	87,633	30,044	141,416
Long term payables	–	–	218,305	–	218,305
	3,553,986	19,925,765	16,603,680	7,343,294	47,426,725

49 FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (Continued)

(c) Jet fuel price risk

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

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

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

	Group		Group	
	2007	**2007**	2006	2006
	Assets	**Liabilities**	Assets	Liabilities
	RMB'000	***RMB'000***	*MB'000*	*RMB'000*
Swaps, collars and forward contracts	**6,493**	**(14,826)**	99,935	(242,108)

	Company		Company	
	2007	**2007**	2006	2006
	Assets	**Liabilities**	Assets	Liabilities
	RMB'000	***RMB'000***	*MB'000*	*RMB'000*
Swaps, collars and forward contracts	**6,493**	**(6,819)**	98,026	(242,108)

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

The following table demonstrates the sensitivity at the balance sheet date to a reasonably possible change in fuel price, with all other variables held constant, of the Group's profit before tax and equity for the year:

	Change in profit before tax *RMB'000*	**Change in equity** *RMB'000*
2007		
If fuel price increased/decreased by RMB1,000 per tonne	**2,928,703**	**2,020,127**
2006		
If fuel price increased/decreased by RMB1,000 per tonne	2,741,117	1,893,141

49 FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (Continued)

(d) Foreign currency risk

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

The following table demonstrates the sensitivity at the balance sheet date to a reasonably possible change in the United States dollar ("US$") exchange rate, with all other variables held constant, of the Group's profit before tax (due to changes in the fair value of monetary assets and liabilities) and equity (due to changes in the fair value of monetary assets and liabilities as well as foreign exchange realignment arising from translating investments in foreign currency into RMB) for the year:

	Change in profit before tax *RMB'000*	**Change in equity** *RMB'000*
2007		
If RMB strengthened/weakened against US$ by 1%	**314,515**	**64,154**
2006		
If RMB strengthened/weakened against US$ by 1%	303,579	145,135

The Group also enters into foreign exchange derivative transactions, including principally collars contracts. The purpose is to manage the foreign currency risk arising from the Group's operations.

49 FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (Continued)

(e) Interest rate risk

The Group's earnings are also affected by changes in interest rates due to the impact of such changes on interest income and expense from short term deposits and other interest-bearing financial assets and liabilities.

The Group plans to use approved derivative instruments such as swaps and collars with approved counter parties and within approved limits. Moreover, the Group aims to limit the exposure to interest rate risk by proper combination of the interest-bearing debts with fixed interest rate and floating interest rate.

The following table sets out the carrying amounts, by maturity, of the Group's financial instruments that are exposed to interest rate risk:

Year ended 31 December 2007

Fixed rate

	Within one year *RMB'000*	In the second year *RMB'000*	In the third to fifth years, inclusive *RMB'000*	Over five years *RMB'000*	Total *RMB'000*
Obligations under finance leases	891,011	1,521,260	2,139,876	–	4,552,147
Bank loans, other loans and corporate bonds	1,198,656	1,543,601	2,479,295	3,164,637	8,386,189
Time deposits (note 29)	2,050,802	–	–	–	2,050,802

Floating rate

	Within one year *RMB'000*	In the second year *RMB'000*	In the third to fifth years, inclusive *RMB'000*	Over five years *RMB'000*	Total *RMB'000*
Obligations under finance leases	1,325,669	1,300,258	3,344,476	5,022,323	10,992,726
Bank loans and other loans	9,780,179	2,495,928	5,702,693	1,229,137	19,207,937
Cash at banks (note 29)	1,974,342	–	–	–	1,974,342

49 FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (Continued)

(e) Interest rate risk (Continued)

Year ended 31 December 2006

Fixed rate

	Within one year *RMB'000*	In the second year *RMB'000*	In the third to fifth years, inclusive *RMB'000*	Over five years *RMB'000*	Total *RMB'000*
Obligations under finance leases	1,889,312	1,508,428	4,439,695	–	7,837,435
Bank loans, other loans and corporate bonds	3,272,260	1,000,997	2,948,271	3,214,576	10,436,104
Bills payable	651,345	–	–	–	651,345
Time deposits (note 29)	3,890,037	–	–	–	3,890,037

Floating rate

	Within one year *RMB'000*	In the second year *RMB'000*	In the third to fifth years, inclusive *RMB'000*	Over five years *RMB'000*	Total *RMB'000*
Obligations under finance leases	465,593	488,526	1,622,014	3,189,192	5,765,325
Bank loans and other loans	7,866,761	1,648,699	2,632,916	1,256,518	13,404,894
Cash at banks (note 29)	1,480,648	–	–	–	1,480,648

Interest on financial instruments bearing floating rates is repriced at intervals of less than one year. Interest on financial instruments bearing fixed rates is fixed until the maturity of the instrument. The other financial instruments of the Group that are not included in the above tables are non-interest-bearing and are therefore not subject to interest rate risk.

The interest-bearing loans subject to floating interest rates are predominately US$ borrowings. The following table demonstrates the sensitivity to a reasonably possible change in interest rates, with all other variables held constant, of the Group's profit before tax (through the impact on floating rate borrowings) and the Company's equity for the year.

	Change in basis points %	Group Change in profit before tax *RMB'000*	Group Change in equity *RMB'000*	Company Change in profit before tax *RMB'000*	Company Change in equity *RMB'000*
2007					
United States dollar	**1%**	**10,007**	**6,705**	**9,536**	**6,389**
2006					
United States dollar	1%	6,042	4,048	5,599	3,751

49 FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (Continued)

(f) Credit risk

The following table sets forth the maximum credit exposure of the Group. The maximum exposure of loans and receivables granted and deposits placed is the carrying amount of these instruments, net of any impairment losses, and the maximum exposure of derivatives is the current fair value. For financial guarantees and loan commitments, the maximum exposure represents the maximum amount the Group which could be required to pay without consideration of the probability of the actual outcome.

	31 December 2007 ***RMB'000***	31 December 2006 *RMB'000*
Interests in associates	**9,542,677**	9,255,474
Advance payments for aircraft and related equipment	**7,652,365**	6,976,054
Deposit for aircraft under operating leases	**257,505**	259,681
Long tern receivable from ultimate holding company	**331,813**	431,813
Available-for-sale investments	**1,997**	6,704
Accounts and bills receivable	**2,795,879**	2,835,227
Deposits and other receivables *(note 28)*	**322,405**	184,358
Derivative financial instruments	**6,493**	99,935
Pledged deposits	**118,624**	211,504
Non-pledged deposits with maturity of more than three months when acquired *(note 29)*	**1,429,179**	1,570,777
Cash and cash equivalents *(note 29)*	**2,477,341**	3,588,404
Due from ultimate holding company	**335,129**	289,933
Due from related companies	**22,881**	14,378
Guarantees *(note 46(d))*	**132,857**	175,449
Commitments *(note 47)*	**71,741,096**	57,830,157
	97,168,241	83,729,848

The above-mentioned financial assets are mainly neither past due nor impaired. Further quantitative data in respect of the Group's exposure to credit risk arising from accounts receivable are disclosed in note 27 to the financial statements.

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

A significant portion of the Group's air tickets are sold by agents participating in the Billing and Settlements Plan ("BSP"), a clearing system between airlines and sales agents organised by the International Air Transportation Association. The balance due from BSP agents amounted to approximately RMB872 million as at 31 December 2007 (2006: RMB647 million).

Except for the above, the Group has no significant concentration of credit risk, with the exposure spreading over a number of counterparties.

49 FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (Continued)

(g) Capital management

The primary objective of the Group's capital management is to safeguard the Group's ability to continue as a going concern and to maintain healthy capital ratios in order to support its business and maximise shareholder value.

The Group manages its capital structure and makes adjustments to it, in light of changes in economic conditions. To maintain or adjust the capital structure, the Group may adjust the dividend payment to shareholders, return capital to shareholders or issue new shares. No changes were made in the objectives, policies or processes during the years ended 31 December 2007 and 31 December 2006.

The Group monitors capital using a gearing ratio, which is calculated as total liabilities divided by total assets. The gearing ratios as at the balance sheet dates are as follows:

	Group	
	2007	2006
	RMB'000	*RMB'000*
Total liabilities	**59,548,924**	52,741,843
Total assets	**91,056,277**	84,477,536
Gearing ratio	**65.40%**	62.43%

50 RELATED PARTY TRANSACTIONS

The Group is part of a larger group of companies under CNAHC and has extensive transactions and relationships with members of CNAHC. Related parties refer to entities of which CNAHC is a shareholder and is able to exercise control or joint control. The transactions were made at prices and terms mutually agreed between the parties. The Directors of the Company are of the opinion that the transactions with related parties (see below) during the year were conducted in the usual course of business.

The Group had the following significant transactions with (i) CNAHC, its subsidiaries (other than the Group) and joint ventures (collectively, the "CNAHC Group"); (ii) its joint ventures; and (iii) associates:

		Group	
		2007	2006
		RMB'000	*RMB'000*
(a)	Included in air traffic revenue		
	Sale of air tickets:		
	CNAHC Group	**4,095**	3,192
	Associates	**3,788**	3,040
		7,883	6,232
	Sale of cargo space:		
	CNAHC Group	**223,493**	209,747
	Charter flights:		
	CNAHC	**493,645**	479,132
(b)	Included in other operating revenue		
	Aircraft engine lease income:		
	Joint venture	**–**	–
	Associate	**3,374**	–
		3,374	–
	Aircraft engineering income:		
	Associates	**24,584**	25,853
	Ground handling services income:		
	CNAHC Group	**321**	1,700
	Joint ventures	**2,743**	2,463
	Associates	**68,875**	56,313
		71,939	60,476
	Bellyhold income:		
	Joint venture	**1,579,185**	1,518,925
	Others:		
	CNAHC Group	**27,391**	24,196
	Joint ventures	**19,614**	9,483
	Associates	**48,416**	36,653
		95,421	70,332

50 RELATED PARTY TRANSACTIONS (Continued)

	Group	
	2007	2006
	RMB'000	*RMB'000*
(c) Included in finance revenue and finance costs		
Interest income:		
Associate	**3,559**	9,220
Interest expense:		
Associate	**6,794**	21,002
(d) Included in operating expenses		
Airport ground services, take-off, landing and depot expenses:		
CNAHC Group	**88,615**	105,255
Associates	**170,947**	210,160
	259,562	315,415
Air catering charges:		
CNAHC Group	**56,248**	50,177
Joint ventures	**136,700**	126,024
Associates	**25,620**	29,472
	218,568	205,673
Repair and maintenance costs:		
Joint ventures	**422,301**	376,598
Associates	**212,857**	155,960
	635,158	532,558
Sale commission expenses :		
CNAHC Group	**7,136**	4,715
Joint venture	**1,768**	–
Associates	**12,226**	6,963
	21,130	11,678
Management fees :		
CNAHC Group	**9,307**	10,623
Aircraft leasing fees :		
Associate	**519,176**	529,893
Others:		
CNAHC Group	**215,816**	102,165
Associates	**24,709**	24,389
Joint ventures	**–**	469
	240,525	127,023

50 RELATED PARTY TRANSACTIONS (Continued)

	Group 2007 RMB'000	Group 2006 RMB'000	Company 2007 RMB'000	Company 2006 RMB'000
(e) Deposits, loans and bills payable:				
Deposits placed with an associate *(note 29)*	**387,962**	200,242	**357,016**	129,516
Loans from an associate	**238,098**	76,461	**151,321**	34,944
Bills payable to an associate *(note 33)*	**–**	95,733	**–**	95,733
(f) Outstanding balances with related parties:				
Long term receivable from ultimate holding company	**331,813**	431,813	**331,813**	431,813
Due from related companies	**22,881**	14,378	**–**	21
Due from associates *(note 21)*	**183,224**	144,914	**40,555**	21,784
Due to associates *(note 21)*	**(123,155)**	(89,426)	**(118,768)**	(105,818)
Due from a joint venture *(note 27)*	**306,831**	332,811	**585,703**	679,206
Due to related companies	**(45,142)**	(39,989)	**(27,730)**	(18,913)
Due to joint ventures *(note 32)*	**(141,419)**	(136,455)	**(334,047)**	(316,482)
Due from ultimate holding company	**335,129**	289,933	**350,377**	304,933
Due from subsidiaries *(note 19)*	**–**	–	**65,367**	55,080
Due to subsidiaries *(note 19)*	**–**	–	**(451,419)**	(499,087)

The long term receivable from CNAHC is unsecured, interest-free and is not repayable within one year from the balance sheet date. Except for the long term receivable from CNAHC, the outstanding balances with other related parties are unsecured, interest-free and are repayable within one year or have no fixed terms of repayment.

	Group 2007 RMB'000	Group 2006 RMB'000
(g) Compensation of key management personnel of the Group:		
Short term employee benefits	**8,363**	8,577
Share-based benefits	**5,728**	–
Post-employment benefits	**259**	187
	14,350	8,764

Further details of the remuneration of the Directors and Supervisors are included in note 10 to the financial statements.

50 RELATED PARTY TRANSACTIONS (Continued)

(h) On 25 August 2004, CNACG entered into two licence agreements with CNAC, pursuant to which CNACG has agreed to grant licences to CNAC, free of royalty, for the rights to use certain trademarks in Hong Kong and Macau, respectively, so long as CNAC is a direct or indirect subsidiary of CNAHC. No royalty charge was levied in respect of the use of these trademarks during each of the two years ended 31 December 2007.

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

The Group operates in an economic environment predominated by enterprises directly or indirectly owned or controlled by the PRC government through its numerous authorities, affiliates or other organisations (collectively, "State-owned Enterprises"). During the year, the Group had transactions with State-owned Enterprises including, but not limited to, the provision of air passenger and air cargo services and purchases of services. The Directors consider that transactions with these State-owned Enterprises are activities in the ordinary course of the Group's business and that the dealings of the Group have not been significantly or unduly affected by the fact that the Group and these State-owned Enterprises are ultimately controlled or owned by the PRC government. The Group has also established pricing policies for products and services, and such pricing policies do not depend on whether or not the customers are State-owned Enterprises. Having due regard to the substance of the relationships, the Directors are of the opinion that none of these transactions are material related party transactions that require separate disclosure.

51 EVENT AFTER THE BALANCE SHEET DATE

On 3 January 2008, CNAC entered into a sale and purchase agreement (the "Agreement") with CITIC and Gold Leaf Enterprises Holdings Ltd. ("Gold Leaf", a wholly-owned subsidiary of CITIC). Pursuant to the Agreement, CNAC has agreed to purchase from Gold Leaf the entire issued share capital of Fine Star Enterprise Corporation (another indirectly wholly-owned subsidiary of CITIC), which in turn holds a 25% equity interest in the registered capital of Air China Cargo. The aggregate consideration payable by CNAC for the transaction amounted to approximately RMB857 million.

52 COMPARATIVE AMOUNTS

Deferred tax liabilities of approximately RMB514 million for the Group and approximately RMB503 million for the Company as at 31 December 2006 have been reclassified from deferred tax assets in the current year's financial statements. In the opinion of the director, such reclassification would provide a more appropriate financial statement presentation and better reflect the Group's and the Company's financial positions.

53 APPROVAL OF THE FINANCIAL STATEMENTS

The financial statements were approved and authorised for issue by the Board of Directors on 17 March 2008.

Consolidated Balance Sheet

31 December 2007

(Prepared under China Accounting Standards)

	31 December 2007 RMB'000	31 December 2006 RMB'000 (Restated)
ASSETS		
CURRENT ASSETS:		
Cash and bank balances	**3,787,152**	4,982,844
Financial assets held for trading	**6,493**	99,935
Bills receivable	**1,599**	–
Accounts receivable	**2,812,327**	2,662,281
Other receivables	**997,205**	847,272
Prepayments	**311,784**	298,704
Inventories	**755,340**	704,367
Total current assets	**8,671,900**	9,595,403
NON-CURRENT ASSETS:		
Long term receivables	**255,340**	293,160
Long term equity investments	**11,404,643**	11,387,551
Fixed assets	**55,000,376**	49,243,169
Construction-in-progress	**10,967,888**	9,309,266
Intangible assets	**1,396,620**	1,291,905
Goodwill	**131,945**	131,945
Deferred tax assets	**385,843**	578,625
Long term deferred expenses	**80,684**	67,931
Total non-current assets	**79,623,339**	72,303,552
Total assets	**88,295,239**	81,898,955

Consolidated Balance Sheet

31 December 2007

(Prepared under China Accounting Standards)

	31 December 2007 RMB'000	31 December 2006 RMB'000 (Restated)
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Short term loans	**6,546,088**	8,016,656
Financial liabilities held for trading	**14,826**	242,108
Bills payable	**–**	610,545
Accounts payable	**6,338,341**	5,869,229
Domestic air traffic liabilities	**437,473**	383,851
International air traffic liabilities	**1,702,490**	1,147,204
Receipts in advance	**53,778**	14,770
Employee compensations payable	**254,073**	193,641
Taxes payable	**1,906,067**	1,700,858
Interest payable	**273,824**	177,946
Other payables	**2,221,096**	1,648,457
Non-current liabilities repayable within one year	**6,344,212**	5,205,258
Total current liabilities	**26,092,268**	25,210,523
NON-CURRENT LIABILITIES:		
Long term loans	**12,938,092**	9,130,330
Corporate bonds	**3,000,000**	3,000,000
Long term payables	**1,301,844**	1,140,234
Obligations under finance leases	**13,328,193**	11,247,855
Provisions	**191,533**	149,021
Deferred tax liabilities	**5,000**	7,000
Total non-current liabilities	**30,764,662**	24,674,440
Total liabilities	**56,856,930**	49,884,963
SHAREHOLDERS' EQUITY		
Share capital	**12,251,362**	12,251,362
Capital reserve	**11,852,408**	13,044,987
Reserve fund	**1,299,214**	716,612
Retained earnings	**6,888,843**	4,192,864
Including: Discretionary reserve fund proposed by Board of Directors	**264,700**	317,902
Dividend proposed by Board of Directors	**837,987**	602,767
Foreign exchange translation reserve	**(1,003,732)**	(203,151)
Equity attributable to equity holders of the Company	**31,288,095**	30,002,674
Minority interests	**150,214**	2,011,318
Total shareholders' equity	**31,438,309**	32,013,992
Total liabilities and shareholders' equity	**88,295,239**	81,898,955

Consolidated Income Statement

Year ended 31 December 2007
(Prepared under China Accounting Standards)

	2007 *RMB'000*	2006 *RMB'000* (Restated)
Revenue from operations	**49,738,921**	43,410,605
Less: Costs of operations	**40,307,624**	36,727,352
Business taxes and surcharges	**1,205,082**	1,005,817
Selling expenses	**3,290,959**	2,540,147
General and administrative expenses	**1,311,598**	1,254,505
Finance costs	**(52,619)**	876,888
Impairment losses in assets	**52,821**	19,457
Add: Gains/(losses) from changes in fair value	**133,840**	(268,041)
Investment income	**1,235,655**	3,525,557
Including: Share of profits and losses of associates and joint ventures	**1,131,024**	590,908
Profit from operations	**4,992,951**	4,243,955
Add: Non-operating income	**333,608**	161,840
Less: Non-operating expenses	**123,424**	87,192
Including: Loss on disposal of non-current assets	**45,212**	29,129
Profit before tax	**5,203,135**	4,318,603
Less: Tax	**1,429,284**	364,253
Net profit	**3,773,851**	3,954,350
Attributable to:		
Equity holders of the Company	**3,881,348**	2,977,195
Minority interests	**(107,497)**	977,155
Earnings per share (RMB):		
(I) Basic	**0.3267**	0.2903
(II) Diluted	**N/A**	N/A

31 December 2007
(Prepared under China Accounting Standards)

EFFECTS OF SIGNIFICANT DIFFERENCES BETWEEN IFRS AND CAS

The effects of the significant differences between the consolidated financial statements of the Group prepared under CAS and IFRS are as follows:

	Notes	2007 RMB'000	2006 RMB'000 (Restated)
Net profit under CAS		**3,881,348**	2,977,195
Deferred taxes	*(i)*	**(40,916)**	(232,066)
Additional depreciation from restatement of costs of fixed assets	*(ii)*	**(149,060)**	(159,746)
Reversal of depreciation and amortisation arising on revaluation	*(iii)*	**446,936**	490,369
Government grant	*(iv)*	**16,900**	(10,987)
Effect of component accounting	*(v)*	**57,635**	234,344
Gain on disposal of an associate	*(vi)*	**–**	(627,761)
Others		**16,154**	16,493
Profit attributable to equity holders of the Company under IFRS		**4,228,997**	2,687,841

	Notes	2007 RMB'000	2006 RMB'000 (Restated)
Equity attributable to equity holders of the Company under CAS		**31,288,095**	30,002,674
Deferred taxes	*(i)*	**(62,319)**	(21,403)
Restatement of costs of fixed assets	*(ii)*	**743,768**	892,828
Reversal of revaluation surplus	*(iii)*	**(972,848)**	(1,419,784)
Government grant	*(iv)*	**(410,242)**	(427,142)
Effect of component accounting	*(v)*	**603,038**	545,403
Gain on disposal of an associate	*(vi)*	**139,919**	139,919
Others		**27,726**	11,763
Equity attributable to equity holders of the Company under IFRS		**31,357,137**	29,724,258

Supplementary Information

31 December 2007
(Prepared under China Accounting Standards)

Note:

(i) This mainly represents differences in deferred tax caused by other difference under IFRS and CAS as explained below.

(ii) Differences in the costs of fixed assets mainly relate to fixed assets acquired in foreign currencies prior to 1 January 1994 and are stated at the equivalent amount of RMB translated at the then prevailing exchange rates prescribed by the government (i.e. the government-prescribed rates). Under IFRS, such differences are stated at the equivalent amount of RMB translated at the then prevailing market rate (i.e. the swap rate), resulting in differences in the costs of fixed assets between the financial statements prepared under IFRS and under CAS.

(iii) In accordance with the accounting policies under IFRS, all assets are recorded at historical costs. Accordingly, the revaluation of assets and their amortisation recorded under CAS are reversed in the financial statements prepared under IFRS.

(iv) Under both IFRS and CAS, government grant or subsidies from government should be debited to receivables from government grant or the relevant assets, and time credited to deferred income in the balance sheet, which is amortised to the income statement on a straight-line basis. Assets received from government grant was debited to asset and credited to capital reserve while cash received was recognised in cash and cash equivalent and subsidy income. As the government grant had no significant impact on the Group's net profit and net assets, it was not adjusted in the group's financial statements prepared under CAS.

(v) This represents timing differences on the adoption of component accounting under IFRS and CAS. Component accounting was adopted by the Group on a prospective basis under IFRS in 2005 while it was adopted on a prospective basis under CAS in 2007.

(vi) This represents the difference in the gain on disposal of the Group's interest in Dragonair to Cathay under IFRS and CAS.

Glossary of Technical Terms

CAPACITY MEASUREMENTS

"available seat kilometres" or "ASKs"	the number of seats available for sale multiplied by the kilometres flown
"available freight tonne kilometres" or "AFTKs"	the number of tonnes of capacity available for the carriage of cargo and mail multiplied by the kilometres flown
"available tonne kilometres" or "ATKs"	the number of tonnes of capacity available for the transportation of revenue load (passengers and cargo) multiplied by the kilometres flown
"tonne"	a metric ton, equivalent to 2,204.6 pounds

TRAFFIC MEASUREMENTS

"revenue passenger kilometres" or "RPKs"	the number of revenue passengers carried multiplied by the kilometres flown
"passenger traffic"	measured in RPKs, unless otherwise specified
"revenue freight tonne kilometres" or "RFTKs"	the revenue cargo and mail load in tonnes multiplied by the kilometres flown
"cargo traffic"	measured in RFTKs, unless otherwise specified
"revenue tonne kilometres" or "RTKs"	the revenue load (passenger and cargo) in tonnes multiplied by the kilometres flown

YIELD MEASUREMENTS

"passenger yield"	revenues from passenger operations divided by RPKs
"cargo yield"	revenues from cargo operations divided by RFTKs

LOAD FACTORS

"cargo load factor"	RFTKs expressed as a percentage of AFTKs
"passenger load factor"	RPKs expressed as a percentage of ASKs
"overall load factor"	RTKs expressed as a percentage of ATKs

UTILISATION

"block hours"	each whole or partial hour elapsing from the moment the chocks are removed from the wheels of the aircraft for flights until the chocks are next again returned to the wheels of the aircraft