

Management Discussion and Analysis



Civil Aviation Industry in China

In 2005, the overall profitability of the civil aviation industry in China was dragged down over 2004 under the tense pressure of fiercely surging oil fuel prices. In light of great steps taken by various governments towards the development of airport industry following the airport localised reforms in 2004, many airports were expanded in response to constantly increasing passenger flows. With marked improvements in airport infrastructures, operation security was further assured coupled with a healthy and contributive competitive environment.

Concerted efforts made by Hainan Provincial Government in opening aviation rights and localising had fostered a gradual increase in international and regional routes and flights. Presently, 51 international and regional routes have been opened by 19 domestic and foreign aviation companies, including 12 regular routes and 39 irregular routes. The opening of aviation rights will create a flurry of foreign passenger sources for Hainan Island. With an optimized structure of passenger source, Hainan Meilan International Airport is set to enjoy continuously growing passenger flows at the same time. In 2006, Hainan Province will endeavour to further explore its passenger flows in European markets through stronger promotional efforts and interchanges and upgraded international reputation in order to solicit more foreign passenger sources.

Tourism in Hainan Province

Hainan Island, being well-known as a paradise resort, has emerged as a popular scenic spot for many domestic and foreign tourists over a decade of leaping developments. In 2005, Hainan Province remarkably consolidated the tourism market so as to actively expand into the international and domestic tourism markets and to gradually convert from a scenic spot to a resort. In addition, through active participations in a number of domestic and foreign marketing campaigns including Moscow International Travel Tour Expo, Expo Aichi, Japan and Korea International Travel Show in Seoul, and through the hosting of a pool of cultural activities like Boao Asia Golf Open Tournament, Film Festivals, Chinese Happiness Stanza and Miss World, Hainan Island is becoming an increasingly famous place with favourable external environment for sustaining business growth of Hainan Meilan International Airport.

Business Review

Overview of Aeronautical Business

In 2005, the Group's production and operation indicators were dampened for the first time over its history due to the strategic reorganizations and structural changes by the airlines, market consolidation in Hainan and a drift of passenger flows upon the commencement of the Guangdong-Hainan Railway. Therefore, to enhance the overall profitability, the Group has established various income growths and cost savings measurement.

Optimistic Exploitation of International Airlines

Since the opening of aviation rights in Hainan Province, the Group has dedicated itself to hold fruitful negotiations with several major international airlines in respect of the exploitation of international and regional routes, by which extensive cooperative intentions were reached. In 2005, Hainan Meilan International Airport delivered impressive growth in international and regional routes. Up to now, seven domestic and foreign airlines have opened eleven international or regional routes departing from or arriving at Hainan Meilan International Airport, reaching destination of Hong Kong, Macau, Seoul, Singapore, Bangkok, Kuala Lumpur, Osaka, Pusan and Fukuoka., etc. Five international airlines including Malaysia Airlines Co. Ltd., Singapore Valuair Airlines Co. Ltd., Singapore Silk Air Co. Ltd., Korea Asiana Airlines Co. Ltd. and Thailand Phuket Airlines Co. Ltd. have opened routes to and from Haikou.

In January 2005, the Group successfully obtained the hosting right of New Routes Asia Conference in 2007 by entering into an agreement with ASM International Company. Haikou will become the first city in China to host an international airline conference. The Group believes the New Routes Asia Conference will not only bring potential gain in aeronautical market of the hosting city, but also represent a valuable opportunity for the group to promote its image and enhance international recognition. Taking advantage of organizing New Routes Asia Conference, the Group plans to lure additional opening of more routes to and from Haikou by foreign airlines through strengthening interchanges with international airlines.



Management Discussion and Analysis



Aviation traffic throughput for 2005 and the comparison figures for the previous year are set out below:

	2005	2004	Change (%)
Aircraft movement	68,879	68,282	0.9%
In which: Domestic	66,383	66,422	-0.1%
Hong Kong/Macau	1,562	1,317	18.6%
International	934	543	72.0%
Passengers Throughput (Ten thousand persons)	702.7	747.8	-6.0%
In which: Domestic	680	730.3	-6.9%
Hong Kong/Macau	14	12.5	12.0%
International	8.7	5	74.0%
Cargoes Throughput (Tones)	94,728.9	98,482.5	-3.8%
In which: Domestic	91,217.7	96,179.6	-5.2%
Hong Kong/Macau	1,938	1,489.5	30.1%
International	1,573.2	813.4	93.4%

Attributable to the opening of the third, fourth and fifth aviation rights and the Group's aggressive approach in exploring more international routes, the number of international airlines grew substantially. It is estimated that the Group's international flights and international passenger throughput will sustain stable growths in 2006. Under unfavourable market environment, the Group's revenue from aeronautical business for the year 2005 was RMB248.36 million, representing a decrease of 4.4% as compared to last year. Details are set out as follows:

	Amount (RMB'000)	Change to last year (%)
Passenger charges	95,366	-6.3%
Aircraft movement fees and related charges	42,262	-0.1%
Airport fee	85,327	-5.4%
Ground handling service fees	25,409	-0.5%
Total revenue from Aeronautical Business	248,364	-4.4%



Overview of Non-Aeronautical Business

In 2005, with the help of the business development experience of Copenhagen Airports, the Group built up a business development model which includes the method of resources utilization and management to suit the development requirement of the airport and stable achievements are made in the non-aeronautical business. The non-aeronautical business revenue was RMB86.48 million, representing a decrease of 13.8% as compared to last year. The decrease in revenue was attributable to the transfer of the retail business of a shopping arcade by the Company to DFS in March 2005 in return for the receipt of franchise income from DFS and the impact of the reduction in passenger and cargo throughput of Hainan Meilan International Airport. Details are set out as follows:

	Amount (RMB'000)	Change to last year (%)
Retail	10,160	-53.4%
Franchise revenue	15,980	14.2%
Leasing of commercial areas in the airport terminal	16,469	-14.7%
Tourism transportation revenue	19,457	-12.2%
Advertising revenue	9,157	11.0%
Car parking fees	5,327	5.0%
Other revenue	9,930	2.4%
Total revenue from non-aeronautical business	86,480	-13.8%

Commercial Sales

The Group entered into a close cooperative relationship with SSP, a world famous catering company and DFS in the year under review in order to put into place a unified and professional commercial management of airports by gradually transforming from self operation to licensed operation. Through the entering into a contract with minimum-guaranteed rental, the Group will be assured of fixed revenue in times of falling turnover while obtaining pro rata additional revenue in times of growing turnover. Losses in association with a reduction in production output were effectively reduced by minimizing operation risks.

Tourism and Traveling

Hainan Meilan International Airport Traveling Company Limited ("Meilan Traveling") provides a wide range of services such as transportation between Hainan Meilan International Airport and Haikou City, hotel reservation, air ticket sales and travel reception. It also actively organises many short tour packages. Due to a reduction in passenger and cargo throughput, turnover from tourism and traveling in 2005 was RMB19.46 million.

Management Discussion and Analysis

Car Parking

Car parking charges is another income contributor for the Group's non-aeronautical business. The turnover in 2005 amounted to RMB5.33 million.

Advertising Business

In 2005, leverage on hosting material events, such as Boao Asia Forum in Hainan, the Group has entered into advertising contracts with Merrill Lynch (Asia Pacific) Limited and Shanghai Asiaray Advertising Limited through the deployment of more promotional resources and efforts and the building up of an extensive sales network. Over 30 reputed enterprises, including Shanghai Brawman Group (上海寶名國際集團), Boao Sofitel Hotel, Sanya Film Festival Coordination Committee (三業電影藝組織委員會) and Hainan Mobile Communication Company Limited, were introduced to take up advertising spaces in Hainan Meilan International Airport. For the year ended 31 December 2005, revenue from advertising business reached RMB9.16 million, equivalent to an approximately 11% growth over 2004.

Retail Business

Revenue from retail business was RMB10.16 million for the year ended 31 December 2005, which represented a 53% decrease over that of last year. It was attributable to the decrease of overall revenue after the transfer of the retail business of the shopping arcade by the Group to DFS in March 2005 in return for the receipt of franchise income from DFS.

Income from Franchise

For the year ended 31 December 2005, income from franchise was RMB15.98 million, representing an increase of 14% over the previous year. This was largely attributable to the outsourcing by the Group of the commercial operating of the airport terminal building to DFS since March 2005 in return for the receipt of franchise income from DFS.

Financial Review

Structure of Assets

As at 31 December 2005, the total assets of the Group amounted to RMB1,717.27 million, representing an increase of 0.8% as compared to last year. The increase was mainly attributable to the increase in the shareholders' equity brought by the operating results.

Cost Structure

In 2005, total operating costs of the Group were RMB99.14 million, representing a decrease of RMB7.13 million or 6.7% over last year. The administrative expenses were RMB62.17 million, representing an increase of RMB6.1 million or 10.9% as compared to last year. The increase in annual administrative expenses was attributable to the following:

1. The logistic expenses paid by the Company to HNA Group rose by RMB1.24 million over the previous year due to increasing crude oil prices and rising costs of other vehicle services;
2. In compliance with new International Financial Reporting Standards, net goodwill of RMB3.49 million was written off.

Cash Flows

In 2005, the Group's net cash flows from operating activities was RMB121.56 million, representing a decrease of 33%, which was primarily due to that the airport fee has not received. During the year, the Group's net cash outflows for investing activities was RMB156.36 million, which was mainly attributable to the capital injection from the Group for the expansion of the terminal building.

Pledge of the Group's Assets

The Group pledged its rights to revenues, including the rights of the airport fee to secure a long-term bank loan of RMB103 million from China Development Bank.

Gearing Ratio

As at 31 December 2005, the current assets of the Group was approximately RMB536.17 million, the total assets was approximately RMB1,717.27 million, a current liability of approximately RMB113.13 million and a total liability of approximately RMB177.39 million. The Group's gearing ratio, representing the ratio of the total bank borrowing to the total asset, was 6%, a decrease of 1.5% in comparison to that of the previous year. The main reason for the improvement was the partial repayment in the amount of RMB25 million by the Group when it fell due.

Exposure to Foreign Exchange Risk

Except the purchase of certain equipment, goods and raw materials which were denominated in US Dollar, the Group's businesses were denominated in RMB. The dividends of H share of the shareholders was published by RMB and paid in HK Dollars. As at 31 December 2005, except that cash and cash equivalents of approximately RMB960,000 were denominated in HK Dollar and US Dollar, all of the Group's assets and liabilities were denominated in RMB. The fluctuation of the exchange rate of RMB to foreign currency may cause a limited impact on the Group's results of operations.

Financial Instruments

As at 31 December 2005, financial instruments of the Group mainly comprised bank loans, cash and bank deposits. The purpose of those financial instruments is to finance the Group's operations. Besides, the Group has other financial instruments in relation to daily operations, such as accounts receivable and accounts payable.

Contingent Liability

As at 31 December 2005, the Group or the Company did not have any significant contingent liabilities.

Purchase, Sales or Redemption of Shares

As at 31 December 2005, neither the Group nor the Company has purchased, sold or redeemed any of the Company's shares.

Employment, Training and Development

As at 31 December 2005, the Group had a total of 691 employees, representing a decrease of 23 employees as compared to last year. This was mainly due to stringent control over the recruitment of personnel and the outsourcing of the business of the shopping arcade. Total staff costs accounted for about 10% of total turnover, representing an increased of 1.6% as compared to last year. The reason of the increase in cost was mainly contributed by the increase in staff welfare expenses by the Group, including the increase in social insurance premiums. Employees are remunerated based on their performance, experience and prevailing industry practices. The Group will review the remuneration policy and its related combination on a regular basis. Performance-based bonuses and commissions may be awarded to employees.

Retirement Pension

The Company and its respective subsidiaries have participated in the employee retirement scheme operated by the relevant domestic government of the PRC. The relevant domestic government shall be responsible for the pension of the retired employees. The Group has to make contribution at a rate of 20% of the salary of the employees of permanent residence in the PRC. For the year ended 31 December 2005, the contribution for the pension was amounted to approximately RMB3.53 million (2004: RMB2.78 million).

Other Information

The Group has no material change in other information in relation to those matters set out in paragraph 32 of Appendix 16 to the Listing Rules in 2005.