CATHAY PACIFIC AIRWAYS LIMITED

CATHAY PACIFIC

ANNUAL REPORT 2006

Stock code: 00293

CATHAY PACIFIC

Cathay Pacific Airways is an international airline registered and based in Hong Kong, offering scheduled passenger and cargo services to 104 destinations in 35 countries and territories.

The Company was founded in Hong Kong in 1946 and has remained deeply committed to its home base, making substantial investments to develop Hong Kong as one of the world's leading global transportation hubs. In addition to our fleet of 102 wide-bodied aircraft, these investments include catering, aircraft maintenance and ground handling companies in addition to our corporate headquarters, Cathay Pacific City, at Hong Kong International Airport.

Contents

2 Financial and Operating Highlights
3 Chairman's Letter
4 2006 in Review
9 Review of Operations
18 Financial Review
26 Directors and Officers
28 Directors' Report
35 Corporate Governance
40 Corporate Responsibility
44 Independent Auditor's Report
45 Principal Accounting Policies
50 Consolidated Profit and Loss Account
51 Consolidated Balance Sheet
52 Company Balance Sheet
53 Consolidated Cash Flow Statement
54 Consolidated Statement of Changes in Equity
56 Company Statement of Changes in Equity
58 Notes to the Accounts
88 Principal Subsidiaries and Associates
90 Statistics
95 Glossary
96 Corporate and Shareholder Information

A Chinese translation of this Annual Report is available upon request from the Company's Registrars.

本年報中文譯本，於本公司之股份登記處備索。

In September 2006, Hong Kong Dragon Airlines Limited ("Dragonair") became a wholly owned subsidiary of Cathay Pacific, while Cathay Pacific and Air China Limited ("Air China") increased their cross-shareholdings to form a closer partnership. Cathay Pacific is also the major shareholder in AHK Air Hong Kong Limited ("AHK"), an all-cargo carrier offering scheduled services in the Asian region.

Cathay Pacific and its subsidiaries employ more than 18,600 people in Hong Kong. The airline is listed on The Stock Exchange of Hong Kong Limited as is its major shareholder.

We are a founding member of the **one**world global alliance whose combined network serves some 600 destinations worldwide. Dragonair will become an affiliate member of **one**world in 2007.

		2006	2005	Change
GROUP FINANCIAL STATISTICS				
Results				
Turnover	*HK$ million*	**60,783**	50,909	**+19.4%**
Profit attributable to Cathay Pacific shareholders	*HK$ million*	**4,088**	3,298	**+24.0%**
Earnings per share	*HK cents*	**115.9**	97.7	**+18.6%**
Dividend per share	*HK cents*	**84.0**	48.0	**+75.0%**
Profit margin	*%*	**8.0**	7.4	**+0.6%pt**
Balance Sheet				
Funds attributable to Cathay Pacific shareholders	*HK$ million*	**45,554**	34,968	**+30.3%**
Net borrowings	*HK$ million*	**16,348**	9,050	**+80.6%**
Shareholders' funds per share	*HK$*	**11.6**	10.3	**+12.6%**
Net debt/equity ratio	*Times*	**0.36**	0.26	**+0.1 times**

		Cathay Pacific and Dragonair*	Cathay Pacific		
		2006	**2006**	2005	**Change**
OPERATING STATISTICS					
Available tonne kilometres ("ATK")	*Million*	**19,684**	**18,866**	17,751	**+6.3%**
Passengers carried	*'000*	**18,097**	**16,728**	15,438	**+8.4%**
Passenger load factor	*%*	**79.5**	**79.9**	78.7	**+1.2%pt**
Passenger yield	*HK cents*	**48.0**	**47.0**	46.3	**+1.5%**
Cargo carried	*'000 tonnes*	**1,308**	**1,199**	1,118	**+7.2%**
Cargo and mail load factor	*%*	**68.6**	**68.3**	67.0	**+1.3%pt**
Cargo and mail yield	*HK$*	**1.70**	**1.69**	1.75	**-3.4%**
Cost per ATK	*HK$*	**2.23**	**2.21**	2.19	**+0.9%**
Cost per ATK without fuel	*HK$*	**1.57**	**1.53**	1.55	**-1.3%**
Aircraft utilisation	*Hours per day*	**12.5**	**12.8**	12.6	**+1.6%**
On-time performance	*%*	**85.2**	**85.9**	86.1	**-0.2%pt**

* *Consolidated operating statistics includes Dragonair's operation from 1st October 2006.*

The Cathay Pacific Group recorded a profit attributable to shareholders of HK$4,088 million for 2006, compared with a profit of HK$3,298 million the previous year. Turnover increased by 19.4% to a new record of HK$60,783 million.

Record passenger numbers and freight volumes contributed to the increase in turnover in 2006, which in turn helped us to a 24.0% increase in profit over the previous year. However continuing high fuel prices served to dampen the final result. Prices eased a little in the latter part of the year but our total fuel bill was HK$20,214 million – up 29.7% on 2005. Fuel surcharges only partially offset the additional cost.

A continuing improvement in productivity coupled with a reduction in controllable costs helped the airline reduce its unit cost excluding fuel by 1.3%.

On the passenger side, the airline's revenue increased by 10.9% to a record HK$33,585 million as the number of passengers carried rose to 16.7 million for the year. Demand from first and business class passengers was high throughout the year, helping yield to increase by 1.5% to HK¢47.0. Additional services on a number of routes contributed to a 7.7% rise in passenger capacity.

The airline set new records for its cargo operation, with the tonnage carried rising by 7.2% to 1,199,000 tonnes and revenue reaching a high of HK$11,980 million. Capacity rose by 5.2% with four new freighter destinations added during the year – Beijing, Chennai, Stockholm and Toronto – and extra flights to Dallas/Atlanta and Shanghai being mounted. Demand remained high out of Hong Kong and Mainland China throughout the year but weakening demand in a number of key markets contributed to a 3.4% fall in yield.

2006 was a landmark year for Cathay Pacific in many ways. The airline received another "Airline of the Year 2006" award – from leading industry journal *Air Transport World* – in February, and then in August took delivery of its 100th aircraft, an Airbus A330-300. Throughout the year we ran a number of events and activities to celebrate our 60th anniversary as Hong Kong's airline.

However, the most significant development took place on 28th September when formal approval of a historic shareholding realignment was received and Dragonair joined the Cathay Pacific Group as a wholly owned subsidiary. The integration of the two carriers will bring significant benefits for passengers and the Hong Kong aviation hub. As part of the realignment, Cathay Pacific and Air China increased their cross-shareholdings and began work on further enhancing their partnership in a number of areas.

We continued to grow the three fleets in the Group in 2006, adding six aircraft at Cathay Pacific and four at Dragonair, while AHK took delivery of two more freighters. In June we confirmed an order for six new Boeing 747-400ERFs, Extended Range Freighters, for the Cathay Pacific fleet which, with their longer range and higher payload, will be key to our success on long haul trunk routes once deliveries commence in May 2008. We also took up two more options on the new Boeing 777-300ER, Extended Range passenger aircraft, taking the total order to 18. These aircraft will begin arriving in September 2007.

Our commitment to product and service excellence remains as high as ever and in September we unveiled Cathay Pacific's new long haul product that will be rolled out across all three classes of travel over the next two years. The new product will help us retain our leadership in comfort and service.

We expect competition to remain keen in 2007 and the high, volatile fuel price will continue to have a major impact on our business. Our focus in the coming year is to continue our efforts to deliver superior service and to grow our operations profitably and thus further strengthen Hong Kong's position as a global aviation hub. We will work to optimize the significant commercial opportunity provided by our purchase of Dragonair.

Christopher Pratt
Chairman
Hong Kong, 7th March 2007

A major shareholding realignment in 2006 saw Dragonair become a wholly owned subsidiary of the Company. As part of the same agreement Air China purchased a 17.5% interest in Cathay Pacific and Cathay Pacific increased its interest in Air China from 10% to 17.3%. Cathay Pacific together with Dragonair now offer significant connectivity to Mainland China with 417 flights each week to 21 destinations.

Record volumes and revenue were achieved for both our passenger and cargo operations in 2006 although the persistently high fuel price continued to erode earnings. During the year Cathay Pacific increased frequency to a number of passenger destinations and opened four new cargo destinations. The Company also announced its largest order to date for new freighters.

CATHAY PACIFIC

Shareholding realignment

- On 28th September 2006, Dragonair became our wholly owned subsidiary following the completion of a shareholding realignment involving Air China, Cathay Pacific, China National Aviation Company Limited ("CNAC"), CITIC Pacific Limited ("CITIC Pacific") and Swire Pacific Limited ("Swire Pacific").
- The integration with Dragonair will bring about cost and revenue synergies and new opportunities that will benefit passengers and enhance Hong Kong's position as a leading international aviation hub.
- Developments since the integration began include the announcement of two new Dragonair destinations, Phuket and Busan, a reduction in the minimum connecting time for passengers travelling between the two airlines and a codeshare to seven destinations.
- Following the restructuring, Air China has become a strategic partner of Cathay Pacific. The partnership will result in a closer cooperation in a number of areas, with a number of joint initiatives expected to be announced in 2007. Closer cooperation with Air China will bring significant benefits for both the Beijing and Hong Kong hubs.

Award winning products and services

- In September we gave a preview of our new long haul inflight product that will feature a complete overhaul in all three classes of travel. The product, which features new seats, inflight entertainment and cabin design, will be rolled out progressively on every aircraft in our long haul fleet from early 2007 and will be completed by mid-2009.
- We opened new lounges in Bangkok following the opening of Suvarnabhumi Airport. Work also commenced on our new facilities at Tokyo's Narita Airport, where we moved terminals in January 2007.

- Cathay Pacific was named "Airline of the Year 2006" by leading industry magazine *Air Transport World*.
- We were also named "Airline of the Year 2006" in the OAG 24th Annual Awards, along with "Best Airline Based in Asia" and "Best Transpacific Airline".
- In November, we were named joint winners, with Air China, of the Centre for Asia Pacific Aviation ("CAPA") "Airline of the Year" honour. We were also named CAPA "Cargo Airline of the Year".
- Other major honours in 2006 include the "Airline of the Year" from leading regional trade publication *Travel Trade Gazette* and "Best Inflight Travel Retailer in Asia Pacific" in the Raven Fox Awards.

Hub development

- We added a new online destination in December with the launch of a daily service to Shanghai.
- Two more destinations – Kota Kinabalu and Phuket – were added to our network in 2006 following a new codeshare arrangement with Dragonair. Busan was also added in January 2007.
- A reduction in the minimum connecting time with Dragonair made it easier and quicker for passengers to transfer through the Hong Kong hub.
- Additional services commenced to Adelaide, Bahrain, Dubai, Frankfurt, Riyadh, Rome and Seoul, while three Penang flights each week were upgraded to a direct service.

The growing fleet

- At the end of 2006 we had 102 aircraft in our fleet, including 84 passenger aircraft and 18 freighters. Our 100th aircraft, an Airbus A330-300, arrived in August 2006. We also took delivery of one Boeing 777-300 and two Boeing 747-400BCFs, Boeing Converted Freighters, and acquired two more Boeing 747-400 aircraft that are being converted into freighters for deployment in 2007.
- We increased our firm order of Boeing 777-300ERs from 16 to 18, with delivery commencing in September 2007. The aircraft will offer a longer range with a higher payload and will be deployed to provide non-stop services on ultra long haul routes.
- In June 2006 we announced our biggest-ever order for new freighters – six Boeing 747-400ERFs. Deliveries commence in May 2008 and the aircraft will be used on North American trunk routes to take advantage of their longer range and bigger payload.

60th anniversary celebration

- We celebrated 60 years of serving Hong Kong in 2006, with a range of events and activities running throughout the year up to our actual birthday on 24th September.
- We used the anniversary celebration to highlight how we have grown with Hong Kong over the past six decades, helping to build the city into an aviation hub and internationally renowned business and tourist destination.

- There were a number of 60th anniversary events aimed at the general public, including a series of roadshows featuring the "Walking on Air" uniform fashion parade and a competition to win air tickets worth HK$600,000.
- The climax of the celebration was a gala party for more than 3,000 people at Sha Tin Racecourse, with HKSAR Chief Executive Donald Tsang as guest of honour.

Pioneer in technology

- The latest version of the Company website was rolled out mid-year, with easier access to information and booking tools.
- The use of electronic ticketing increased in 2006, with around 71% of our passengers receiving their tickets in this way by the end of the year. The benefits of e-ticketing include a reduction in ticketing costs and greater convenience for our customers.
- We now have interline e-ticketing in place with all our **one**world partners.
- We further promoted our Online Check-In service to ease congestion at airports and provide more convenience for travellers. Use of the service increased by 60% during the year, and the number of bookings made online increased by a similar amount.
- In December we unveiled the second phase of our online shopping site, allowing passengers to pay for inflight purchases using Asia Miles.

Partnerships

- **one**world, the airline alliance of which we are a founder member, confirmed that three more airlines – Japan Airlines, Malev and Royal Jordanian – will become full members in early 2007. At the same time, Aer Lingus will leave the alliance.
- Our subsidiary, Dragonair, announced that it would become an affiliate member of **one**world in 2007. LAN Argentina and LAN Ecuador will also become affiliates of the alliance, as will five Japan Airlines affiliates.
- Asia Miles membership rose to more than 2.8 million in 2006, with the number of partners rising to more than 250 in nine categories.
- We announced that The Marco Polo Club would become the single loyalty programme for both Cathay Pacific and Dragonair, replacing the latter's Elite programme from 1st January 2007.

DRAGONAIR

Award winning products and services

- Dragonair was voted "Best Airline – China" for the fifth consecutive year in the international Skytrax passenger survey.
- We were voted "Best China Airline" for the second consecutive year in the 2006 *Business Traveller Asia-Pacific* Awards.
- Our Economy Class was voted the best of any airline in the 2006 *Business Traveller China* Travel Awards, also for the second consecutive year.
- We opened newly designed reservations and ticketing offices in Kota Kinabalu, Shanghai, Shenyang and Taichung. The new design is in line with the style of our new cabin interiors.

Hub development

- We launched a thrice-weekly service to Shenyang via Dalian in April.
- Dragonair operates passenger services to 30 destinations in Asia, including 21 in Mainland China. Dragonair also provided freighter services to 10 destinations covering cities in Asia, Europe, Middle East and the United States in 2006.
- We relaunched our scheduled service to Phuket in Thailand in December and also launched a thrice-weekly service to Busan in South Korea in January 2007.
- We increased our freighter services to Shanghai to 17 a week from 1st January 2007 and withdrew services to Amsterdam, Dubai, Frankfurt and Manchester from 1st February 2007.
- Our summer schedule saw increased frequencies to 10 Mainland China destinations and three regional cities.
- The winter schedule saw a reduction in the minimum connecting time between Dragonair and Cathay Pacific flights, from 60 minutes to 50 minutes. As a result, 451 new connections became available to international travellers.
- In our winter 2006 schedule we operated one additional weekly passenger flight to Tokyo, resulting in a daily service to the Japanese capital.

The growing fleet

- We took delivery of three wide-bodied Airbus A330-300 aircraft in 2006 – in January, April and October.
- By the end of 2006, our freighter fleet grew to five with the addition of a Boeing 747-400BCF aircraft.
- All four aircraft wet leased to Air China will be returned by 2008, two Airbus A330s, one Airbus A320 in 2007 and one Airbus A330 in 2008.

Pioneer in technology

- In March we introduced e-ticketing for individual passengers on five routes from and to Hong Kong: Bangkok, Beijing, Kaohsiung, Shanghai and Taipei.
- We selected Ezycargo, Asia's leading air-cargo booking portal, to provide an online option that enables forwarders to better manage their shipments.
- Our website was revamped to provide additional user functions and a more contemporary look.

Partnerships

- We started operating codeshare services with Cathay Pacific to Beijing, Kota Kinabalu, Phuket, Shanghai, Tokyo and Xiamen in December. The codeshare also applies on our Busan route, which was launched in January 2007.
- We announced our intention to become an affiliate member of **one**world in 2007.

AIR HONG KONG

- AHK took delivery of two new Airbus A300-600F freighters in May and June 2006, taking its fleet size to eight.
- The carrier's seventh freighter replaced the wet lease operation to Bangkok and Penang. The eighth freighter is deployed on the Nagoya route, which was launched as an AHK destination in October.
- We now serve eight Asian cities: Bangkok, Nagoya, Osaka, Penang, Seoul, Singapore, Taipei and Tokyo.

FLEET PROFILE

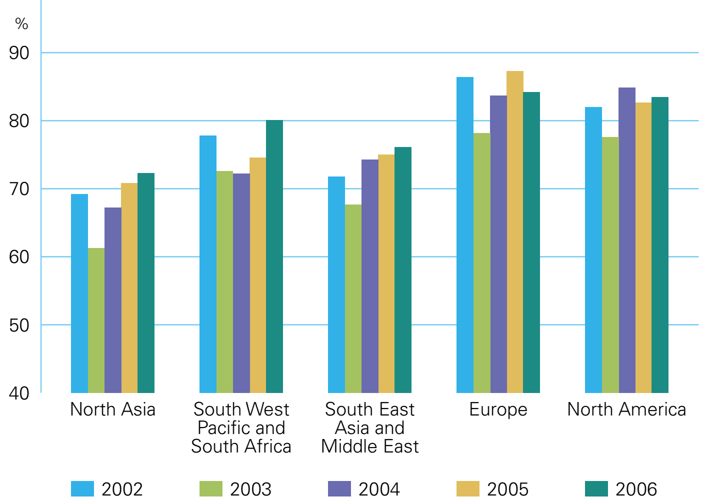
Aircraft type	Number as at 31st December 2006	Leased			Firm orders				Expiry of operating leases					
	Owned	Finance	Operating	**Total**	'07	'08	'09 and beyond	**Total**	'08	'09	'10	'11	'12 and beyond	Purchase rights
Aircraft operated by Cathay Pacific:														
A330-300	6	18	3	**27**	2	3[a]		**5**				3		
A340-300	1	10	4	**15**								4		
A340-600			3	**3**					3					
747-400	18		4	**22**[b]	2[c]			**2**					4	
747-200F	4	3		**7**										
747-400F	2	4		**6**										
747-400BCF	5			**5**[d]	1			**1**						
747-400ERF						3	3	**6**						
777-200	1	4		**5**										
777-300	2	10		**12**										
777-300ER					5[e]	5[e]	8	**18**						20[f]
Total	39	49	14	**102**	10	11	11	**32**	3			7	4	20
Aircraft operated by Dragonair:														
A320	3	2	5	**10**[g]						1	1	3		
A321	2		4	**6**							2	2		
A330	2	3	11	**16**[h]					1	1	1	2	6	
747-200F	1			**1**										
747-300SF	3			**3**										
747-400BCF	1			**1**	3	1		**4**						
Total	12	5	20	**37**	3	1		**4**	1	2	4	7	6	
Aircraft operated by AHK:														
A300-600F	2	6		**8**										

[a] *Aircraft on 7.5 year operating leases.*
[b] *One aircraft under reconfiguration.*
[c] *Aircraft on 8 and 9 year operating leases.*
[d] *Two aircraft under reconfiguration.*
[e] *Two aircraft on 10 year operating leases.*
[f] *Purchase rights for aircraft delivered by 2017.*
[g] *One aircraft leased out to Air China.*
[h] *Three aircraft leased out to Air China.*

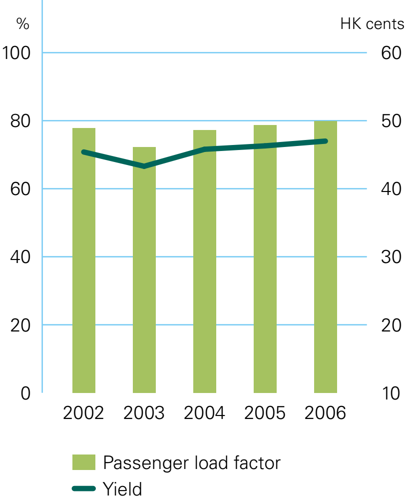
CATHAY PACIFIC

In 2006 we surpassed previous passenger records, with our highest ever revenue and passenger numbers on an average load factor of 79.9%. Passenger demand remained buoyant throughout the year and strong corporate demand helped to drive up yield by 1.5% to HK47.0 cents. Yields in economy class suffered, however, due to strong competition on key long haul and regional flights. Capacity increased by 7.7% with additional services mounted and new aircraft joining the fleet.

Load factor by region



Passenger load factor and yield



Available seat kilometres ("ASK"), load factor and yield by region:

	ASK (million)			Load factor (%)			Yield
	2006	2005	**Change**	**2006**	2005	**Change**	**Change**
North Asia	**13,796**	13,057	**+5.7%**	**72.3**	70.8	**+1.5%pt**	**-3.3%**
South West Pacific and South Africa	**14,230**	14,656	**-2.9%**	**80.1**	74.6	**+5.5%pt**	**+2.0%**
South East Asia and Middle East	**18,375**	17,376	**+5.7%**	**76.1**	75.0	**+1.1%pt**	**+5.0%**
Europe	**18,884**	16,181	**+16.7%**	**84.2**	87.3	**-3.1%pt**	**-0.2%**
North America	**23,833**	21,496	**+10.9%**	**83.5**	82.7	**+0.8%pt**	**+5.3%**
Overall	**89,118**	82,766	**+7.7%**	**79.9**	78.7	**+1.2%pt**	**+1.5%**

Cathay Pacific's award-winning service style is designed to make every one of our customers feel special.

Comments by region are as follows:

North Asia

- The addition of a fifth daily flight to Seoul in January generated a growth in outbound traffic from Korea. The country remains popular as a leisure destination for Hong Kong travellers.
- We increased our presence in Mainland China by adding a new daily service to Shanghai in December.
- A new codeshare arrangement with Dragonair – applying on flights to Beijing, Shanghai, Xiamen and Tokyo in North Asia – was introduced in December, giving customers more choice and greater flexibility.
- We also codeshare with Dragonair on its new service to Busan, Korea's second city, which was launched in January 2007.
- Our performance in the Japan market remained steady, with some growth in the number of tourists flying to Hong Kong.
- We enjoyed high load factors to Taiwan throughout 2006, although strong competition had a negative impact on yield.

South West Pacific and South Africa

- Two new flights a week were added to Adelaide in June, bolstering our presence in South Australia.
- The Auckland service went twice-daily for the winter schedule, helping to match seasonal demand.
- Closer economic ties between South Africa and Mainland China boosted demand on our Johannesburg service, while strong corporate traffic boosted yield on the route.

South East Asia and Middle East

- In April, we began three direct flights to Penang each week instead of routing all flights through Kuala Lumpur. The change proved popular with leisure travellers.
- Passenger traffic to and from the Philippines was strong throughout the year, with a number of extra flights mounted to Cebu to meet high demand.
- Strong competition continues to impact our Singapore business, though demand remains high and we have seen some yield improvement.

Europe

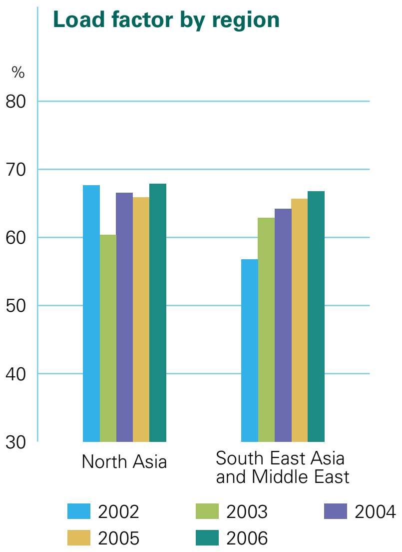
- Demand remained high from business travellers on the London route. However increased competition put pressure on the economy class load factor and yield.
- We added three flights to Frankfurt, making it a 10-times-a-week service, and turned Rome into a daily service with two more flights a week.

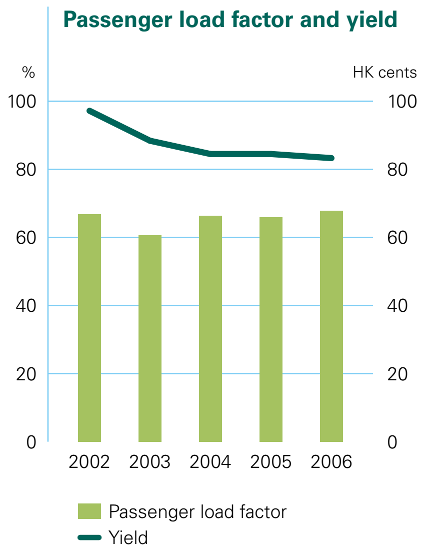
North America

- We increased our capacity to North America by 10.9% in 2006. Load factors were not particularly high but yields improved on all routes.
- Demand was strong in the premium cabins to all North American destinations.
- The introduction of new Boeing 777-300ER aircraft from September 2007 will allow more direct services on ultra long haul North American flights with an increased payload.

DRAGONAIR

It was a steady year for Dragonair, with additional flights to Beijing and various secondary destinations in Mainland China mounted, and a new destination, Phuket, added. The average load factor for the year was 67.8% and passenger revenue growth kept pace with capacity growth despite increasing competition on key routes reducing yield. The integration with Cathay Pacific is expected to bring significant benefits in 2007.





Available seat kilometres ("ASK"), load factor and yield by region:

	ASK (million)			Load factor (%)			Yield
	2006	2005	**Change**	**2006**	2005	**Change**	**Change**
North Asia	**9,858**	9,186	**+7.3%**	**67.9**	65.9	**+2.0%pt**	**-2.8%**
South East Asia and Middle East	**747**	879	**-15.0%**	**66.8**	65.7	**+1.1%pt**	**+13.8%**
Overall	**10,605**	10,065	**+5.4%**	**67.8**	65.9	**+1.9%pt**	**-1.4%**

Comments by region are as follows:

North Asia

- The Beijing route was under pressure from increased competition throughout 2006.
- Competition also increased on the Shanghai route but strong demand helped sustain yield.
- The load factor on some secondary Chinese routes was not high. The integration with Cathay Pacific will allow Dragonair to get more feed from its sister carrier's international network.
- A thrice-weekly service to Busan started in January 2007, again leveraging on Cathay Pacific's international network.
- Competition kept revenue growth on the Taiwan route behind capacity growth.
- The Tokyo route benefited from an enhanced schedule and a new codeshare arrangement with Cathay Pacific.

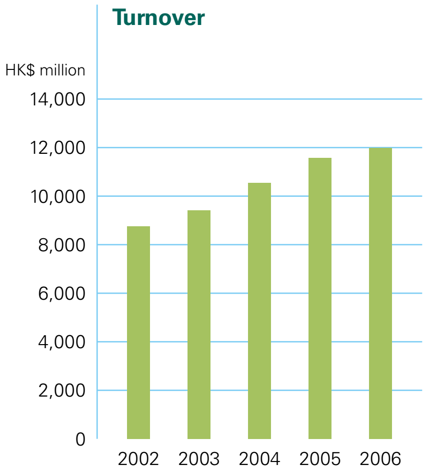
South East Asia and Middle East

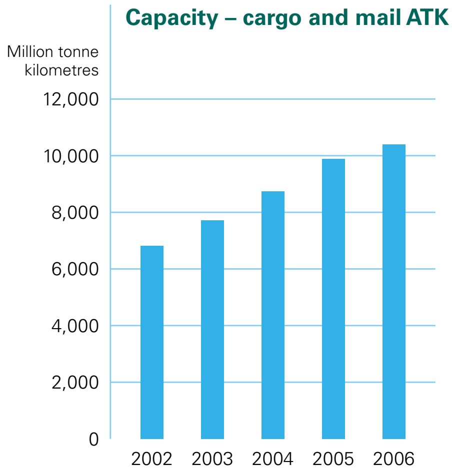
- Flights began to Phuket in December, the first destination launch for Dragonair since the integration with Cathay Pacific.
- Both Phuket and Kota Kinabalu will benefit from the codeshare with Cathay Pacific that began in December 2006.
- We cancelled our scheduled services to Bangkok in September.
- Performance on the Phnom Penh route improved during the year and will benefit from being able to feed from Cathay Pacific's international network.
- The Dhaka route performed above expectations.

Cathay Pacific's popular fashion show Walking on Air showcases our stylish uniforms from 1946 to the present. As part of the airline's 60th Anniversary celebrations in 2006, cabin staff on many of our flights wore vintage uniforms.

CATHAY PACIFIC

Cathay Pacific set new revenue and tonnage records as cargo capacity increased by 5.2%. Cargo yield dropped by 3.4% in the face of weak demand for exports out of Australia, Europe and the United States. Growth in cargo tonnage out of Mainland China remained strong despite a significant increase in competitor capacity. Hong Kong faces increasing competition from new airports in the region but remains the leading gateway to the Pearl River Delta with good prospects for further growth.



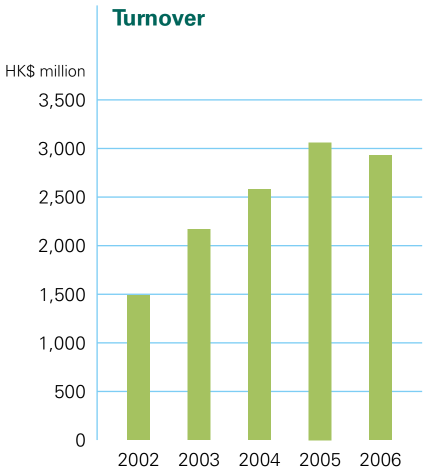


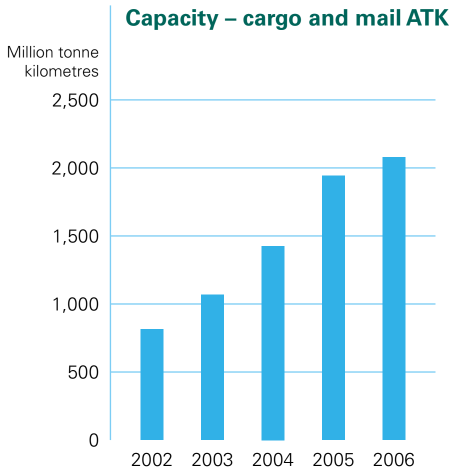
	ATK (million)			Load factor (%)			Yield
	2006	2005	**Change**	**2006**	2005	**Change**	**Change**
Cathay Pacific	**10,391**	9,879	**+5.2%**	**68.3**	67.0	**+1.3%pt**	**-3.4%**

- Two additional Boeing 747-400BCF aircraft were added to the fleet. At the end of 2006 we operated a fleet of seven Boeing 747-200Fs, six Boeing 747-400Fs and three Boeing 747-400BCFs.
- The airline will take delivery of three more Boeing 747-400BCFs in 2007 and has exercised options to convert two more aircraft for delivery in 2008 and 2009. The airline has options on four more conversions.
- In addition, the airline has ordered six Boeing 747-400ERFs for delivery in 2008 and 2009.
- New freighter services were launched to Beijing, Chennai, Stockholm and Toronto, bringing the total number of freighter destinations to 31.
- High fuel prices had a negative effect on the profitability of our older Boeing 747-200F freighter fleet. The adverse impact of high fuel prices was only partially offset by fuel surcharges.
- CAPA named Cathay Pacific as its "Cargo Airline of the Year" for having the most impact on the development of the region's air cargo industry.

DRAGONAIR

Tonnage rose to a new annual high of 395,385 tonnes but yields were under pressure throughout the year as a result of increasing competition and softening markets.





	ATK (million)			Load factor (%)			Yield
	2006	2005	**Change**	**2006**	2005	**Change**	**Change**
Dragonair	**2,080**	1,942	**+7.1%**	**72.7**	72.6	**+0.1%pt**	**-10.8%**

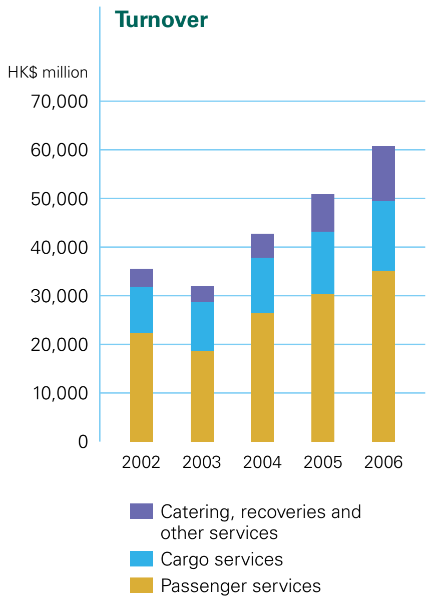
- Dragonair took delivery of its first Boeing 747-400BCF aircraft at the end of 2006, and another was delivered in January 2007. They will be used on European routes after initial deployment in the region for crew training purposes.
- Two more Boeing 747-400BCFs are due to be delivered in 2007 and one more in 2008, increasing Dragonair's freighter fleet to nine by the end of 2008.
- High fuel prices and lower yields led to reduced freighter profitability.
- There was a softening in the market into and out of Japan.
- Dragonair resumed its thrice-weekly freighter service to Xiamen in November.
- Two more freighter flights were added to Frankfurt in 2006, bringing the total to five frequencies per week.

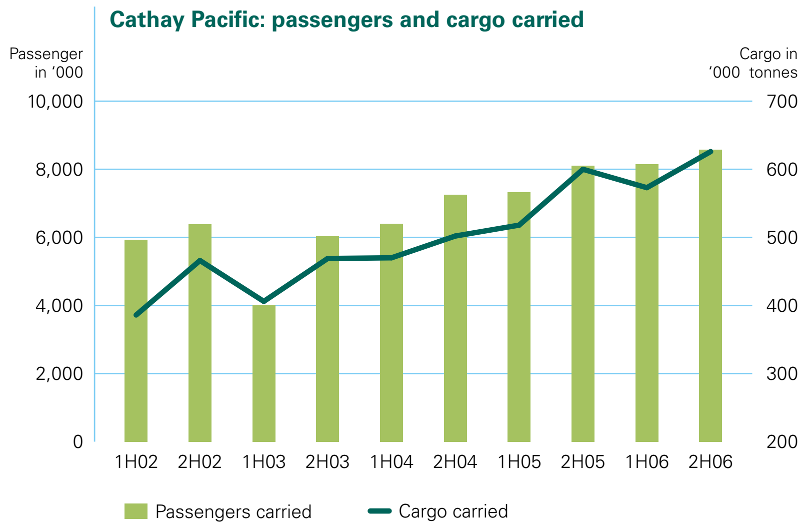
The Cathay Pacific Group reported an attributable profit of HK$4,088 million against a profit of HK$3,298 million in 2005. The improved results reflect strong demand however, high fuel prices continued to impact our profitability.

Turnover

	Group*		Cathay Pacific	
	2006 HK$M	2005 HK$M	**2006 HK$M**	2005 HK$M
Passenger services	**35,155**	30,274	**33,585**	30,274
Cargo services	**14,251**	12,852	**11,980**	11,585
Catering, recoveries and other services	**11,377**	7,783	**9,501**	6,529
Turnover	**60,783**	50,909	**55,066**	48,388

* *Turnover includes Dragonair results from 1st October 2006.*





- Group turnover rose by 19.4% on 2005.

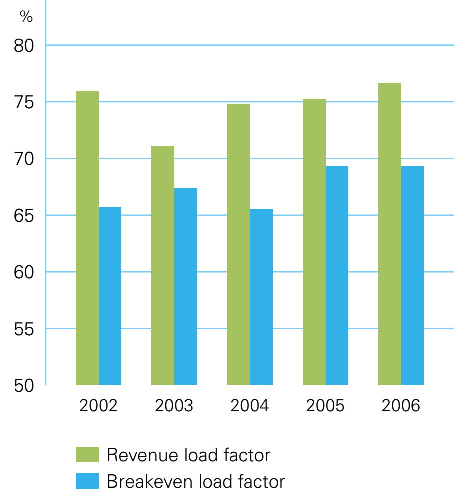
Cathay Pacific

- Passenger turnover increased by 10.9% to HK$33,585 million as a result of strong demand. The number of passengers carried increased by 8.4% to 16.7 million and revenue passenger kilometres increased by 9.3%.
- Passenger load factor increased by 1.2 percentage points to 79.9% while available seat kilometres increased by 7.7%.
- Passenger yield increased by 1.5% to HK¢47.0.
- First and business class revenues increased by 16.0% and the front-end load factor increased from 66.0% to 67.5%. Economy class revenue increased by 8.3% and the economy class load factor increased from 80.9% to 82.1%.
- Cargo turnover rose by 3.4% to HK$11,980 million with a 5.2% increase in capacity. Exports demand from Mainland China through Hong Kong remained strong.
- Cargo load factor increased by 1.3 percentage points while cargo yield decreased by 3.4% to HK$1.69.

The improvement in traffic turnover comprises:

		HK$M
+7.7%	Passenger capacity	**2,312**
+5.2%	Cargo and mail capacity	**601**
+1.2%pt	Passenger load factor	**476**
+1.3%pt	Cargo and mail load factor	**240**
+1.5%	Passenger yield	**523**
-3.4%	Cargo and mail yield	**(446)**
		3,706

Cathay Pacific: revenue and breakeven load factor



- Revenue load factor increased by 1.4 percentage points to 76.6% while the breakeven load factor was 69.3%.
- The annualised revenue effect on changes in yield and load factor is set out below:

	HK$M
+ 1 percentage point in passenger load factor	**419**
+ 1 percentage point in cargo and mail load factor	**175**
+ HK¢1 in passenger yield	**712**
+ HK¢1 in cargo and mail yield	**71**

Operating expenses

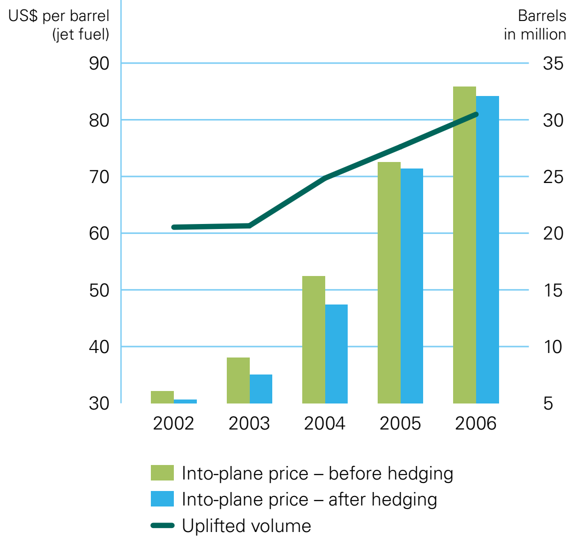
Net operating expenses after deduction of Group recoveries of HK$9,995 million (2005: HK$6,446 million) and of Cathay Pacific recoveries HK$9,501 million (2005: HK$6,529 million) are analysed as follows:

	Group*			Cathay Pacific		
	2006 HK$M	2005 HK$M	Change	2006 HK$M	2005 HK$M	Change
Staff	9,950	9,025	+10.2%	8,553	8,132	+5.2%
Inflight service and passenger expenses	1,987	1,783	+11.4%	1,899	1,783	+6.5%
Landing, parking and route expenses	6,948	5,977	+16.2%	6,384	5,832	+9.5%
Fuel	13,333	11,640	+14.5%	12,641	11,400	+10.9%
Aircraft maintenance	5,330	4,527	+17.7%	4,882	4,459	+9.5%
Aircraft depreciation and operating leases	5,160	4,882	+5.7%	4,789	4,755	+0.7%
Other depreciation and operating leases	862	790	+9.1%	625	590	+5.9%
Commissions	668	555	+20.4%	622	555	+12.1%
Exchange gain	(271)	(156)	+73.7%	(271)	(148)	+83.1%
Others	1,603	1,297	+23.6%	1,222	1,147	+6.5%
Net operating expenses	45,570	40,320	+13.0%	41,346	38,505	+7.4%
Net finance charges	465	444	+4.7%	287	361	-20.5%
Total net operating expenses	46,035	40,764	+12.9%	41,633	38,866	+7.1%

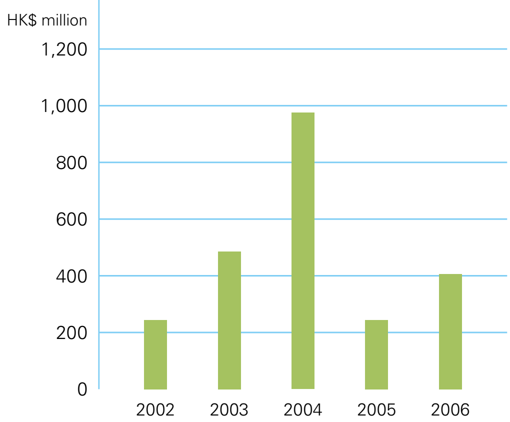
* *Includes Dragonair's expenses from 1st October 2006.*

- Group operating expenses rose 12.9% to HK$46,035 million.

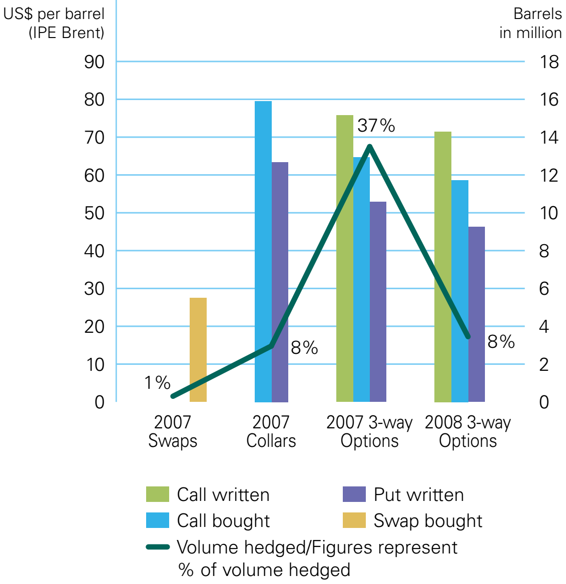
Fuel price and consumption



Hedging gain

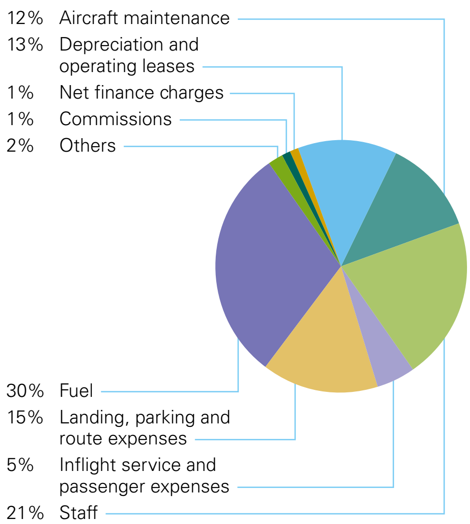


Fuel hedging



Cathay Pacific

Total net operating expenses



- Staff costs increased due to an increase in the average number of staff with 209 staff being transferred from Dragonair following the integration.
- Inflight service and passenger expenses rose due to an 8.4% increase in passenger numbers.
- Landing, parking and route expenses increased as a result of additional flights.
- Fuel costs increased due to an 18.5% increase in the average into-plane fuel price to US$86 per barrel and a 5.8% increase in consumption to 29 million barrels. Fuel surcharges increased from HK$3,948 million to HK$6,470 million.
- Fuel hedging gains increased by HK$181 million to HK$426 million and include unrealised mark to market gains of HK$158 million (2005: HK$19 million).
- Aircraft maintenance increased as a result of the fleet expansion.
- Aircraft depreciation and operating leases increased due to the new aircraft deliveries and were partly offset by the return of two wet leased freighters.
- Net finance charges decreased due to higher income from investment funds.
- Cathay Pacific's cost per ATK increased from HK$2.19 to HK$2.21 due to higher fuel prices.

Dragonair

- Dragonair became a wholly owned subsidiary of Cathay Pacific following the completion of the shareholding realignment involving Air China, Cathay Pacific, CNAC, CITIC Pacific and Swire Pacific.
- Synergies and opportunities that arise from linking Cathay Pacific's international network with Dragonair's extensive Mainland China services will bring benefits to both carriers. As a result, goodwill of HK$7,214 million has been recognised.
- Passenger revenue was high as a result of strong demand. During the year 5.6 million passengers were carried. Passenger load factor was 67.8% with yield at HK¢83.3.
- Cargo turnover decreased with yield declining to HK$1.94 as a result of strong competition and softening markets. The airline carried 395,385 tonnes of freight during the year. Cargo load factor was 72.7%.
- The high price of fuel continued to affect the airline's profitability. Fuel costs now account for 19% of the airline's total net operating expenses.
- The Group result includes 100% of Dragonair's profit from 1st October 2006. This amounts to HK$28 million.

Review of other subsidiaries and associates

The results recorded by our other subsidiaries and associates were satisfactory. The share of profits from associates increased by 11.9% to HK$301 million. Hong Kong Aircraft Engineering Company Limited reported a higher profit than 2005.

A review of their performance and operations is outlined below:

Air China Limited ("Air China")

- Air China is the national flag carrier and a leading provider of passenger, cargo and other airline related services in Mainland China.
- The airline serves 78 domestic and 43 international destinations in the world.
- Following the completion of the shareholding realignment involving Air China, Cathay Pacific, CNAC, CITIC Pacific and Swire Pacific, Cathay Pacific now owns a 17.3% interest in Air China.
- The Group has two representatives on the Board of Directors of Air China and will equity account for its share of Air China's profit.
- The Group's share of Air China's profit is based on accounts drawn up three months in arrears and consequently the 2006 results do not include our equity interest in the company for the period 28th September to 31st December 2006.

AHK Air Hong Kong Limited ("AHK")

- This all-cargo carrier, of which 60% is owned by Cathay Pacific, continued to operate express cargo services for DHL Express as its core business.
- During the year AHK took delivery of two new Airbus A300-600F freighters and further expanded its overnight express cargo network to Nagoya.
- With its network expansion capacity increased by 6.3%. Load factor increased by 3.1 percentage points and yield increased by 3.6%.
- AHK recorded a higher profit in 2006 despite the adverse impact of higher fuel prices.

Cathay Pacific Catering Services (H.K.) Limited ("CPCS")

- CPCS, a wholly owned subsidiary, is the principal flight kitchen in Hong Kong.
- The company produced a record 20.7 million meals in 2006 and accounts for 67% of the airline catering market in Hong Kong. Business volume increased by 13% over 2005.
- Helped by effective cost controls and productivity improvement initiatives the company recorded a satisfactory result in 2006.
- The performance of other inflight catering kitchens in Asia and Canada were also encouraging with higher profits being recorded in 2006.

Hong Kong Airport Services Limited ("HAS")

- HAS, a wholly owned subsidiary, is the largest franchised ramp handling company at Hong Kong International Airport ("HKIA").
- The number of flights handled grew by 2.7% to a new record.
- Margins came under pressure as customer airlines attempted to reduce costs while operating costs in Hong Kong increased.

Hong Kong Aircraft Engineering Company Limited ("HAECO")

- Cathay Pacific holds a 27.5% interest in HAECO and a direct 9.0% holding in HAECO's subsidiary Taikoo (Xiamen) Aircraft Engineering Company Limited ("TAECO"). The HAECO group provides a range of aviation maintenance and repair services. Its most substantial operations are aircraft maintenance and modification work in Hong Kong and Xiamen, and Rolls Royce engine overhaul work performed by jointly controlled companies Hong Kong Aero Engine Services Limited ("HAESL") and Singapore Aero Engine Services Limited ("SAESL").
- HAECO's profit increased by 37.0% to HK$846.8 million for the year due to capacity expansion and continuing strong demand for its services. The majority of the growth was due to strong demand for heavy maintenance in the hangars of both HAECO and TAECO. There was also good growth in engine overhaul work at HAESL and SAESL.
- The HAECO group is expanding rapidly. Its second hangar at HKIA was opened in December 2006 and a third hangar is planned to open in early 2009. TAECO is constructing two more hangars in Xiamen – one of which is scheduled to open in mid-2007 and the other in early 2009. A new joint venture, in which Cathay Pacific has a direct 9.9% stake, has been formed to overhaul landing gear in Xiamen. Furthermore, HAESL is building an extension to its engine build shop which is due to open in early 2008.
- Rapid growth has required a high level of recruitment with total staff numbers increasing by 1,935 to 10,118 during the year. Further growth is planned in 2007 to fully staff the new facilities.

Hong Kong International Airport Services Limited ("HIAS")

- Following the acquisition of Dragonair HIAS became a wholly owned subsidiary. The company provides airport ground handling services in Hong Kong to Dragonair and other airlines.
- The company handled 34,055 flights in 2006, representing a 13.4% increase over 2005.
- HIAS recorded a satisfactory performance for the year.

Taxation

- Tax charges increased by HK$282 million to HK$782 million reflecting increased profits and under provisions for prior years.

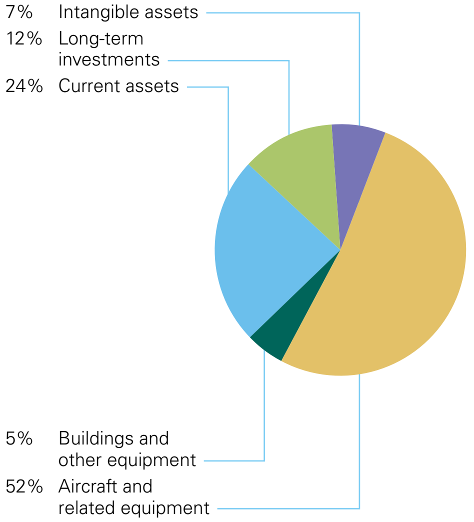
Dividends

- Dividends paid and proposed for the year are HK$3,304 million representing a dividend cover of 1.2 times.
- Dividends per share increased from HK¢48 to HK¢84.

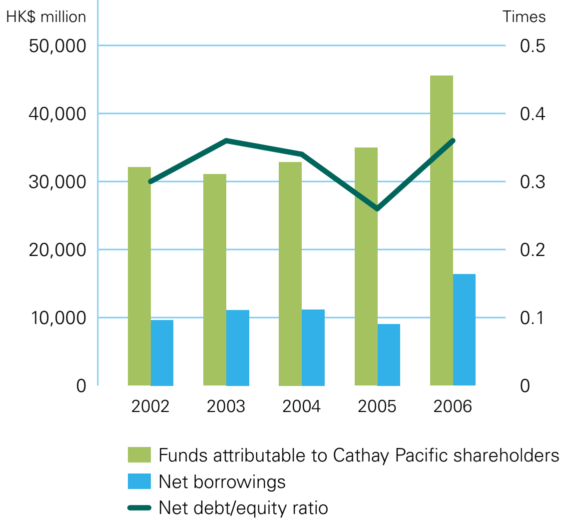
Assets

- Total assets as at 31st December 2006 were HK$103,090 million.
- During the year, additions to fixed assets were HK$5,272 million, comprising HK$5,075 million for aircraft and related equipment and HK$197 million for other equipment.

Total assets



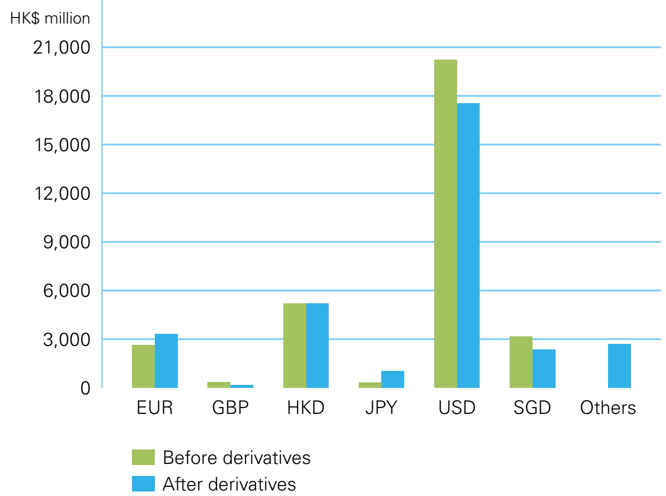
Net debt and equity



Borrowings and capital

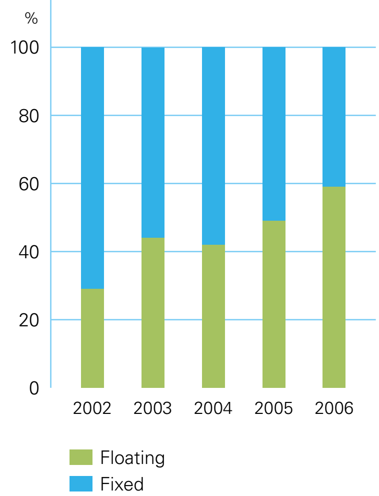
- Borrowings increased by 42.3% to HK$31,943 million compared with HK$22,455 million in 2005.
- Borrowings are mainly denominated in US dollars, Hong Kong dollars, Singapore dollars and Euros, and are fully repayable by 2018 with 41% at fixed rates of interest net of derivatives.
- Liquid funds, 81% of which are denominated in US dollars, increased by 16.1% to HK$15,624 million.
- Net borrowings increased by 80.6% to HK$16,348 million.
- Funds attributable to Cathay Pacific shareholders increased by 30.3% to HK$45,554 million.
- Net debt/equity ratio increased from 0.26 times to 0.36 times.

Borrowings before and after derivatives



Others include CAD, KRW, NZD and TWD.

Interest rate profile: borrowings



Value added

The following table summarises the distribution of the Group's value added in 2005 and 2006.

	2006 HK$M	2005 HK$M
Total revenue	**60,783**	50,909
Less: Purchases of goods and services	**(41,360)**	(33,778)
Value added by the Group	**19,423**	17,131
Add: Share of profits of associates	**301**	269
Total value added available for distribution	**19,724**	17,400
Applied as follows:		
To employees		
– Salaries and other staff costs	**9,950**	9,025
To governments		
– Corporation taxes	**782**	500
To providers of capital		
– Dividends – paid	**2,045**	676
– proposed	**1,259**	947
– Minority interests	**184**	170
– Net finance charges	**465**	444
Retained for re-investment and future growth		
– Depreciation	**4,255**	3,963
– Profit after dividends	**784**	1,675
Total value added	**19,724**	17,400

- The Group value added increased by HK$2,324 million mainly due to an increase in revenue.
- Dividends paid and proposed increased by HK$1,681 million while the amount retained for re-investment and future growth decreased by HK$599 million.

Executive Directors

PRATT, Christopher Dale#, CBE, aged 50, has been Chairman and a Director of the Company since February 2006. He is also Chairman of John Swire & Sons (H.K.) Limited, Swire Pacific Limited and Hong Kong Aircraft Engineering Company Limited, and a Director of Swire Properties Limited, The Hongkong and Shanghai Banking Corporation Limited and Air China Limited. He joined the Swire group in 1978 and in addition to Hong Kong has worked for the group in Australia and Papua New Guinea.

ATKINSON, Robert Michael James#, aged 53, has been Finance Director of the Company since June 1997. He is also a Director of Hong Kong Dragon Airlines Limited. He joined the Swire group in 1979 and in addition to Hong Kong has worked for the group in Japan, the United Kingdom and the United States.

CHEN, Nan Lok Philip#, aged 51, has been a Director of the Company since March 1997. He was appointed Deputy Managing Director in March 1997, Chief Operating Officer in July 1998 and Chief Executive in January 2005. He is also a Director of John Swire & Sons (H.K.) Limited, Swire Pacific Limited and Air China Limited. He is also Chairman of Hong Kong Dragon Airlines Limited. He joined the Swire group in 1977 and in addition to Hong Kong has worked for the group in Mainland China and the Asia Pacific region.

TANG, Kin Wing Augustus, aged 48, has been a Director of the Company since January 2007. He is also a Director of Hong Kong Dragon Airlines Limited. He joined the Company in 1982 and has worked with the Company in Hong Kong, Malaysia and Japan.

TYLER, Antony Nigel#, aged 51, has been a Director of the Company since December 1996. He was appointed Director Corporate Development in December 1996 and Chief Operating Officer in January 2005. He is also a Director of John Swire & Sons (H.K.) Limited, Hong Kong Aircraft Engineering Company Limited and Hong Kong Dragon Airlines Limited. He joined the Swire group in 1977 and in addition to Hong Kong has worked for the group in Australia, the Philippines, Canada, Japan, Italy and the United Kingdom.

Non-Executive Directors

CUBBON, Martin#, aged 49, has been a Director of the Company since September 1998. He is also Finance Director of Swire Pacific Limited and a Director of John Swire & Sons (H.K.) Limited, Swire Properties Limited and Hong Kong Aircraft Engineering Company Limited. He joined the Swire group in 1986.

FAN, Hung Ling Henry, aged 58, has been a Director of the Company since October 1992 except for the period from March to June 1996. He was appointed Deputy Chairman in January 1997. He is Managing Director of CITIC Pacific Limited.

HO, Cho Ying Davy#, aged 59, has been a Director of the Company since May 2006. He is currently Chairman of the Swire group's Taiwan operations and of a number of Swire group companies with shipping and travel interests. He joined the Swire group in 1970 and has worked for the group in Hong Kong and Taiwan.

HUGHES-HALLETT, James Wyndham John#+, aged 57, has been a Director of the Company since July 1998 and served as Chairman of the Board from June 1999 to December 2004. He is Chairman of John Swire & Sons Limited and a Director of Swire Pacific Limited and Swire Properties Limited. He is also a Director of HSBC Holdings plc. He joined the Swire group in 1976 and in addition to Hong Kong has worked for the group in Japan, Taiwan and Australia.

LI, Jiaxiang, aged 57, has been Deputy Chairman and a Director of the Company since October 2006. He is President of China National Aviation Holding Company and Chairman of Air China Limited.

MOORE, Vernon Francis, aged 60, has been a Director of the Company since October 1992 except for the period from March to June 1996. He is an Executive Director of CITIC Pacific Limited and a Director of CLP Holdings Limited.

WOODS, Robert Barclay, aged 60, has been a Director of the Company since August 2006. He is Chairman of P&O Ferries Limited and Southampton Container Terminals Limited, and a Director of John Swire & Sons Limited.

ZHANG, Lan*, aged 51, has been a Director of the Company since October 2006. She is Vice President of Air China Limited, Chairman of Air China Development Corporation (Hong Kong) Limited and a Director of Shandong Aviation Group Corporation.

Independent Non-Executive Directors

LEE, Ting Chang Peter+*, aged 53, has been a Director of the Company since May 2002. He is Chairman of Hysan Development Company Limited and is also a Director of CLP Holdings Limited, Hang Seng Bank Limited and SCMP Group Limited.

OR, Ching Fai Raymond*, aged 57, has been a Director of the Company since February 2000. He is Vice-Chairman and Chief Executive of Hang Seng Bank Limited. He is also a Director of The Hongkong and Shanghai Banking Corporation Limited, Esprit Holdings Limited, Hutchison Whampoa Limited and 2009 East Asian Games (Hong Kong) Limited.

SO, Chak Kwong Jack*, aged 61, has been a Director of the Company since September 2002. He is Deputy Chairman and Group Managing Director of PCCW Limited. He is also a Director of The Hongkong and Shanghai Banking Corporation Limited.

TUNG, Chee Chen+, aged 64, has been a Director of the Company since September 2002. He is Chairman of Orient Overseas (International) Limited.

Alternate Director

CHANG, Li Hsien Leslie, aged 52, has been Alternate Director to FAN, Hung Ling Henry since November 2006. He is Deputy Managing Director of CITIC Pacific Limited.

Executive Officers

BARRINGTON, William Edward James#, aged 47, has been Director Sales and Marketing since March 2000. He joined the Swire group in 1982.

CHAU, Siu Cheong William, aged 53, has been Director Personnel since May 2000. He joined the Swire group in 1973.

CHONG, Wai Yan Quince, aged 43, has been Director Service Delivery since July 2004. She joined the Swire group in 1998.

GIBBS, Christopher Patrick, aged 45, has been Engineering Director since January 2007. He joined the Swire group in 1992.

MATHISON, Ronald James#, aged 45, has been Director and General Manager Cargo since June 2004. He joined the Swire group in 1984.

NICOL, Edward Brian#, aged 53, has been Director Information Management since January 2003. He joined the Swire group in 1975.

RHODES, Nicholas Peter#, aged 48, has been Director Flight Operations since January 2003. He joined the Swire group in 1980.

Secretary

FU, Yat Hung David#, aged 43, has been Company Secretary since January 2006. He joined the Swire group in 1988.

Employees of the John Swire & Sons Limited group
\+ *Member of the Remuneration Committee*
* *Member of the Audit Committee*

We submit our report and the audited accounts for the year ended 31st December 2006 which are on pages 45 to 89.

Activities

Cathay Pacific Airways Limited (the "Company") is managed and controlled in Hong Kong. As well as operating scheduled airline services, the Company and its subsidiaries (the "Group") are engaged in other related areas including airline catering, aircraft handling and aircraft engineering. The airline operations are principally to and from Hong Kong, which is where most of the Group's other activities are also carried out. Details are set out in note 1 to the accounts.

Details of principal subsidiaries, their main areas of operation and particulars of their issued capital, and details of principal associates are listed on pages 88 and 89.

Accounts

The profit of the Group for the year ended 31st December 2006 and the state of affairs of the Group and the Company at that date are set out in the accounts on pages 50 to 89.

Dividends

We recommend the payment of a final dividend of HK¢32 per share for the year ended 31st December 2006. Together with the interim dividend of HK¢20 per share paid on 3rd October 2006 and the special interim dividend of HK¢32 per share paid on 20th November 2006, this makes a total dividend for the year of HK¢84 per share. This represents a total distribution for the year of HK$3,304 million. Subject to shareholders' approval of the final dividend at the Annual General Meeting on 9th May 2007, payment of the final dividend will be made on 1st June 2007 to shareholders registered at the close of business on the record date, 9th May 2007.

The register of members will be closed from 4th May 2007 to 9th May 2007, both dates inclusive, during which period no transfer of shares will be effected. In order to qualify for the entitlement of the final dividend, all transfer forms accompanied by the relevant share certificates must be lodged with the Company's share registrars, Computershare Hong Kong Investor Services Limited, 17th Floor, Hopewell Centre, 183 Queen's Road East, Hong Kong, for registration not later than 4:30 p.m. on Thursday, 3rd May 2007.

Reserves

Movements in the reserves of the Group and the Company during the year are set out in the statement of changes in equity on pages 54 to 57.

Accounting policies

The principal accounting policies are set out on pages 45 to 49.

Donations

During the year, the Company and its subsidiaries made charitable donations amounting to HK$11 million in direct payments, a further HK$10 million in the form of discounts on airline travel and 64,700,000 shares of CNAC worth HK$181 million.

Fixed assets

Movements of fixed assets are shown in note 8 to the accounts. Details of aircraft acquisitions are set out on page 8.

Bank and other borrowings

The net bank loans, overdrafts and other borrowings, including obligations under finance leases, of the Group and the Company are shown in notes 13 and 18 to the accounts.

Share capital

During the year under review, the Group did not purchase or redeem any shares in the Company.

The Company adopted a share option scheme on 10th March 1999. During the year, 7,019,500 shares were issued under the scheme. Details of the scheme can be found in note 19 to the accounts.

Following approval at the Company's Extraordinary General Meeting held on 22nd August 2006, the authorised share capital of the Company increased from HK$780,000,000 (comprising 3,900,000,000 ordinary shares of HK$0.20 each) to HK$1,000,000,000 (comprising 5,000,000,000 ordinary shares of HK$0.20 each) on 22nd August 2006; and the Company issued 548,045,724 new shares of HK$0.20 each at an issue price of HK$13.50 per share on 28th September 2006 as part consideration for the acquisition of the shares of Dragonair.

At 31st December 2006, 3,935,697,572 shares were in issue (31st December 2005: 3,380,632,348 shares). Details of the movement of share capital can be found in note 19 to the accounts.

Commitments and contingencies

The details of capital commitments and contingent liabilities of the Group and the Company as at 31st December 2006 are set out in note 27 to the accounts.

Agreement for services

The Company has an agreement for services with John Swire & Sons (H.K.) Limited ("JSSHK"), the particulars of which are set out in the section on continuing connected transactions.

As directors and/or employees of the John Swire & Sons Limited ("Swire") group, Christopher Pratt, Robert Atkinson, Philip Chen, Martin Cubbon, Davy Ho, James Hughes-Hallett, Tony Tyler and Robert Woods are interested in the JSSHK Services Agreement (as defined below). David Turnbull was interested as a director and an employee of the Swire group until his resignation on 31st January 2006.

Particulars of the fees paid and the expenses reimbursed for the year ended 31st December 2006 are set out below and also given in note 26 to the accounts.

Significant contracts

Contracts between the Company and HAECO and its subsidiary TAECO for the maintenance and overhaul of aircraft and related equipment accounted for approximately 3% of the airline's net operating expenses in 2006. Like the Company, HAECO is an associate of Swire Pacific; all contracts have been concluded on normal commercial terms in the ordinary course of the business of both parties.

Major transaction

Cathay Pacific Aircraft Services Limited ("CPAS"), a wholly owned subsidiary of the Company, entered into a purchase agreement with The Boeing Company on 22nd June 2006 for the acquisition of six Boeing 747-400ERF freighters. This transaction constituted a major transaction under the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the "Listing Rules") in respect of which an announcement dated 22nd June 2006 was published and a circular dated 29th June 2006 was sent to shareholders.

Discloseable transaction

CPAS entered into an agreement with The Boeing Company on 1st June 2006 for the acquisition of two Boeing 777-300ER aircraft. This transaction constituted a discloseable transaction under the Listing Rules in respect of which an announcement dated 1st June 2006 was published and a circular dated 8th June 2006 was sent to shareholders.

Discloseable and connected transactions

The Company entered into a Restructuring Agreement with Air China, CNAC, CITIC Pacific and Swire Pacific on 8th June 2006 in respect of the restructuring of the parties' shareholdings in the Company and Dragonair and the acquisition by the Company of additional Air China H Shares.

Pursuant to the Restructuring Agreement, the Company purchased 411,034,293 shares (representing 82.2% shareholding) of Dragonair (based on a valuation of 100% of Dragonair at HK$10 billion or HK$20.00 per share of Dragonair) which the Company did not already own for a total consideration of HK$8,220,685,860 which was satisfied by a combination of the issue of 548,045,724 new shares of the Company at an issue price of HK$13.50 each and HK$822,068,586 in cash; Air China acquired 40,128,292 shares of the Company at HK$13.50 per share from Swire Pacific; Air China acquired 359,170,636 shares of the Company at HK$13.50 per share from CITIC Pacific; the Company subscribed for an additional 1,179,151,364 Air China H Shares at a subscription price of HK$3.45 per share totalling HK$4,068,072,206.

Swire Pacific and CITIC Pacific are substantial shareholders of the Company and are therefore connected persons of the Company under the Listing Rules. The acquisition of 38,551,808 Dragonair shares from Swire Pacific, the acquisition of 142,482,484 Dragonair shares from CITIC Pacific, the allotment of 51,402,411 new shares of the Company to Swire Pacific, and the allotment of 189,976,645 new shares of the Company to CITIC Pacific under the Restructuring Agreement constituted connected transactions of the Company under the Listing Rules. The acquisition of the 82.2% shareholding in Dragonair and the subscription for additional Air China H Shares under the Restructuring Agreement constituted discloseable transactions of the Company under the Listing Rules. In respect of these discloseable and connected transactions, an announcement dated 8th June 2006 was published and a circular dated 6th July 2006 was sent to shareholders.

Following completion of the Restructuring Agreement on 28th September 2006, Dragonair became a wholly owned subsidiary of the Company; the Company held 2,124,818,455 H Shares (representing 17.3% shareholding) of Air China; and Swire Pacific, Air China (including its subsidiary CNAC) and CITIC Pacific directly or indirectly held 1,572,332,028 shares (representing 39.99% shareholding), 687,895,263 shares (representing 17.5% shareholding) and 687,895,263 shares (representing 17.5% shareholding) respectively of the Company.

Continuing connected transactions

During the year ended 31st December 2006, the Group had the following continuing connected transactions, details of which are set out below:

(a) Pursuant to an agreement dated 17th October 2002 (the "DHL Services Agreement") with DHL International GmbH (formerly DHL International Limited) ("DHL"), AHK has provided to DHL services in respect of the sale of space on certain cargo services operated by AHK in the Asian region for the carriage of DHL's door to door air express materials. Payment is made in cash by DHL to AHK against invoice presented monthly within 30 days from the date of receipt of the invoice. The term of the DHL Services Agreement is from 17th October 2002 to 31st December 2018.

    DHL is a connected person of the Company because of its 40% attributable interest in the Company's subsidiary AHK. The transactions under the DHL Services Agreement are continuing connected transactions in respect of which announcements dated 17th October 2002 and 27th June 2005 were published and a circular dated 12th July 2005 was sent to shareholders.

The fees payable by DHL to AHK under the DHL Services Agreement totalled HK$1,369 million for the year ended 31st December 2006.

(b) Pursuant to the amendments made to the Cargo Capacity (Network Block Space) Agreement ("BSA") and Network Cargo Joint Sales Agreement ("JSA") both dated 6th December 1999, the Company provides cargo capacity for the carriage of DHL's air express materials between Hong Kong and Beijing, Nagoya and Shanghai and acts as the agent for DHL to sell reserved space surplus to DHL's requirements. Payment is made in cash by DHL to the Company against an invoice presented at the end of each two-week period within 21 days from the date of the invoice. The term of the BSA and JSA (as amended) is from 6th March 2000 until on or before 31st December 2007.

DHL is a connected person of the Company because of its 40% attributable interest in the Company's subsidiary AHK. The transactions under the BSA and JSA are continuing connected transactions in respect of which announcements dated 19th April 2005 and 28th February 2007 were published.

The fees and commissions payable by DHL to the Company under the BSA and JSA totalled HK$385 million for the year ended 31st December 2006.

(c) Pursuant to an agreement dated 1st December 2004 ("JSSHK Services Agreement") with JSSHK, JSSHK provides services to the Company and its subsidiaries. The services comprise advice and expertise of the directors and senior officers of the Swire group including (but not limited to) assistance in negotiating with regulatory and other governmental or official bodies, full or part time services of members of the staff of the Swire group, other administrative and similar services and such other services as may be agreed from time to time.

In return for these services, JSSHK receives annual service fees calculated as 2.5% of the Company's consolidated profit before taxation and minority interests after certain adjustments. The fees for each year are payable in cash in arrears in two instalments, an interim payment by the end of October and a final payment by the end of April of the following year, adjusted to take account of the interim payment. The Company also reimburses the Swire group for all the expenses incurred in the provision of the services at cost.

The term of the JSSHK Services Agreement is from 1st January 2005 to 31st December 2007 and is renewable for successive periods of three years thereafter unless either party to it gives to the other notice of termination of not less than three months expiring on any 31st December.

Swire is the holding company of Swire Pacific which owns approximately 40% of the issued capital of the Company and JSSHK, a wholly owned subsidiary of Swire, is therefore a connected person of the Company under the Listing Rules. The transactions under the JSSHK Services Agreement are continuing connected transactions in respect of which an announcement dated 1st December 2004 was published.

For the year ended 31st December 2006, the fees payable by the Company to JSSHK under the JSSHK Services Agreement totalled HK$125 million and expenses of HK$124 million were reimbursed at cost.

(d) Pursuant to an agreement dated 31st May 2005 ("PCCW Services Agreement") between Cathay Pacific Loyalty Programmes Limited ("CPLP") with PCCW Teleservices (Hong Kong) Limited ("Teleservices"), Teleservices provides services to CPLP. The services comprise the provision of a service centre and handling of customer calls and related administration for the Company's frequent flyer and customer loyalty programmes. In return for the services, CPLP pays to Teleservices a monthly charge based on cost plus a margin. Teleservices is paid an additional margin upon the achievement of certain performance criteria and efficiency targets, and deductions are imposed for underachievement. Payment is made in cash by CPLP within 45 days from the date of receipt of Teleservices' invoice. The term of the PCCW Services Agreement is from 1st June 2005 to 31st May 2008.

Teleservices is an indirect wholly owned subsidiary of PCCW Limited which indirectly holds a 37% equity interest in the Company's subsidiary Abacus Distribution Systems (Hong Kong) Limited. Teleservices is therefore a connected person of the Company under the Listing Rules. The transactions under the PCCW Services Agreement are continuing connected transactions in respect of which an announcement dated 31st May 2005 was published.

The fees payable by CPLP to Teleservices under the PCCW Services Agreement totalled HK$64 million for the year ended 31st December 2006.

(e) Pursuant to the maintenance service agreements dated 10th November 2005 with HAECO and TAECO ("HAECO Services Agreements"), HAECO and TAECO provide services to the Company's aircraft fleet. The services comprise line maintenance, base maintenance, comprehensive stores and logistics support, component and avionics overhaul, material supply, engineering services and ancillary services at Hong Kong International Airport and/or Xiamen. Payment is made in cash by the Company to HAECO/TAECO within 30 days upon receipt of the invoice. The term of the HAECO Services Agreements is from 1st January 2006 to 31st December 2007.

HAECO is a connected person of the Company by virtue of it being an associate of the Company's substantial shareholder Swire Pacific. TAECO is a non-wholly owned subsidiary of HAECO and is therefore also a connected person of the Company. The transactions under the HAECO Services Agreements are continuing connected transactions in respect of which an announcement dated 10th November 2005 was published and a circular dated 22nd November 2005 was sent to shareholders.

The fees payable by the Company to HAECO/TAECO under the HAECO Services Agreements totalled HK$1,195 million for the year ended 31st December 2006.

Three independent non-executive Directors, who are not interested in any connected transactions with the Group, have reviewed and confirmed that the continuing connected transactions as set out above have been entered into by the Group:

(a) in the ordinary and usual course of business of the Group;

(b) either on normal commercial terms or, if there are not sufficient comparable transactions to judge whether they are on normal commercial terms, on terms no less favourable to the Group than terms available to or from (as appropriate) independent third parties; and

(c) in accordance with the relevant agreement governing them on terms that are fair and reasonable and in the interests of the shareholders of the Company as a whole.

The Auditors of the Company have also reviewed these transactions and confirmed to the Board that:

(a) they have been approved by the Board of the Company;

(b) they are in accordance with the pricing policies of the Group (if the transactions involve provision of goods or services by the Group);

(c) they have been entered into in accordance with the relevant agreements governing the transactions; and

(d) they have not exceeded the relevant annual caps disclosed in previous announcements.

Major customers and suppliers

5.7% of sales and 27.6% of purchases during the year were attributable to the Group's five largest customers and suppliers respectively. 1.4% of sales were made to the Group's largest customer while 6.7% of purchases were made from the Group's largest supplier.

Directors

Christopher Pratt was appointed Chairman and a Director on 1st February 2006. Davy Ho, Robert Woods, Zhang Lan and Augustus Tang were appointed Directors on 11th May, 10th August, 23rd October 2006 and 1st January 2007 respectively. Li Jiaxiang was appointed Deputy Chairman and a Director on 23rd October 2006. Leslie Chang was appointed Alternate Director to Henry Fan on 7th November 2006. All the other present Directors of the Company whose names are listed on pages 26 and 27 served throughout the year. In addition, David Turnbull served as Chairman and a Director until his resignation on 31st January 2006; Carl Yung and Zhang Xianlin served as Directors until their resignation with effect from 28th September and 23rd October 2006 respectively; and Derek Cridland served as a Director until his retirement on 31st December 2006.

The Company has received from each of its independent non-executive Directors an annual confirmation of his independence pursuant to Listing Rule 3.13 and the Company still considers all its independent non-executive Directors to be independent.

Article 93 of the Company's Articles of Association provides for all the Directors to retire at the third Annual General Meeting following their election by ordinary resolution. In accordance therewith, Robert Atkinson retires this year and, being eligible, offers himself for re-election.

Davy Ho, Li Jiaxiang, Augustus Tang, Robert Woods and Zhang Lan, having been appointed as Directors of the Company under Article 91 since the last Annual General Meeting, also retire and, being eligible, offer themselves for election.

Each of the Directors has entered into a letter of appointment, which constitutes a service contract, with the Company for a term of up to three years until his retirement under Article 91 or Article 93 of the Articles of Association of the Company, which will be renewed for a term of three years upon each election/re-election. 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).

Directors' fees paid to the independent non-executive Directors during the year totalled HK$1,190,000; they received no other emoluments from the Company or any of its subsidiaries.

Directors' interests

At 31st December 2006, the register maintained under Section 352 of the Securities and Futures Ordinance ("SFO") showed that Directors held the following beneficial interests (all being personal interests) in the shares of Cathay Pacific Airways Limited:

	No. of shares	Percentage of issued capital
Philip Chen	9,000	0.00023
Derek Cridland	17,000	0.00043
Tony Tyler	5,000	0.00013

Other than as stated above, no Director or chief executive of Cathay Pacific Airways Limited had any interest or short position, whether beneficial or non-beneficial, in the shares or underlying shares (including options) and debentures of Cathay Pacific Airways Limited or any of its associated corporations (within the meaning of Part XV of the SFO).

Directors' interests in competing business

Pursuant to Rule 8.10 of the Listing Rules, Christopher Pratt, Philip Chen and Li Jiaxiang have disclosed that they are directors of Air China. Zhang Xianlin has disclosed that he is a supervisor of Air China. Air China competes or is likely to compete, either directly or indirectly, with the businesses of the Company as it operates airline services to certain destinations which are also served by the Company.

Substantial shareholders

The register of interests in shares and short positions maintained under Section 336 of the SFO shows that at 31st December 2006 the Company had been notified of the following interests in the shares of the Company held by substantial shareholders and other persons:

	No. of shares	Percentage of issued capital	Type of interest (Note)
1. Air China Limited	2,948,122,554	74.98	Attributable interest (b)
2. China National Aviation Holding Company	2,948,122,554	74.98	Attributable interest (c)
3. China National Aviation Company Limited	2,948,122,554	74.98	Attributable interest (c)
4. CITIC Pacific Limited	2,948,122,554	74.98	Attributable interest
5. Swire Pacific Limited	2,948,122,554	74.98	Beneficial owner
6. John Swire & Sons Limited	2,948,122,554	74.98	Attributable interest (d)

Note: At 31st December 2006:

(a) Under Section 317 of the Securities and Futures Ordinance, each of Air China, CNAC, CITIC Pacific and Swire Pacific, being a party to the Shareholders' Agreement in relation to the Company dated 8th June 2006, was deemed to be interested in a total of 2,948,122,554 shares of the Company, comprising:

(i) 1,572,332,028 shares directly held by Swire Pacific;

(ii) 687,895,263 shares indirectly held by CITIC Pacific and its wholly owned subsidiary Super Supreme Company Limited, comprising the following shares held by their wholly owned subsidiaries: 286,451,154 shares held by Custain Limited, 189,976,645 shares held by Grand Link Investments Holdings Ltd., 21,809,399 shares held by Perfect Match Assets Holdings Ltd., and 189,658,065 shares held by Smooth Tone Investments Ltd.

(iii) 288,596,335 shares indirectly held by CNAC, via its wholly owned subsidiary Angel Paradise Ltd.; and

(iv) 399,298,928 shares indirectly held by Air China and its subsidiary Total Transform Group Limited, comprising the following shares held by their wholly owned subsidiaries: 191,922,273 shares held by Easerich Investments Inc. and 207,376,655 shares held by Motive Link Investments Inc.

(b) Air China is deemed to be interested in the 288,596,335 shares indirectly held by its subsidiary CNAC.

(c) China National Aviation Holding Company is deemed to be interested in a total of 2,948,122,554 shares of the Company, in which its subsidiaries Air China and CNAC are deemed interested.

(d) Swire and its wholly owned subsidiary JSSHK are deemed to be interested in a total of 2,948,122,554 shares of the Company by virtue of the Swire group's direct or indirect interest in shares of Swire Pacific representing approximately 33.28% of the issued capital and approximately 54.35% of the voting rights.

Public float

From information publicly available to the Company and within the knowledge of its Directors, at least 25% of the Company's total issued share capital are held by the public at all times.

Auditors

KPMG retire and, being eligible, offer themselves for re-appointment. A resolution for the re-appointment of KPMG as Auditors to the Company is to be proposed at the forthcoming Annual General Meeting.

By order of the Board

Christopher Pratt
Chairman
Hong Kong, 7th March 2007

Cathay Pacific is committed to maintaining a high standard of corporate governance and devotes considerable effort to identifying and formalising best practices of corporate governance. The Company has complied throughout the year with all the code provisions set out in the Code on Corporate Governance Practices (the "CG Code") contained in Appendix 14 of the Listing Rules. The Company has also put in place corporate governance practices to meet most of the recommended best practices in the CG Code.

The Board of Directors

The Board is chaired by Christopher Pratt (the "Chairman"). There are five executive Directors and twelve non-executive Directors, four of whom are independent. Names and other details of the Directors are given on pages 26 and 27 of this report. All Directors are able to take independent professional advice in furtherance of their duties if necessary. The independent non-executive Directors are high calibre executives with diversified industry expertise and serve the important function of providing adequate checks and balances for safeguarding the interests of shareholders and the Company as a whole.

To ensure a balance of power and authority, the role of the Chairman is separate from that of the Chief Executive ("CE"). The current CE is Philip Chen. The Board regularly reviews its structure, size and composition to ensure its expertise and independence are maintained. It also identifies and nominates qualified individuals, who are expected to have such expertise to make a positive contribution to the performance of the Board, to be additional Directors or fill Board vacancies as and when they arise. A Director appointed by the Board to fill a casual vacancy is subject to election of shareholders at the first general meeting after his appointment and all Directors have to retire at the third annual general meeting following their election by ordinary resolution, but are eligible for re-election.

All Directors disclose to the Board on their first appointment their interests as director or otherwise in other companies or organisations and such declarations of interests are updated annually. When the Board considers any proposal or transaction in which a Director has a conflict of interest, he declares his interest and is required to abstain from voting.

The Board is accountable to the shareholders for leading the Company in a responsible and effective manner. It determines the overall strategies, monitors and controls operating and financial performance and sets appropriate policies to manage risks in pursuit of the Company's strategic objectives. It is also responsible for presenting a balanced, clear and understandable assessment of the financial and other information contained in the Company's accounts, announcements and other disclosures required under the Listing Rules or other statutory requirements. Day-to-day management of the Company's business is delegated to the CE. Matters reserved for the Board are those affecting the Company's overall strategic policies, finances and shareholders. These include: financial statements, dividend policy, significant changes in accounting policy, the annual operating budgets, material contracts, major financing arrangements, major investments, risk management strategy and treasury policies. The functions of the Board and the powers delegated to the CE are reviewed periodically to ensure that they remain appropriate. The Board has established the following committees: the Board Safety Review Committee, the Executive Committee, the Finance Committee, the Remuneration Committee and the Audit Committee, the latter two with the participation of independent non-executive Directors.

The Board of Directors held six meetings during 2006, the attendance of which, taking into account dates of appointment or resignation, was as follows:

Christopher Pratt (5/5), Robert Atkinson (6/6), Philip Chen (6/6), Derek Cridland (6/6), Martin Cubbon (6/6), Henry Fan (4/6), Davy Ho (3/3), James Hughes-Hallett (6/6), Peter Lee (6/6), Li Jiaxiang (1/1), Vernon Moore (6/6), Raymond Or (5/6), Jack So (6/6), David Turnbull (1/1), Tony Tyler (6/6), Tung Chee Chen (5/6), Robert Woods (2/2), Carl Yung (3/5), Zhang Xianlin (1/5) and Zhang Lan (1/1); Leslie Chang (alternate to Henry Fan) (1/1).

Securities Transactions

The Company has adopted codes of conduct regarding securities transactions by Directors (the "Securities Code") and relevant employees (as defined in the CG Code) on terms no less exacting than the required standard set out in the Model Code for Securities Transactions by Directors of Listed Issuers (the "Model Code") contained in Appendix 10 of the Listing Rules. A copy of the Securities Code is sent to each Director of the Company first on his appointment and thereafter twice annually, one month before the date of the board meeting to approve the Company's half-year result and annual result, with a reminder that the Director cannot deal in the securities and derivatives of the Company until after such results have been published.

Under the Securities Code, Directors of the Company are required to notify the Chairman and receive a dated written acknowledgement before dealing in the securities and derivatives of the Company and, in the case of the Chairman himself, he must notify the Chairman of the Audit Committee and receive a dated written acknowledgement before any dealing.

On specific enquiries made, all Directors have confirmed that they have complied with the required standard set out in the Model Code throughout the year.

Directors' interests as at 31st December 2006 in the shares of the Company and its associated corporations (within the meaning of Part XV of the Securities and Futures Ordinance) are set out on page 33.

Board Safety Review Committee

The Board Safety Review Committee reviews and reports to the Board on safety issues. It meets three times a year and comprises two executive Directors, the CE and Tony Tyler, two non-executive Directors, Vernon Moore and Jack So, three executive officers, Christopher Gibbs, Nick Rhodes and Quince Chong, the General Manager Flying, Captain Richard Hall and the Head of Corporate Safety, Richard Howell. It is chaired by the immediate past Director Flight Operations, Ken Barley.

Executive Committee

The Executive Committee is chaired by the CE and comprises three executive Directors, Tony Tyler, Robert Atkinson and Augustus Tang, and four non-executive Directors, Martin Cubbon, Li Jiaxiang, Vernon Moore and Zhang Lan. It meets monthly and is responsible to the Board for overseeing and setting the strategic direction of the Company.

Management Committee

The Management Committee meets once a month and is responsible to the Board for overseeing the day-to-day operation of the Company. It is chaired by the CE and comprises three executive Directors, Tony Tyler, Robert Atkinson and Augustus Tang, and all seven executive officers, James Barrington, William Chau, Quince Chong, Christopher Gibbs, Ronald Mathison, Edward Nicol and Nick Rhodes.

Finance Committee

The Finance Committee meets monthly to review the financial position of the Company and is responsible for establishing the financial risk management policy. It is chaired by the CE and comprises three executive Directors, Tony Tyler, Robert Atkinson and Augustus Tang, three non-executive Directors, Martin Cubbon, Vernon Moore and Zhang Lan, the General Manager Corporate Finance, Keith Fung, and an independent representative from the financial community. Reports on its decisions and recommendations are presented at Board meetings.

Remuneration Committee

The Remuneration Committee comprises two independent non-executive Directors, Peter Lee and Tung Chee Chen, and is chaired by the Company's past Chairman, James Hughes-Hallett who is also a non-executive Director.

Under the Services Agreement between the Company and JSSHK, which has been considered in detail and approved by the Directors of the Board who are not connected with the Swire group, staff at various levels, including executive Directors, are seconded to the Company. Those staff report to and take instructions from the Board of the Company but remain employees of Swire.

In order to be able to attract and retain international staff of suitable calibre, the Swire group provides a competitive remuneration package. This comprises salary, housing, provident fund, leave passage and education allowances and, after three years' service, a bonus related to the profit of the overall Swire group. The provision of housing affords ease of relocation either within Hong Kong or elsewhere in accordance with the needs of the business and as part of the training process whereby managers gain practical experience in various businesses within the Swire group, and payment of bonuses on a group-wide basis enables postings to be made to group companies with very different profitability profiles. Whilst bonuses are calculated by reference to the profits of the Swire group overall, a significant part of such profits are usually derived from the Company.

Although the remuneration of these executives is not entirely linked to the profits of the Company, it is considered that, given the volatility of the aviation business, this has contributed considerably to the maintenance of a stable, motivated and high-calibre senior management team in the Company. Furthermore, as a substantial shareholder of the Company, it is in the best interest of Swire to see that executives of high quality are seconded to and retained within the Company.

A number of Directors and senior staff with specialist skills are employed directly by the Company on similar terms.

This policy and the levels of remuneration paid to executive Directors of the Company were reviewed by the Remuneration Committee. At its meeting in November, the Remuneration Committee considered a report prepared for it by independent consultants, Mercer Human Resource Consulting Limited, which confirmed that the remuneration of the Company's executive Directors was in line with comparators in peer group companies. The Committee approved individual Directors' remuneration packages to be paid in respect of 2007.

No Director takes part in any discussion about his own remuneration. The remuneration of independent non-executive Directors is determined by the Board in consideration of the complexity of the business and the responsibility involved.

Annual fees of independent non-executive Directors in 2006 were as follows:

Director's fee	HK$160,000
Fee for serving on Audit Committee	HK$150,000
Fee for serving on Remuneration Committee	HK$50,000

The Remuneration Committee held two meetings during 2006, the attendance of which was as follows:

James Hughes-Hallett (2/2), Peter Lee (2/2) and Tung Chee Chen (2/2).

Audit Committee

The Audit Committee is responsible to the Board and consists of four non-executive Directors, three of whom are independent. The members currently are Zhang Lan, Peter Lee and Jack So. It is chaired by an independent non-executive Director, Raymond Or.

The Committee reviewed the completeness, accuracy and fairness of the Company's reports and accounts and provided assurance to the Board that these comply with accounting standards, stock exchange and legal requirements. The Committee also reviewed the adequacy and effectiveness of the internal control and risk management systems. It reviewed the work done by the internal and external auditors, the relevant fees and terms, results of audits performed by the external auditors and appropriate actions required on significant control weaknesses. The external auditors, the Finance Director and the Internal Audit Manager also attended these meetings.

The Audit Committee held three meetings during 2006, the attendance of which, taking into account dates of appointment or resignation, was as follows:

Peter Lee (3/3), Vernon Moore (2/2), Raymond Or (3/3), Jack So (3/3) and Zhang Lan (1/1).

Expenditure Control Committee

The Expenditure Control Committee meets monthly to evaluate and approve capital expenditure. It is chaired by one executive Director, Tony Tyler and comprises two executive Directors, Robert Atkinson and Augustus Tang.

Internal Control and Internal Audit

The internal control system has been designed to safeguard corporate assets, maintaining proper accounting records and ensure transactions are executed in accordance with management's authorisation. The system comprises a well-established organisational structure and comprehensive policies and standards.

The Internal Audit Department provides an independent review of the adequacy and effectiveness of the internal control system. The audit plan, which is prepared based on risk assessment methodology, is discussed and agreed every year with the Audit Committee. In addition to its agreed annual schedule of work, the Department conducts other special reviews as required. The Internal Audit Manager has direct access to the Audit Committee. Audit reports are sent to the Chief Operating Officer, the Finance Director, external auditors and the relevant management of the auditee department. A summary of major audit findings is reported quarterly to the Board and reviewed by the Audit Committee. As a key criterion of assessing the effectiveness of the internal control system, the Board and the Committee actively monitor the number and seriousness of findings raised by the Internal Audit Department and also the corrective actions taken by relevant departments.

Detailed control guidelines have been set and made available to all employees of the Company regarding handling and dissemination of corporate data which is price sensitive.

Systems and procedures are in place to identify, control and report on major risks, including business, safety, legal, financial, environmental and reputational risks. Exposures to these risks are monitored by the Board with the assistance of various committees and senior management.

The Board is responsible for the system of internal control and for reviewing its effectiveness. For the year under review, the Board considered that the Company's internal control system is adequate and effective and the Company has complied with the code provisions on internal control of the CG Code.

External Auditors

The external auditors are primarily responsible for auditing and reporting on the annual financial statements. In 2006 the total remuneration paid to the external auditors was HK$10 million, being HK$8 million for audit and HK$2 million for tax advice.

Airline Safety Review Committee

The Airline Safety Review Committee meets monthly to review the Company's exposure to operational risk. It reviews the work of the Cabin Safety Review Committee, the Operational Ramp Safety Committee and the Engineering Mandatory Occurrence Report Meeting. It is chaired by the Head of Corporate Safety and comprises Directors and senior management of all operational departments as well as senior management from the ground handling company, HAS, and the aircraft maintenance company, HAECO.

Investor Relations

The Company continues to enhance relationships and communication with its investors. Extensive information about the Company's performance and activities is provided in the Annual Report and the Interim Report which are sent to shareholders. Regular dialogue with institutional investors and analysts is in place to keep them abreast of the Company's development. Inquiries from investors are dealt with in an informative and timely manner. All shareholders are encouraged to attend the annual general meeting to discuss matters relating to the Company. Any inquiries from shareholders can be addressed to the Corporate Communication Department whose contact details are given on page 96.

In order to promote effective communication, the Company maintains its website at *www.cathaypacific.com* on which financial and other information relating to the Company and its business is disclosed.

Shareholders may request an extraordinary general meeting to be convened in accordance with Section 113 of the Companies Ordinance.

In continuing to recognise our responsibility towards our stakeholders, and in meeting the expectations of our passengers, staff, investors and the community at large, we undertook a stakeholder dialogue exercise in 2006. This helped to identify the key issues for our first standalone Corporate Social Responsibility ("CSR") Report, which is now available at *www.cathaypacific.com*.

The dialogue, undertaken by an independent facilitator, revealed that in general Cathay Pacific is seen as a successful company with a positive image and brand, and is viewed as a company that is particularly strong in community involvement and generous with sponsorship and charities. Communication was identified as an area for improvement and this had been addressed by the publication of the CSR Report and, internally, through an internal website dedicated to environmental matters.

Cathay Pacific strives to be a good corporate citizen, adhering to rigorous ethical and professional standards and insisting on high levels of honest, accountable and transparent decision-making in all areas of operations. We endeavour to deliver superior financial returns and to achieve operational excellence in everything we do.

Contribution to the community

We have always held a strong belief that we should put something back into the communities in which we operate, and which have given us so much support over the years. This is particularly true in our home market, Hong Kong, where we support a number of community initiatives throughout the year.

Our signature youth-development programme in Hong Kong is "I Can Fly", which gives 1,000 local teenagers the chance to learn more about aviation and also devise their own community service initiatives. Our pilots and staff act as mentors throughout the programme. We also support the Life Education Activity Programme ("LEAP"), which tours Hong Kong schools to promote healthy lifestyles and teach young people about the dangers of drug and alcohol abuse. In the 2005/2006 academic year, some 75,000 students received LEAP's interactive, health-based drug prevention programmes.

We have been supporting UNICEF through the Change for Good inflight fundraising programme since 1991, raising more than HK$74 million during that time. Change for Good raised almost HK$10 million in the 2005/2006 programme year with an average of one month's proceeds going to the Cathay Pacific Wheelchair Bank. Set up to provide specially adapted chairs for children with neuromuscular diseases, the Wheelchair Bank recently celebrated its 10th anniversary.

The Cathay Pacific International Wilderness Experience has been running since 1994, taking young people from Hong Kong and various cities around the Asia Pacific region to a safari camp in South Africa. The programme aims to promote ecological awareness and cross-cultural understanding among the young participants. So far, more than 550 people have taken part.

Our travel reward programme, Asia Miles, has four charity partners – Oxfam, UNICEF, Project Orbis and CARE – that are supported by members' donations of miles. We continue to support staff in the development of their own community projects, which include the

Sunnyside Club – a charity set up in 1983 to improve the lives of handicapped youngsters in Hong Kong. Many of our overseas offices also support local charity efforts in the countries in which they operate.

We donated 64.7 million shares held in CNAC to charity. The donation, valued at HK$181 million, helped a total of 70 charitable bodies, including 63 in Hong Kong, six in Mainland China and one Asian-wide body.

Environment

In recognising the small – but high profile – contribution made by aviation to global carbon dioxide emissions, Cathay Pacific is supporting all efforts to reduce fuel wastage and maximise efficiency in its operations. Internally, we are developing a climate change strategy, assessing the most appropriate mechanisms for us to address climate change, through improved efficiency within the airline and by working closely with industry partners. This includes continuing to identify and implement weight-saving measures inflight, and considering the possibility of carbon offsetting through investment in projects elsewhere. Carbon offsetting would be undertaken only as part of an overall strategy that includes taking all feasible steps to maximise efficiency for our own flight and ground operations.

We continue to work closely with regulators and industry partners in providing technical expertise and support to proposals for improved routings and flight paths. In particular, a new route over Mainland China was approved in 2006 that is now being used by Cathay Pacific's European services. This route, known as Yankee 1, saved the airline 120 hours of flight time during the initial three months, amounting to approximately 1,200 tonnes of fuel saved and reducing carbon dioxide emissions by more than 3,500 tonnes.

Many more routes within our network are currently being assessed and there is scope for significant further improvements over the next two years.

We make every effort to instil the guiding principles of the 4Rs – "replace, reduce, reuse and recycle" – into every area of our business. In March 2006, we took a significant step forward in our inflight waste management when we implemented an initiative to sort and separate aluminium cans and plastic bottles on all Cathay Pacific flights arriving into Hong Kong. This successful initiative has prevented approximately 486,788 cans and 329,370 bottles from going into Hong Kong's landfills. Inflight our plastic cutlery is collected for recycling and on inbound flights magazines are sorted for reuse or collected and sent for recycling when obsolete. The airline will continue to identify other recycling initiatives, at the same time working to ensure that resources are better managed to produce less waste.

We also continue to identify areas for resource and waste management in our ground operations, including placing a significant emphasis on recycling. In our offices we collect paper, cans, printer cartridges, CDs, plastic bottles and rechargeable batteries. We have provided more waste separation facilities in various training areas and classrooms at our headquarters and in the Flight Training Centre complex, and we also continue to investigate waste recycling opportunities at destinations worldwide.

Communication on environmental issues has been improved through the development of a comprehensive environment-specific site on the Company's Intranet. This covers global issues such as climate change as well as local environmental concerns including clean air and waste management. The site provides numerous green ideas that staff can adopt both at home and in the office.

We at Cathay Pacific recognise a responsibility to promote environmental awareness wherever possible. Our aim is to help engender a deeper appreciation of nature and a greater awareness of people's individual responsibility towards the environment. We are Diamond members of the WWF Corporate Membership Programme, and in 2006 the Cathay Pacific "All Stars" team took part in the WWF Big Bird Race. We also worked with the WWF to set up the Asian Waterbird Conservation Fund, making an initial contribution of HK$500,000, helping to conserve the wetland habitats of migratory waterbirds across Asia.

We continue to make an effort to give our staff the opportunity to participate in environmental activities, helping to develop a keener awareness of the issues at stake. Cathay Pacific joined the Friends of the Earth Corporate Afforestation Scheme in 2004 – a three-year tree planting and management programme launched by the Agriculture, Fisheries and Conservation Department. This has allowed the airline to establish a 10,000-tree woodland site on Lantau Peak, which staff visit on an annual basis. In 2006 we also organised visits to the Ping Sham Historical Trail and Wetland Park Walk and to the Hoi Ha Marine Life Centre.

Health and safety

The safety and security of our passengers and staff is our highest priority, and our mission is to make Cathay Pacific Airways the safest airline in the world. Every effort is made to ensure that we operate in a manner that safeguards the health and safety of all sectors of the community. Our businesses comply with international regulatory requirements or with our own higher standards as applicable. As part of our corporate good governance, we proactively identify and manage potential threats and hazards, apply risk management processes in our decision-making, and appraise new systems and work practices for their safety implications.

Our health and safety policies are kept constantly under review, and continuous efforts are made to achieve performance improvements. Staff are provided with effective and appropriate education and training, as well as timely feedback on security, health and safety issues; we encourage management to set the very highest standards by personal example. Every employee is responsible for ensuring that, in all aspects of their daily work, SAFETY COMES FIRST. We encourage our business partners, contractors and suppliers to share our vision.

We implement programmes to safeguard the health of customers and staff. We continually monitor air quality in our aircraft to ensure a safe, healthy and comfortable environment for passengers and crew. We undertake similar monitoring in our Hong Kong headquarters, Cathay Pacific City, and in our training facilities and airport lounges, and have been certified by the Hong Kong Special Administration Region Government for indoor air quality. We monitor the exposure of aircrew to cosmic radiation and ensure annual dosages are below international guideline limits. Cabin crew can call a 24-hour aero-medical advisory service should a passenger fall ill during a flight. We adhere closely to advisories issued by the World Health Organisation, IATA, The Centre for Disease Control and Hong Kong Department of Health. We provide a variety of services for special needs customers, as well as advice to passengers on maintaining good health inflight.

Commitment to staff

We aim to provide our staff with a safe, healthy, comfortable workplace that is free from discrimination on grounds of race, sex, colour, religion or disability. We are committed to providing fair employment conditions, good promotional prospects, a balance between work and life, and we aim to be recognised as an employer of choice.

Cathay Pacific and its subsidiaries employ over 25,000 people worldwide. More than 18,600 Cathay Pacific staff are Hong Kong-based, making the Cathay Pacific Group one of Hong Kong's biggest employers. We are committed to investing in the long-term development of Hong Kong's aviation industry. Our Cadet Pilot Programme has provided career opportunities with Cathay Pacific for more than 240 cadets since 1988, and around 22 potential pilots gain their wings each year. So far, 39 cadets have progressed to the rank of Captain.

The planned expansion of our fleet over the next five years will see us continue to create local jobs and career opportunities. Training is one of the most important investments we make in human resources. We have progressively introduced leading-edge training and development programmes to up-skill our workforce, encourage collaborative problem solving, strong executive development and business-driven learning.

We recognise that our commercial success relies on the full participation of our staff and we are committed to their health and well-being. We have recently overhauled our systems for monitoring work-related injuries – especially amongst cabin crew. At Cathay Pacific City we offer on-site fitness programmes, health promotion and work injury prevention workshops, and provide an Employee Assistance Programme that offers confidential counselling.

We review our human resource and remuneration policies regularly in the light of local legislation, industry practice, market conditions and the performance of individuals and the Company. We promote a culture of open communication in which staff can report concerns without fear of retribution. We never forget our business depends on the skill, dedication and loyalty of our staff: their teamwork keeps us strong and successful.

Valuing customers

Our goal is to deliver superior service and value to our customers and to become the world's most admired airline. We recognise that the quality of the service we provide sets us apart from our competitors. We are committed to meeting our on-time performance goals, maintaining and growing our international route network, and increasing flight frequencies to meet market demand. We strive to deliver Service Straight from the Heart and we take pride in making our customers feel safe, welcome, comfortable and, above all, reassured. We anticipate our customers' needs and aim not just to meet, but surpass their expectations. We go beyond ensuring satisfaction in order to strengthen customer loyalty and enhance the profitability of the airline.