



中航興業有限公司

CHINA NATIONAL AVIATION COMPANY LIMITED

(incorporated in Hong Kong with limited liability)

(Stock Code: 1110)

2005 INTERIM RESULTS ANNOUNCEMENT

The Board of Directors (the “Directors”) of China National Aviation Company Limited (the “Company”) is pleased to present the unaudited condensed consolidated interim financial information of the Company and its subsidiaries (collectively the “Group”) for the six months ended 30th June, 2005 as set out below:

UNAUDITED CONDENSED CONSOLIDATED INCOME STATEMENT

For the six months ended 30th June, 2005

		Six months ended 30th June, 2005	2004 Restated
	Note	HK\$'000	HK\$'000
Turnover	2	1,199,150	788,129
Other revenue		34,018	2,226
Total revenue		1,233,168	790,355
Staff costs		155,140	107,421
Passenger catering and service costs		114,971	43,064
Fuel costs		261,057	144,635
Route operating costs		247,039	195,076
Aircraft maintenance costs		109,725	52,929
Aircraft leases and equipment costs		206,701	161,840
Depreciation and amortisation costs		37,530	40,900
Sales and promotion costs		38,336	26,029
Other operating costs		43,899	34,305
Total operating expenses		1,214,398	806,199
Operating profit/(loss)	3	18,770	(15,844)
Finance costs	4	(1,802)	–
Share of profits less losses of associates		120,498	144,825
Profit before income tax		137,466	128,981
Income tax expense	5	(5,812)	(1,055)
Profit for the period		131,654	127,926
Attributable to:			
Equity holders of the Company		122,910	120,644
Minority interests		8,744	7,282
		131,654	127,926
Interim dividend	6	26,501	19,876
Earnings per share for profit attributable to the equity holders of the Company during the period		HK cents	HK cents
– Basic	7	3.71	3.64
– Diluted	7	3.67	3.61

UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEET

As at 30th June, 2005

		30th June, 2005	31st December, 2004 Restated
	Note	HK\$'000	HK\$'000
Assets			
Non-current assets			
Property, plant and equipment		469,341	495,786
Land use rights		2,315	2,355
Intangible assets		529,240	529,249
Interests in associates		1,518,652	1,603,586
Lease and equipment deposits		55,433	68,762
Deferred income tax assets		20,342	21,777
Loans to associates		82,103	82,103
		2,677,426	2,803,618
Current assets			
Available-for-sale investment		18,313	18,313
Derivative financial assets		15,144	–
Inventories, at cost		54,343	54,045
Trade and other receivables	8	263,700	258,465
Cash and cash equivalents		985,206	746,793
Pledged bank deposits		74,627	67,455
		1,411,333	1,145,071
Total assets		4,088,759	3,948,689
EQUITY			
Capital and reserves attributable to the Company's equity holders			
Share capital		331,268	331,268
Reserves		2,731,039	2,636,368
		3,062,307	2,967,636
Minority interests		249,172	282,292
Total equity		3,311,479	3,249,928
LIABILITIES			
Non-current liabilities			
Provision for overhaul and major checks		134,284	91,939
Current liabilities			
Trade and other payables	9	476,912	416,572
Sales in advance of carriage		110,491	118,061
Current income tax liabilities		2,541	2,972
Short-term bank loans – unsecured		53,052	69,217
		642,996	606,822
Total liabilities		777,280	698,761
Total equity and liabilities		4,088,759	3,948,689
Net current assets		768,337	538,249
Total assets less current liabilities		3,445,763	3,341,867

NOTES:

1. Basis of preparation and accounting policies

This unaudited condensed consolidated financial information (“Interim Financial Information”) has been prepared in accordance with Hong Kong Accounting Standard (“HKAS”) 34 “Interim Financial Reporting” issued by the Hong Kong Institute of Certified Public Accountants (“HKICPA”).

The Interim Financial Information should be read in conjunction with the 2004 annual accounts.

The accounting policies and methods of computation used in the preparation of the Interim Financial Information are consistent with those used in the 2004 annual accounts except that the Group has changed certain of its accounting policies following its adoption of new/revised Hong Kong Financial Reporting Standards (“HKFRS”) and HKAS (collectively the “new HKFRSs”) which are effective for accounting periods commencing on or after 1st January, 2005.

The Interim Financial Information has been prepared in accordance with those HKFRS standards and interpretations issued and effective as at the time of preparing the Interim Financial Information. The HKFRS standards and interpretations that will be applicable at 31st December, 2005, including those that will be applicable on an optional basis, are not known with certainty at the time of preparing the Interim Financial Information.

The following is a summary of material changes in principal accounting policies or presentation of financial statements as a result of the adoption of the new HKFRSs:

- HKAS 17**
The adoption of revised HKAS 17 has resulted in a change in the accounting policy relating to the reclassification of land use rights from property, plant and equipment. The up-front prepayments made for the land use rights are expensed in the income statement on a straight-line basis over the term of the land use rights or where there is impairment, the impairment is expensed in the income statement.
- HKAS 31**
The Group adopted the proportionate consolidation under HKAS 31 to account for its interests in jointly controlled entities. In prior years, the Group's interests in jointly controlled entities were accounted for by the equity method. The adoption of the proportionate consolidation under HKAS 31 represents a change in accounting policy.
- HKASs 32 and 39**
The adoption of HKASs 32 and 39 has resulted in a change in the accounting policy relating to the classification of available-for-sale financial assets. It has also resulted in the recognition of derivative financial instruments at fair value and the change in the recognition and measurement of hedging activities.
- HKFRS 3, HKAS 36 and HKAS 38**
The adoption of HKFRS 3, HKAS 36 and HKAS 38 has resulted in a change in the accounting policy for goodwill. Until 31st December, 2004, goodwill was:

- Amortised on a straight line basis over its estimated useful lives of not more than 20 years; and
- Assessed for an indication of impairment at each balance sheet date.

In accordance with the provisions of HKFRS 3:

- The Group ceased amortisation of goodwill from 1st January, 2005;
- Accumulated amortisation as at 31st December, 2004 has been eliminated with a corresponding decrease in the cost of goodwill; and
- From 1st January, 2005 onwards, goodwill is tested annually for impairment, as well as when there are indications of impairment.

The Group has reassessed the carrying value of its intangible assets in accordance with the provisions of HKAS 38. No adjustment resulted from this reassessment.

The following is a summary of effect of adopting the new HKFRSs on the Interim Financial Information:

(a) Condensed consolidated income statement

For the six months ended 30th June, 2005

	HKAS 31 HK\$'000	HKASs 32 & 39 HK\$'000	HKFRS 3 HK\$'000	Total HK\$'000
Turnover	119,368	–	–	119,368
Other revenue	93	–	–	93
Total revenue	119,461	–	–	119,461
Staff costs	30,789	–	–	30,789
Passenger catering and service costs	59,717	–	–	59,717
Fuel costs	–	(15,144)	–	(15,144)
Depreciation and amortisation costs	5,634	–	(18,515)	(12,881)
Other operating costs	6,873	–	–	6,873
Total operating expenses	103,013	(15,144)	(18,515)	69,354
Operating profit	16,448	15,144	18,515	50,107
Finance costs	(1,802)	–	–	(1,802)
Share of profit less losses of associates	–	(1,033)	–	(1,033)
Share of profit less losses of jointly controlled entities	(14,646)	–	–	(14,646)
Profit before income tax	–	14,111	18,515	32,626
Income tax expense	–	–	–	–
Profit for the period	–	14,111	18,515	32,626
Earnings per share	HK cents	HK cents	HK cents	HK cents
– Basic	–	0.43	0.56	0.98
– Diluted	–	0.42	0.56	0.97

There is no material impact of adopting the new HKFRSs on the condensed consolidated income statement for the six months ended 30th June, 2004.

(b) Condensed consolidated balance sheet

As at 30th June, 2005

	Increase/(decrease) Effect of adopting HKASs 32 & 39				Total
	HKAS 17 HK\$'000	HKAS 31 HK\$'000	HKAS 32 HK\$'000	HKFRS 3 HK\$'000	HK\$'000
Property, plant and equipment	(2,315)	122,780	–	–	120,465
Land use rights	2,315	–	–	–	2,315
Intangible assets	–	241,937	–	16,987	258,924
Interests in associates	–	–	3,841	1,528	5,369
Interests in jointly controlled entities	–	(356,343)	–	–	(356,343)
Deferred income tax assets	–	2,682	–	–	2,682
Available-for-sale investment	–	18,313	–	–	18,313
Derivative financial assets	–	–	15,144	–	15,144
Inventories	–	6,821	–	–	6,821
Trade and other receivables	–	53,664	–	–	53,664
Cash and cash equivalents	–	29,340	–	–	29,340
Pledged bank deposits	–	6	–	–	6
Total assets	–	119,200	18,985	18,515	156,700
Trade and other payables	–	63,797	–	–	63,797
Current tax liabilities	–	2,351	–	–	2,351
Short-term bank loans	–	–	–	–	–
– unsecured	–	53,052	–	–	53,052
Total liabilities	–	119,200	–	–	119,200
Total equity	–	–	18,985	18,515	37,500

As at 31st December, 2004

	Increase/(decrease) Effect of adopting		Total
	HKAS 17 HK\$'000	HKAS 31 HK\$'000	HK\$'000
Property, plant and equipment	(2,355)	126,308	123,953
Land use rights	2,355	–	2,355
Intangible assets	–	241,937	241,937
Interests in jointly controlled entities	–	(345,532)	(345,532)
Deferred income tax assets	–	2,483	2,483
Available-for-sale investment	–	18,313	18,313
Inventories	–	7,574	7,574
Trade and other receivables	–	55,867	55,867
Cash and cash equivalents	–	21,201	21,201
Pledged bank deposits	–	6,235	6,235
Total assets	–	134,386	134,386
Trade and other payables	–	62,833	62,833
Current tax liabilities	–	2,336	2,336
Short-term bank loans - unsecured	–	69,217	69,217
Total liabilities	–	134,386	134,386
Total equity	–	–	–

Note:

The adoption of HKASs 32 and 39 has resulted in a decrease in opening reserves and interests in associates at 1st January, 2005 by the same amount of approximately HK\$19,023,000.

2. Turnover and segment information

Turnover

	Six months ended 30 June,	
	2005 HK\$'000	2004 HK\$'000
Traffic revenue		
– Passenger services	736,672	607,596
– cargo and mail services	343,111	180,533
Airline catering revenue	119,367	–
	<u>1,199,150</u>	<u>788,129</u>

Primary reporting format – Business segments

The Group is organised into four main business segments including airline operation, airport ground handling, airline catering, logistics and other businesses.

An analysis of the Group's revenue, results, assets and liabilities by business segments is as follows:

	Six months ended 30th June, 2005				
	Airline operation HK\$'000	Airport ground handling HK\$'000	Airline catering HK\$'000	Logistics and other businesses HK\$'000	Group HK\$'000
Segment revenue	1,107,017	–	119,368	–	1,226,385
Segment results	5,477	–	16,354	–	21,831
Interest income					6,783
Unallocated costs					(9,844)
Operating profit					18,770
Finance costs					(1,802)
Share of profits less losses of associates	54,337	62,761	4,998	(1,598)	120,498
Profit before income tax					137,466
Income tax expense					(5,812)
Profit for the period					131,654
Capital expenditure	9,069	–	2,106	–	11,175
Depreciation	31,887	–	5,594	–	37,481
Amortisation	9	–	40	–	49
Reversal of provision for impairment of trade receivables	(790)	–	–	–	(790)
	<u>1,123,615</u>	<u>34,560</u>	<u>472,860</u>	<u>47,542</u>	<u>1,678,577</u>
Segment assets	1,123,615	34,560	472,860	47,542	1,678,577
Interests in associates	1,302,735	120,371	120,111	(24,565)	1,518,652
Unallocated assets					891,530
Total assets					4,088,759
Segment liabilities	654,587	–	116,644	–	771,231
Unallocated liabilities					6,049
Total liabilities					777,280

At 30th June, 2005

	Airline operation HK\$'000	Airport ground handling HK\$'000	Airline catering HK\$'000	Logistics and other businesses HK\$'000	Group HK\$'000
Segment revenue	789,434	–	–	–	789,434
Segment results	4,131	–	–	–	4,131
Interest income					921
Unallocated costs					(20,896)
Operating loss					(15,844)
Share of profits less losses of associates	91,578	57,950	–	(4,703)	144,825
Profit before income tax					128,981
Income tax expense					(1,055)
Profit for the period					127,926
Capital expenditure	3,038	–	–	–	3,038
Depreciation	31,449	–	–	–	31,449
Amortisation	9,449	–	–	–	9,449
Provision for impairment of trade receivables	710	–	–	–	710

Restated
At 31st December, 2004

Segment assets	1,093,647	34,560	477,434	47,542	1,653,183
Interests in associates	1,404,726	106,721	115,113	(22,974)	1,603,586
Unallocated assets					691,920
Total assets					3,948,689
Segment liabilities	559,318	–	132,052	–	691,370
Unallocated liabilities					7,391
Total liabilities					698,761

Secondary reporting format – Geographical segments

The Group operates in three main geographical areas including China mainland, Taiwan and other regions (mainly Macau, Thailand and Philippines). The Group's airline operation business is mainly operated in places in China mainland, Taiwan and other regions. The Group's airline catering business is operated in China mainland.

	Segment revenue Six months ended 30th June,		Segment result Six months ended 30th June,	
	2005 HK\$'000	2004 HK\$'000	2005 HK\$'000	2004 HK\$'000
China mainland	551,830	313,778	(22,056)	(19,948)
Taiwan	607,474	428,883	77,695	44,628
Other regions	67,081	46,773	(33,808)	(20,549)
	<u>1,226,385</u>	<u>789,434</u>	<u>21,831</u>	<u>4,131</u>
Interest income			6,783	921
Unallocated cost			(9,844)	(20,896)
Operating profit/(loss)			<u>18,770</u>	<u>(15,844)</u>

The major revenue-earning assets of the Group in respect of airline operation are its aircraft fleet, all of which are registered in Macau. Since the Group's aircraft fleet is deployed flexibly across its route network, the Directors consider that there is no meaningful basis to allocating such assets to geographical segments.

The Group's assets and capital expenditure in respect of airline catering business are located in China Mainland.

The Group's other assets, other than those mentioned in the above, and capital expenditure are mainly located in Macau.

3. Operating profit/(loss)

The following items have been included in arriving at operating profit/(loss):

	Six months ended 30th June,	
	2005 HK\$'000	2004 HK\$'000
Crediting		
Fair value gains on derivative financial assets	18,365	–
Charging		
Amortisation of intangible assets	9	9,449
Amortisation of land use rights	40	–
Cost of inventories expensed	67,361	46,060
Depreciation of property, plant and equipment	37,481	31,449
Finance costs		
	Six months ended 30th June,	2004
	2005	HK\$'000
Interest expenses on short-term bank loans	1,802	–
Income tax expense		
Hong Kong profits tax has been provided at the rate of 17.5% (six months ended 30th June, 2004: 17.5%) on the estimated assessable profit for the period. Macau complementary tax has been provided at the rate of 15.75% (six months ended 30th June, 2004: 15.75%) on the estimated assessable profit for the period. Taxation outside Hong Kong and Macau has been calculated on the estimated assessable profit for the period at the rates of taxation prevailing in the countries in which the Group operates.		
	Six months ended 30th June,	2004
	2005	HK\$'000
Current income tax	–	(100)
– Macau complementary tax	–	542
– Taxation outside Hong Kong and Macau	4,409	–
– Over provisions in prior years	(66)	–
Deferred income tax	1,469	613
	<u>5,812</u>	<u>1,055</u>

Share of associates' taxation for the six months ended 30th June, 2005 of HK\$26,573,000 (six months ended 30th June, 2004: HK\$21,743,000) is included in the condensed consolidated income statement as share of profits less losses of associates.

6. Interim dividend

	Six months ended 30th June,	
	2005 HK\$'000	2004 HK\$'000
Interim dividend proposed of HK0.8 cent (six months ended 30th June, 2004: HK0.6 cent) per ordinary share	26,501	19,876

Notes:

- (a) At a meeting held on 23rd March, 2005, the Directors proposed a final dividend of HK\$1.0 cent per ordinary share for the year ended 31st December, 2004, which was paid on 28th June, 2005 and has been reflected as an appropriation of retained profits for the six months ended 30th June, 2005.
- (b) At a meeting held on 30th August, 2005, the Directors declared an interim dividend of HK0.8 cent per share for the year ending 31st December, 2005. This proposed dividend is not reflected as a dividend payable in these Interim Financial Information, but will be reflected as an appropriation of retained earnings for the year ending 31st December, 2005.

7. Earnings per share

Basic

Basic earnings per share is calculated by dividing the profit attributable to equity holders of the Company by the weighted average number of ordinary shares in issue during the period.

	Six months ended 30th June, 2005 HK\$'000	2004 HK\$'000
Profit attributable to equity holders of the Company	122,910	120,644
Weighted average number of ordinary shares in issue (thousands)	3,312,680	3,312,680
Basic earnings per share (HK cents per share)	3.71	3.64

Diluted

Diluted earnings per share is calculated adjusting the weighted average number of ordinary shares outstanding to assume conversion of all dilutive options. A calculation is done to determine the number of shares that could have been acquired at fair value (determined as the average annual market share price of the Company's shares) based on the monetary value of the subscription rights attached to outstanding share options. The number of shares calculated as above is compared with the number of shares that would have been issued assuming the exercise of the share options.

	Six months ended 30th June, 2005 HK\$'000	2004 HK\$'000
Profit attributable to the equity holders of the Company	122,910	120,644
Weighted average number of ordinary shares in issue (thousands)	3,312,680	3,312,680
Adjustment for share options (thousands)	35,741	29,951
Weighted average number of ordinary shares for diluted earnings per share (thousands)	3,348,421	3,342,631
Diluted earnings per share (HK cents per share)	3.67	3.61

8. Trade and other receivables

Trade and other receivables include trade receivables from third parties, the immediate holding company, an associate and related companies. The credit terms granted to sales agents and other trade customers are ranging from 15 days to 90 days. The age analysis of trade receivables is as follows:

	30th June, 2005 HK\$'000	31st December, 2004 Restated HK\$'000
Within 30 days	184,153	180,644
31 - 60 days	23,591	19,360
61 - 90 days	4,412	8,628
Over 90 days	9,062	12,649
	221,218	221,281

9. Trade and other payables

Trade and other payables include trade payables to third parties, an associate, a fellow subsidiary and related companies. The age analysis of the trade payables is as follows:

	30th June, 2005 HK\$'000	31st December, 2004 Restated HK\$'000
Within 30 days	133,893	103,314
31 - 60 days	42,885	39,569
61 - 90 days	10,848	12,392
Over 90 days	7,968	9,040
	195,594	164,315

Review of Operations

During the first half of 2005, the Group continued the growth momentum of 2004. However, mounting oil prices inevitably added pressure to the aviation industry. With effective cost control measures and new business drivers, the Group supported a healthy operation in the face of a more difficult operating environment.

The Group has established a strong presence in the airline catering industry, following the successful acquisition of a 60 percent equity interest in Beijing Air Catering Co., Ltd and Southwest Air Catering Company Limited respectively, and an approximately 20 percent equity interest in LSG Lufthansa Service Hong Kong Limited in 2004. Contribution from this sector accounted for approximately 9.7 percent and 12.9 percent of the total revenue and profit attributable to equity holders of the Company respectively. The management believes that this sector will be significant to enhance the Group's resilience in dealing with the industry's fast-changing landscape in the future.

For the six months ended 30th June, 2005, turnover of the Group increased 52 percent to HK\$1.2 billion. Operating profits of the Group in the period reached HK\$18.8 million compared to last year's operating loss of HK\$15.8 million. The Group recorded a profit attributable to equity holders of the Company of HK\$122.9 million, up 1.9 percent compared to last year's HK\$120.6 million. Basic earnings per share were HK3.71 cents (2004: HK3.64 cents).

Air Macau Company Limited ("Air Macau")

The operation of Air Macau in the first half of 2005 was influenced by rising fuel prices and the entry of other low-cost-carriers ("LCC") in the Macau SAR. To remain profitable in such a competitive environment, Air Macau adopted effective measures such as suspending services that suffered operational losses and reallocating resources to more promising markets. Moreover, Air Macau would further contain operating costs by enhancing its efficiency and productivity with streamlined workflows and procedures.

During the period, Air Macau doubled its daily passenger service to Beijing, making a total of 14 scheduled flights weekly. Air Macau also increased its scheduled flights to Taipei to 76 weekly, Kaohsiung to 28 weekly, Manila and Nanjing to three weekly and Seoul to seven weekly respectively. Meanwhile, services to Bangkok were suspended since May 2005 for commercial reasons. "Privileges", a new passenger loyalty program, was introduced in February 2005 replacing the former CIP Club. By 30th June, 2005, "Privileges" has successfully recruited over 30,000 members, confirming its position as one of the most attractive airline loyalty programs in Asia. In line with the plan of International Air Transport Association (IATA) to implement e-ticket services for all carriers by 2007, Air Macau set up a division to work on its internet booking and electronic ticketing arrangements in early 2005. Furthermore, Air Macau reinforced its efforts and resources in the cargo business. By the end of the first half of 2005, Air Macau has increased its freighter schedule to 58 weekly; including 33 weekly to Taipei, 11 weekly to Shanghai, ten weekly to Shenzhen and four weekly to Xiamen.

Total operating revenue in the first half of 2005 (MOP 1,112.18 million) increased 37 percent compared to the same period of 2004 (MOP 811.77 million). Number of flights operated rose 20.1 percent, from 9,549 flights in the first half of 2004 to 11,466 in the first half of 2005. Air Macau carried 980,535 passengers in the first half of 2005, representing an increase of 24.1 percent from 790,355 in the same period of 2004. Cargo tonnage increased 72.4 percent from 37,423.62 tonnes in 2004 to 64,524.44 tonnes in 2005.

Passenger activities in terms of revenue passenger kilometres ("RPK") increased 21.8 percent from 943.68 million in 2004 to 1,149.47 million in 2005. Passenger load factor increased from 66.08 percent in 2004 to 69.12 percent in 2005. Cargo activities in terms of cargo tonne kilometres ("CTK") increased 98.01 percent from 36.20 million in 2004 to 71.68 million in 2005. On the other hand, cargo load factor slightly decreased from 65.17 percent in 2004 to 65.16 percent in 2005.

As at 30th June, 2005, Air Macau operated a fleet of 16 aircraft, of which 12 were passenger aircraft (seven Airbus 321s, one A320 and four A319s) and four were freighters (three A300-B4 and one Boeing 727-200). Air Macau is currently operating in a network of 13 cities – Beijing, Chengdu, Haikou, Kunming, Guilin, Nanking, Shanghai, Xiamen, Shenzhen, Taipei, Kaohsiung, Manila and Seoul.

Hong Kong Dragon Airlines Limited ("Dragonair")

Rising fuel prices affected Dragonair significantly as the system-wide fuel price increased substantially by 47.0 percent over the same period last year. Fuel accounted for 23.0 percent of total operating costs, an increase of 6.7 percentage points over the same period last year. Apart from the fuel hedging program and fuel surcharge partially offsetting the negative impact caused by soaring fuel prices, Dragonair also adopted stringent cost control measures to cut down other operating costs. Unit cost per available tonne kilometre (excluding fuel) dropped by 7.4 percent.

Passenger revenue surged significantly by 18.8 percent over the same period in 2004 to HK\$2,733.5 million, due to increased passenger service capacity to the PRC and a new passenger route to Tokyo since April 2004. Total passenger carried reached 2.4 million, representing a 15.5 percent increase over the same period last year. Passenger load factor was up by 2.8 percentage points to 64.1 percent and passenger yield per RPK increased by 2.6 percent.

Cargo revenue increased by 40.7 percent compared to the same period in 2004. Cargo demand remained robust with 180,000 tonnes of cargo carried in the first half of 2005, representing a growth of 21.8 percent. This was contributed by higher tonnage carried by our new passenger and freighter services. However, cargo load factor decreased by 2.5 percentage points to 71.6 percent. Cargo yield per CTK remained stable as compared to the same period of 2004. In April 2005, Dragonair launched its first trans-Pacific freighter service to New York using a wet-leased B747-400 freighter.

As at 30th June, 2005, Dragonair operated passenger services to 30 destinations in Asia, of which 21 were in China mainland. It also offered freighter services to 11 destinations in Asia, Europe and the USA.

Two A330s under operating lease were delivered in March and May 2005, while one purchased A320 was delivered in April 2005. By the end of June 2005, the Dragonair fleet included 11 A320s, six A321s, 12 A330s, one B747-200 freighter, three B747-300 freighters, one wet leased B747-400 freighter and one wet leased A300B4 freighter. One A330 under operating lease will be delivered in October 2005.

The code-share agreement with Air China Limited has been extended in 2005 to cover Beijing, Hangzhou and Wuhan, in addition to Chengdu, Chongqing, Dalian and Tianjin, which were opened under the same agreement signed in 2004.

Dragonair celebrated its 20th anniversary in May 2005. Over the past two decades, Dragonair has developed into a full-service passenger carrier dedicated to serving major markets in the world. The airline's quality service has been recognised with the Award of the "Best Airline – China" for four consecutive years from 2002 to 2005. Despite higher fuel costs, with ongoing fleet expansion plans for both passenger and freighter services and efforts in controlling costs, the management remains optimistic about the future development of the airline.

Beijing Air Catering Co., Ltd ("BACL")

During the first half of 2005, BACL provided in-flight catering services for 48,329 flights, up 13 percent over the same period last year. The total number of in-flight meals served increased 12 percent over the same period last year to over 6.4 million, equivalent to daily handling about 35,600 in-flight meals on average. It remains the largest in-flight caterer in Beijing Capital International Airport with an approximately 80 percent market share.

With the upcoming 2008 Beijing Olympic Games, more flights will be expected in Beijing Capital International Airport in the following years. BACL is well positioned to capture the growing demand of in-flight catering services.

Southwest Air Catering Company Limited ("SWACL")

During the first half of 2005, SWACL provided in-flight catering services for 11,500 flights, an increase of 14 percent over the same period last year. The total number of in-flight meals served increased to over 1.6 million, equivalent to daily handling of about 9,000 in-flight meals on average. It remains the largest in-flight caterer in Chengdu Shuangliu International Airport with a market share of approximately 70 percent.

With the new catering building commencing its operation in the second half of 2004, it has the capacity of handling 20,000 in-flight meals per day. This strengthened capability enables SWACL to serve more airline customers. Among the newly secured China mainland and foreign airlines, Dragonair has also started using SWACL's in-flight catering services from August 2005.

LSG Lufthansa Service Hong Kong Limited ("LLSHK")

Compared to the first half of 2004, the number of meals served and the number of flights catered by LLSHK increased 12.3 percent and 13.1 percent respectively because of a rising demand in air travel.

Despite higher revenue as a result of frequent air travel, the profit margin in the first half of 2005 maintained at about the same level as the same period last year. This was mainly due to price-cut policies of most airlines. Various lean and cost saving measures are in place to cope with such pressure.

Continual revenue and volume growth will be expected in the second half of 2005 in light of the growing air travel in the summer vacation period.

Jardine Airport Services Limited ("JASL")

In the first half of 2005, consolidated turnover of JASL increased 12.7 percent mainly due to an increase in flight frequencies handled. JASL handled 32,330 aircraft movements, an increase of 16.6 percent over that of 2004, and maintained approximately 40 percent share of the third-party ground handling market at Hong Kong International Airport ("HK Airport"). Jardine Air Terminal Services Limited ("JATS") handled 42,628 aircraft movements, an increase of 9.8 percent compared to the same period of 2004, representing an approximately 60 percent share of the third-party ramp handling market at the HK Airport.

Given the strong support and business connections with its shareholders, JASL will continue to explore and secure new business opportunities in the China mainland.

Menzies Macau Airport Services Limited ("Menzies Macau")

For the first six months ended 30th June, 2005, Menzies Macau handled 10,389 aircraft turns, representing an increase of 18 percent over the same period last year. However, Menzies Macau handled 9% less cargo compared to the same period of 2004. The reduction in cargo volume was due to keen competitions from the surrounding airports.

With the commencement of other foreign LCC passenger services to Macau and Air Macau's additional freighter flights, Menzies Macau is expecting a growth in its aircraft and cargo handling services during the second half of 2005.

Tradeport Hong Kong Limited (“Tradeport Hong Kong”)

Tradeport Hong Kong grew significantly during the first half of 2005. At the end of June 2005, space utilisation of the Logistics Centre was 66 percent against 48 percent in June 2004. The major rental agreement for the whole ground floor of the Logistics Centre was concluded during the review period. Revenue from existing customers also rose considerably. Consolidated revenue in the first half of 2005 was HK\$28.5 million, up 96 percent over the same period last year.

Outlook

With the opening of the Hong Kong Disneyland and the burgeoning entertainment and gaming industry in Macau, tourism in these regions will remain upbeat in the second half of 2005. The frequent air travel in Asia will help open up more business opportunities for the aviation industry as a whole.

However, high fuel costs throughout 2005 may dampen the future of the industry. The Group will alleviate the impact with continuous efforts to achieve a streamlined operation and new business ventures. For instance, the newly acquired catering business will become a pillar of an upward development of the Group. Entry of other airlines may be generally seen as a ground for fierce competition in the aviation industry. However, the Group believes the participation of these new players will translate into a catalyst for tourism in Asia.

With an aim to fully capitalise on the business prospects in Asia, the Group’s initiatives in LCC business have been well underway. Despite a more competitive and dynamic operating environment ahead, the Group is confident to achieve business growth in the second half of 2005.

Financial Review

Liquidity and Financial Resources

As at 30th June, 2005, the capital and reserves attributable to the Company’s equity holders amounted to HK\$3,062 million, compared to HK\$2,968 million as at 31st December, 2004.

The Group generally financed its operations with cash flows generated internally. As at 30th June, 2005, the Group had cash and bank balances of a total amount of approximately HK\$1,060 million and total assets of approximately HK\$4,089 million, as compared to HK\$814 million and HK\$3,949 million respectively as at 31st December, 2004. The current liabilities of the Group increased from HK\$607 million (restated as at 31st December, 2004) to HK\$643 million as at 30th June, 2005. The Group consistently maintained a strong working capital base that provides a good foundation for the Group’s future business development.

Share Capital

There were no options granted or exercised during the period, and 104,378,000 options remained outstanding as at 30th June, 2005.

As at 30th June, 2005, 3,312,680,000 shares were in issue (31st December, 2004: 3,312,680,000 shares).

Contingent Liabilities and Commitments

As of 30th June, 2005, the Group had given a guarantee to a bank for loan facilities granted to an associate totalling HK\$20,000,000 (31st December, 2004: HK\$15,000,000).

As of 30th June, 2005, the Group had given a guarantee to a bank for loan facilities granted to a jointly controlled entity of Reminbi (“RMB”) 115,000,000 (equivalent to approximately HK\$108,184,000). Loans of RMB58,300,000 (equivalent to approximately HK\$54,845,000) were drawdown by the jointly controlled entity as at 30th June, 2005. The Group’s proportionate share of bank loans of HK\$32,907,000 had been included in the condensed consolidated balance sheet as at 30th June, 2005 (31st December, 2004: Nil).

In February 2001, the Group together with the Tradeport Logistics Centre consortium partners jointly gave a guarantee to the Airport Authority Hong Kong in respect of their obligations to provide sufficient funding for the development of the Tradeport Logistics Centre. On 17th March, 2004, the Airport Authority Hong Kong agreed to reduce the maximum liability limit from approximately HK\$780 million to approximately HK\$312 million. The Directors are of the opinion that, had the Group been required to perform its obligation under the guarantee in the event of default of all of the consortium partners, the maximum amount of the contingent liabilities assumed, including the Group’s estimated share of capital commitments of approximately HK\$78 million, would have been approximately HK\$312 million.

The Group’s proportionate share of capital expenditure of the jointly controlled entities in respect of property, plant and equipment at the balance sheet date but not yet incurred is as follows:

	30th June, 2005 HK\$’000	31st December, 2004 HK\$’000
Contracted but not provided for	3,591	—

Charge on Assets

The shares of Tradeport held by the Group were pledged as securities for a banking facility granted to Tradeport.

Foreign Exchange and Currency Risks

The Group generates a portion of its revenue from ticket sales in certain foreign jurisdictions giving rise to exposures to fluctuation in foreign exchange rates. The Group continuously monitors its foreign currency positions and does not consider that it has a significant exposure to foreign exchange risk from any currency.

Human Resources

The bulk of human resources of the Company and their remuneration, amongst others, are covered by a management services agreement concluded with the Company’s fellow subsidiary, China National Aviation Corporation (Group) Limited. Likewise, China National Aviation Corporation (Macau) Limited also concluded a management services agreement with CNAC (Macau) Aviation Limited. Both agreements were negotiated under normal commercial terms and conditions.

Air Macau, a 51 per cent held subsidiary, employs about 928 staff (six months ended 30th June, 2004: 740 staff). Employees’ remuneration packages are designed and structured based on the foregoing market conditions, relevant laws and regulations, industry practices and standards, work performance, education or professional training background and past working experience.

As at 30th June, 2005, BACL has 1,089 staff and SWACL has 600 staff.

SUBSEQUENT EVENT

On 7th July, 2005, the Group approved an additional capital contribution in a jointly controlled entity amounted to RMB30,000,000 (equivalent to approximately HK\$28,222,000).

PURCHASE, SALE OR REDEEM OF SECURITIES

In the first half of 2005, the Group did not purchase, sell or redeem any of the listed securities of the Company.

AUDIT COMMITTEE

The Audit Committee of the Company has discussed and reviewed with the Company’s management the Interim Financial Information of the Group for the six months ended 30th June, 2005, and has also discussed among themselves matters including internal control and financial reporting.

CORPORATE GOVERNANCE

The Company has complied with the code provisions set out in Appendix 14 “Code on Corporate Governance Practices” (“the Code”) to the Rules Governing the Listing of Securities on the Stock Exchange (“Listing Rules”) (save for the relevant code provisions on internal control which are applicable to the accounting periods commencing on or after 1st July, 2005), with certain deviations from the code provisions A.1.3, B.1.4, C.3.4, D.1.1 and D.1.2 of the Code. The deviations mainly concern about the notice to regular board meetings, the terms of reference and the disclosure of information of the Remuneration and the Audit Committee, and the determination of authorities and duties delegated to the management by the Board.

INTERIM DIVIDEND

The Directors have declared an interim dividend of HK0.8 cent per share for the six months ended 30th June, 2005 (six months ended 30th June, 2004: HK0.6 cent per share) payable to the shareholders (“Eligible Shareholders”) whose names appear on the Register of Members of the Company on Friday, 23rd September, 2005. Dividend will be despatched to the Eligible Shareholders on or about Thursday, 13th October, 2005.

CLOSURE OF REGISTER OF MEMBERS

The Register of Members will be closed from Tuesday, 20th September, 2005 to Friday, 23rd September, 2005 both days inclusive, during which period no transfers of shares will be registered. In order to qualify for the interim dividend, all transfer documents together with 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 not later than 4:00 p.m. on Friday, 16th September, 2005.

PUBLICATION OF DETAILED RESULTS ANNOUNCEMENT ON THE STOCK EXCHANGE’S WEBSITE

A detailed interim results announcement containing all the information in respect of the Company required by paragraphs 46(1) to (6) of Appendix 16 of the Listing Rules will be published on The Stock Exchange of Hong Kong Limited’s website in due course.

BOARD OF DIRECTORS

At the date hereof, the Board of Directors of the Company comprises Mr. Kong Dong as Chairman, Mr. Chuang Shih Ping, Mr. Zhang Xianlin, Mr. Tsang Hing Kwong, Thomas, Mr. Gu Tiefei and Mr. Zhao Xiaohang as Executive Directors and Mr. Lok Kung Nam, Dr. Hu Hung Lick, Henry, Mr. Ho Tsu Kwok, Charles, Mr. Li Kwok Heem, John and Ms. Chan Ching Har, Eliza as independent Non-Executive Directors.

On behalf of the Board
KONG DONG
Chairman