

MANAGEMENT DISCUSSION AND ANALYSIS

In the first half of 2003, the outbreak of Severe Acute Respiratory Syndrome ("SARS") had a significant adverse impact on the economy of the People's Republic of China (the "PRC"), and on the operations of Hainan Meilan Airport Company Limited ("Meilan Airport" or the "Company") and its subsidiaries (collectively the "Group"). During the six months ended 30 June 2003, the Group's total revenue was approximately RMB133,000,000, a decrease of 3.8% as compared to the corresponding period of last year. Net profit fell by 40.7% to approximately RMB52,000,000. Earnings per share was RMB0.11 (six months ended 30 June 2002: RMB0.35).

BUSINESS REVIEW

1. *Aeronautical Business*

Affected by SARS, accumulative passenger throughput totaled approximately 2,508,000 for the six months ended 30 June 2003 and achieved 41.8% of the full-year target, a decrease of 11.7% from that of the corresponding period of last year. Aircraft movements recorded 31,254 and completed 47.4% of the full year target, comparable to that of the same period of last year. Of the total aircraft movements, transportation movement recorded 23,863, a decline of 12.3% from that of the corresponding period of last year. Cargo throughput defined by 1.2% as compared to that of the corresponding period of last year, reaching 40,507.1 tons, which accounted for 51.4% of the full-year target.

The tourism industry of the PRC has been seriously hit by SARS since its outbreak in April 2003. On 20 April 2003, the State Council and China National Tourism Administration made various announcements on cancelling the Labour Day public holiday and prohibiting tourists from infected areas to travel to other regions, and prohibiting visits to infected areas for tourism purposes. These various announcements brought about substantial adverse impacts on the Group's operations. Passenger throughput, aircraft movements and cargo throughput dived, recording approximately 630,000, 13,666 and 14,072 tons respectively in the second quarter of 2003, representing decreases of 48.4%, 5.7% and 25.5% as compared to that of the corresponding period of last year, respectively.

The adversely affected operations of the Group resulted in a decrease of its aeronautical revenue for the six months ended 30 June 2003. Aeronautical revenue was approximately RMB91,000,000, representing 41.0% of the full-year target and a decrease of 16.9% as compared to that of the corresponding period of last year.

During the first half of 2003, the Group actively sought the approval of Civil Aviation Administration of China ("CAAC") for Meilan Airport to attain the status of an international airport. In order to comply with the requirements of this status in respect of infrastructure and capabilities in customs inspection, the Group completed the construction of a new customs and inspection joint operation building that will be commissioned soon by using proceeds raised from the H Share Offer in 2002. Meanwhile, in view of the rising traffic volume, the Group also implemented its planned expansion to build a new apron (the full completion and commissioning of which is scheduled by September 2003) and to commence the requisite preparations for the expansion of the Terminal.

Subsequently, Meilan Airport attained the qualification of an international airport at the end of July 2003. By virtue of such qualification, applications by domestic and foreign airlines to operate international flights via Meilan Airport will be accepted by CAAC by means of simplified approval procedures, which will enable Meilan Airport to handle more international flights. On 24 March 2003, CAAC approved Hainan Province as a trial zone for liberalising the third, fourth and fifth categories of aviation rights (namely air passenger and cargo transportation rights). The Board understands that such policy to liberalise aviation rights would mean that foreign airlines as well as airlines from Hong Kong, Macau and Taiwan may schedule direct flights to Hainan and/or flights to other countries via Hainan through bilateral or multi-lateral agreements without being subject to any principles concerning bilateral aviation on an equality basis. They may also, by virtue of fifth category of aviation rights, load or unload passengers, cargo and mail at Hainan. As Hainan Province's gateway airport, Meilan Airport is set to benefit from the liberalisation of such aviation rights, which was the first of its kind in Mainland China.



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The liberalisation of aviation rights for Hainan Province and the attainment of the status of an international airport for Haikou Meilan Airport will drive the growth of revenues from the Group's aeronautical business segment and revenues from non-aeronautical sources such as the sale of duty-free goods and tourism services. It plays an indispensable role in shaping a more renowned image of the Company and building Haikou Meilan Airport into a regional hub for international flights.

2. *Non-aeronautical Business*

For the first half of 2003, the Group's revenue generated from its non-aeronautical businesses amounted to approximately RMB43,000,000, representing an increase of 44.6% as compared to the corresponding period of last year and a 47.0% completion of the full-year target. The growth is mainly attributable to the income generated from the acquisition of interests in Hainan Meilan Airport Travelling Company Limited ("Meilan Travelling"), interests in Haikou Meilan Airport Duty-Free Shop Limited ("DFG"), franchise in respect of a cargo centre and car parking facilities (the "Four Asset Items") from the Parent Company in May 2002, as well as the revenue from the management of Sanya Phoenix Airport since August 2002.

In the first half of 2003, revenues generated from the Four Asset Items increased by approximately RMB18,000,000 as compared to that of the corresponding period of last year, of which the sale of duty-free goods, the provision of tourism and travel services, cargo transportation and car parking accounted for an increase of approximately RMB3,720,000, RMB9,040,000, RMB3,960,000 and RMB1,300,000, as respectively, compared to the corresponding period of last year.

The Group received an increase of management fee of RMB1,070,000 for the management of Sanya Phoenix Airport.

The outbreak of SARS had a significant impact on the Group's traffic throughputs as well as the commercial leasing business at the Terminal. Compared to the corresponding period of last year, the Group's leasing revenue from the Terminal fell by 34.0% to RMB8,000,000.

Notwithstanding the impact of the SARS outbreak, the management has been committed to minimizing its negative impacts by adopting various measures in connection with its non-aeronautical businesses to strengthen management and improve revenue during the first half of the year:

- A scientific management system was implemented on the sale of duty-free goods. Despite the declined passenger throughput in May and June of the year, DFG still managed to generate revenue amounting to approximately RMB4,200,000, growing by 21.5% as compared to that of the corresponding period of last year;
- Exploration of both its advertising media and advertising clientele was underway to optimize the efficiency of its airport advertising resources. Hainan Haikou Meilan Airport Advertising Company Limited ("Meilan Advertising") recorded revenue of approximately RMB2,700,000, representing a 10.0% growth as compared to that of the corresponding period of last year and a 45.7% completion of the full-year target;
- Measures to improve the internal operation and management were implemented by Meilan Travelling to raise its economic efficiency. In spite of the plunge of passenger throughput in the second quarter, Meilan Travelling still achieved revenue amounting to approximately RMB9,900,000, representing a relatively slight decrease of 18.0% as compared to the figure for the same period of last year; and
- Surveys and researches were commenced to identify opportunities to streamline commercial activities at the departure terminal. Following international standards for industry development, the Group invited ACNielsen, a renowned international market researcher, to conduct a survey project on the demands of passengers to lay a solid foundation for the systematic development of airport resources and the introduction of international commercial operators for the ongoing expansion of the commercial activities at the airport.



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3. *Active pursuit of policy support from the government*

At present, applications for a range of concessionary policies to mitigate the impact of SARS have received government approval after strong lobbying efforts. For example, the local tax authority has consented to the grant of full exemption of business tax, urban construction fee and education surcharges in respect of aircraft movement service income to the Company for the period from 1 May to 30 September, which are expected to reduce tax charges by approximately RMB2,100,000. The Company has also obtained the consent of local tax authority in respect of the full exemption of property tax for the period from April 2003 to December 2003, which is expected to translate into a reduction of expenses of nearly RMB2,500,000. It is anticipated that the aforesaid concessionary policies will cut the Company's expenditure by a total of nearly RMB5,000,000.

4. *Proactive participation amidst liberalised aviation rights to prepare for resumption of full-capacity operation*

Currently, Hainan Province has been approved by CAAC to liberalise the third, fourth and fifth categories of aviation rights (the "Liberalised Aviation Rights") on a trial basis. The Group has been taking an active part in it, such as improving the design of the airport to perform a better transit function; providing its ground handling personnel with more intensified training on international aircraft transportation business with a view to equipping them with the expertise necessary for handling international transportation of passengers and cargoes and financial matters regarding international aviation; improving the customs inspection function of the airport in collaboration with the airport customs inspection authority; applying for the qualification of sales agency for serving international passengers and cargoes; obtaining the status of an authorised business agency from overseas airlines and so forth. These aim at preparing for the forthcoming resumption of operation at full capacity and to recoup under-production during the first half of the year.

FINANCIAL REVIEW

1. *Liquidity and Financial Resources*

As at 30 June 2003, the Group had total current assets of approximately RMB762,000,000, comprising cash and cash equivalents of RMB468,000,000, short-term investments of approximately RMB200,000,000, net accounts receivable of approximately RMB19,000,000, inventories of approximately RMB2,700,000, prepayments, deposits and other receivables of approximately RMB6,500,000, and amounts due from related parties of approximately RMB65,000,000.

The Group's current liabilities were approximately RMB176,000,000 as at 30 June 2003, comprising short-term bank loan of approximately RMB50,000,000, outstanding principal balance of long term loan payable to China Development Bank of approximately RMB62,000,000, accounts payable of approximately RMB1,700,000, accrued liabilities and other payables of approximately RMB37,000,000, airport fee payable of approximately RMB8,600,000, due to related parties of approximately RMB14,000,000, tax payable of approximately RMB1,300,000, and deposits received of approximately RMB1,300,000.

2. *Operating Costs*

For the first half of 2003, operating costs of the Group were approximately RMB42,000,000, representing an increase of 39.8% compared to the corresponding period of last year. The rise in expenses was mainly attributable to the increase in costs and expenses of approximately RMB6,640,000 in relation to the acquisition of the Four Asset Items in May 2002 and the increase in depreciation and amortization of approximately RMB2,500,000 brought by the Company's asset revaluation surplus in August 2002 and the addition of new assets. Although the Group imposed wage reduction measures on its staff during the SARS outbreak, the increase in incentive payments to the employees in January 2003 pushed up the overall wage expenses by approximately RMB1,300,000.



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The Group's administrative expenses for the first half of 2003 were approximately RMB27,000,000, representing an increase of 206% over the corresponding period of previous year. This was mainly attributable to the increase in administrative expenses of Meilan Travelling and DFG of approximately RMB800,000, the increase in sponsor's fee and legal fee as well as the technical service fee to Copenhagen Airports A/S, a shareholder of the Company, of approximately RMB7,100,000 subsequent to the Company's listing in November 2002, the increase in auditors' remuneration of approximately RMB700,000, remuneration for the management for 2003 amounting to approximately RMB1,300,000, year-end bonus for 2003 of approximately RMB1,000,000 expected to be payable to employees, the increase in staff expenses of approximately RMB3,300,000 and the increase in the Group's supporting service fee of approximately RMB2,300,000.

3. *Gearing Ratio and Current Ratio*

As at 30 June 2003, the Group had total current assets of approximately RMB762,000,000, total assets of approximately RMB1,631,000,000, total current liabilities of approximately RMB176,000,000, and total liabilities of RMB320,000,000.

Gearing ratio (total liabilities/total assets) of the Group was 19.6% and current ratio (current assets/current liabilities) was 433.0%, representing a decrease of 3.0% and 230.9% respectively as compared to the corresponding period of last year. This was mainly attributed to the net repayment of long-term loans amounting to RMB74,000,000 during the period under review. Included in the current liabilities of the Group was an amount of RMB62,000,000, being the outstanding portion, to be repayable soon, of a RMB264,000,000 long-term loan.

4. *Charges on the Group's Assets*

The Company pledged its land use rights amounting to approximately RMB50,000,000 to secure for a long-term bank loan of RMB62,000,000 and pledged its operating revenue and the right to the retention of Airport Management and Construction Fee to secure for a long-term bank loan of RMB128,000,000.

5. *The Group's Capital Structure*

The Group's financings comprised bank borrowings and shareholders' funds.

As at 30 June 2003, the Group had bank borrowings of RMB240,000,000, comprising a short-term bank loan of RMB50,000,000 from China Development Bank which is interest-bearing at a rate of 5.31% per annum, unsecured and repayable on 9 September 2003; a long-term bank loan of RMB62,000,000 which will be repayable soon and is secured by the land use rights of approximately RMB50,000,000 of the Group; and a long-term loan of RMB128,000,000 which is secured by the Group's operating revenue. Each of the two aforesaid long-term loans bears a weighted-average interest rate of 5.76% per annum.

6. *Material Investment, Performance and Future Prospects*

In May 2003, the Company entered into a designated investment agreement with Xiangcai Securities Company Limited, pursuant to which Xiangcai Securities Company Limited was engaged by the Company to invest on behalf of the Company an amount of RMB200,000,000 on short-term investment portfolio comprising government bonds and repurchased government debentures traded on recognized securities exchanges in the PRC. Xiangcai Securities Company Limited guaranteed the Company an annual return rate of not less than 2.5%.



7. *Acquisition and Disposal*

The Company had no material acquisition and disposal of asset as at 30 June 2003.



8. *Entrusted Deposits and Overdue Fixed Deposits*

The Company had no entrusted deposits and overdue fixed deposits as at 30 June 2003.



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9. *Contingent Liabilities*

As at 30 June 2003, the Group had contingent liabilities in terms of discounted trade bill of RMB50,214,000.

PROSPECTS FOR THE SECOND HALF OF THE YEAR

As Hainan Island stood out as one of the few areas in China not affected by SARS, we are cautiously optimistic that Meilan Airport will benefit from the rebound and resurgent growth of Hainan's tourist industry in the second half of 2003 following the elimination of SARS. Coupled with the international airport status and the Liberalised Aviation Rights policy of Hainan, the Board believes that Meilan Airport, being the main gateway from Mainland China to Hainan, will witness increased international transit flights and passengers. The Board is confident that the Company will continue to achieve satisfactory results in both its aeronautical and non-aeronautical businesses.

Looking ahead, the Group will continue to be committed in its efforts to improve its cost structures, enhance its operational and management efficiency and quality of service, in accordance with the general criteria of sound financial conditions, management best practice, efficient operations and effective controls and be dedicated to its corporate mission "to be the most successful regional airport management company in China, offering quality and safe airport services". We will endeavour to eliminate the negative impact of SARS and procure steady recovery and development of its businesses. Capitalising on the opportunities presented by the policy in re-aligning airport ownership in Mainland China according to geographical locations, we will, in the meanwhile, endeavour to actively identify opportunities to acquire or merge with other airports, with a view to securing further growth in revenues and earnings. In pursuit of our goal of becoming a regional airport management company, we will step up with plans to establish a regional group specialising in airport management. Given the Liberalised Aviation Rights at Hainan, we will also leverage on such exceptional opportunity to focus on its development into a major gateway airport in Mainland China. The Group is confident to maintain its excellent record in flight safety. We will continue to apply funds raised in the H Share Offer in November 2002 in carrying out our existing plans and implementing our strategy oriented at business development and growth, with a view to the continuing enhancement of the Company's value and returns to shareholders.

INTERIM DIVIDEND

The Board has recommended the payment of an interim dividend of RMB2.7 cents per share for the six months ended 30 June 2003. In accordance with the Articles of Association of the Company, dividends payable to holders of Domestic Shares will be paid in Renminbi, whereas dividends payable to holders of H Shares will be calculated and declared in Renminbi and paid in Hong Kong Dollars. The exchange rate to be adopted shall be the average closing rates for the five working days preceding the date of dividend declaration as quoted by the People's Bank of China.

CLOSURE OF REGISTER OF MEMBERS

The Register of Members of the Company will be closed from Monday, 15 September 2003 to Monday, 22 September 2003, both days inclusive, during which period no transfer of shares will be registered. In order to qualify for the interim dividend, all instruments of transfers, accompanied by the relevant share certificates, must be lodged with the H Share Registrar of the Company, Computershare Hong Kong Investor Services Limited at Shop 1712-1716, 17th Floor, Hopewell Centre, 183 Queen's Road East, Wanchai, Hong Kong, no later than 4:00 p.m. on Thursday, 11 September 2003. The interim dividend is expected to be payable on or before Friday, 20 October 2003 to shareholders whose names appear on the Register of Members on Friday, 22 September 2003.

MATERIAL LITIGATION OR ARBITRATION

The Company had no material litigation or arbitration as at 30 June 2003.

