



中航興業有限公司

CHINA NATIONAL AVIATION COMPANY LIMITED

(於香港註冊成立之有限公司)

(incorporated in Hong Kong with limited liability)

2002

中期報告

INTERIM REPORT



CORPORATE INFORMATION

Directors

Kong Dong (*Chairman*)
Chuang Shih Ping
Zhang Xianlin
Tsang Hing Kwong, Thomas
Gu Tiefei
Lok Kung Nam*
Hu Hung Lick, Henry*
Ho Tsu Kwok, Charles*
Li Kwok Heem, John*

* *Independent Non-Executive Directors*

Company Secretary

Li Man Kit

Registered Office

5th Floor, CNAC House
12 Tung Fai Road
Hong Kong International Airport
Lantau
Hong Kong

Principal Bankers

Bank of China (Hong Kong) Limited
Nanyang Commercial Bank, Ltd.
Bank of Communications, Hong Kong Branch
Dao Heng Bank Limited

Solicitors

Baker & McKenzie

Auditors

PricewaterhouseCoopers

Share Registrars

Computershare Hong Kong Investor Services Limited
19th Floor, Hopewell Centre
183 Queen's Road East
Wanchai
Hong Kong



The Board of Directors (the “Directors”) of the China National Aviation Company Limited (the “Company”) is pleased to present the Group’s Interim Report and condensed accounts for the six months ended 30th June 2002. The consolidated results, consolidated cash flow statement and consolidated statement of changes in equity for the Group for the six months ended 30th June 2002, and the consolidated balance sheet as at 30th June 2002 of the Group, all of which are unaudited and condensed, along with selected explanatory notes, are set out on pages 8 to 26 of this report.

MANAGEMENT DISCUSSION AND ANALYSIS

Review of Operations and Prospects

For the six months ended 30th June 2002, the Group recorded a profit attributable to shareholders of HK\$137.2 million, an increase of approximately 6.5 percent over the corresponding period in 2001.

In March 2002, the Group has completed the acquisition of the entire equity interest in China National Aviation Corporation (Macau) Company Limited (“CNAC Macau”) which consists of (i) a 51 percent interest in Air Macau Company Limited (“Air Macau”); (ii) a 26 percent direct interest in Menzies Macau Airport Services Limited (“Menzies Macau”); and (iii) a 20 percent direct interest in Macau Aircraft Repair and Conversion Company Limited (“MARCCO”). As such CNAC Macau became a wholly owned subsidiary of the Company and the financial results of CNAC Macau and Air Macau were consolidated into the Group’s accounts, while the financial results of Menzies Macau and MARCCO were equity accounted for in the Group’s accounts. Under the acquisition agreement and as part of the consideration for the acquisition, the Group has also vested the entire effective interest in the share capital of Sinobest International Limited (“Sinobest”) in China National Aviation Corporation (Group) Limited (“CNAC Group”). As a result, the turnover and operating profit of the Group for the period under review were HK\$486.2 million and HK\$45.5 million compared to HK\$12.3 million and HK\$18.5 million respectively of the corresponding period in 2001.

In the first two months of 2002, the performance of the aviation businesses of the Group was adversely affected mainly by the aftermath of the 911 catastrophe and the late Chinese New Year this year as compared to the same period of 2001. Since March 2002, the aviation industry within the region has experienced healthy recovery with a slight growth as compared to the same period of last year.

Air Macau Company Limited

Air Macau was established in Macau in 1994 as the home based carrier in Macau and commenced commercial operation in November 1995 under a concession agreement, with an exclusive right for a 25-year period until the year 2020. Air Macau currently has sales offices and agents in 21 cities with a workforce of approximately 700 staff.

In the first six months of 2002, Air Macau operated more than 170 flights per week between Macau and 13 destinations in Asia, namely Beijing, Guilin, Haikou, Kunming, Nanjing, Ningbo, Shanghai, Xiamen, Chengdu, Bangkok, Manila, Taipei and Kaohsiung.



For the first six months ended 30th June 2002, Air Macau recorded a slight decline of 0.8 percent and 0.9 percent in revenue and total number of passengers carried respectively over the same period of 2001. The available seat kilometre and revenue passenger kilometre increased by 11.3 percent and 4.3 percent respectively as compared to the same period of last year. As a result of increase in scheduled operation and capacity, the average passenger load factor was reduced by 4.8 percentage points to 71.2 percent as compared to the same period of last year. Yield per passenger for the first six months of 2002 reduced slightly by 3.7 percent as compared to the same period of 2001.

Cargo revenue and tonnage carried increased by 26.7 percent and 27.8 percent respectively over the same period of last year. Cargo load factor also increased by 8.9 percentage points to 61.2 percent. Due to the increase in scheduled operation and capacity, the average cargo yield per cargo tonne kilometre reduced by 13.7 percent as compare to the same period of 2001.

Air Macau took delivery of its first and second A319 in June and August 2002 respectively. This put the fleet in service to two A319s, three A320s, five A321s and one wet-leased B757. All aircraft are under operating leases, except for one A321 owned aircraft and one B757 aircraft under wet lease. With the two new A319s and more new aircraft coming online, Air Macau plans to increase weekly frequency to Kunming, Beijing, Kaohsiung and Taipei, as well as develop new regional routes. Air Macau has commenced its passenger service to Singapore in August 2002.

Hong Kong Dragon Airlines Limited (“Dragonair”)

Dragonair recorded a 15.4 percent increase in revenue and a 3.8 percent decrease in profit before taxation for the period. The available seat kilometre and total number of passengers carried increased by 20.5 percent and 14.1 percent respectively over that of the corresponding period last year. The passenger load factor and yield decreased by 3.9 percentage points and 6.7 percent respectively over the same period of 2001 mainly due to the increase of additional capacity, less front-end traffic, market competition and cancellation of fuel surcharge during the period under review.

With the introduction of the two purchased freighters late last year to replace the wet-leased freighter, cargo revenue and tonnage carried surged by 55.7 percent and 63.6 percent respectively over the same period of last year. Cargo load factor also increased by 6.3 percentage points to 76.1 percent. Whilst cargo yield for passenger aircraft decreased by 9.3 percent mainly due to the withdrawal of cargo fuel surcharge in January 2002, and more transshipment at lower sector prorates, the effect was partly offset by the re-introduction of a minimal cargo fuel surcharge from late April 2002 onwards. Cargo yield for freighter increased by 14.2 percent mainly due to higher yield of the Osaka and Shanghai freighter services, and a stronger European market as well.

Dragonair took deliveries of one A320 and one A321 in March 2002 under operating lease, and one purchased A330 in late June 2002. The fleet in service of Dragonair became eight A320s, four A321s, seven A330s and two B747-300 freighters at the end of June 2002. Dragonair has purchased one B747-300 combi aircraft which is undergoing modification in Xiamen for conversion into full freighter and is targeted to put into service by November 2002. Dragonair also scheduled to take delivery of one purchased A330 in December 2002 to further expand its passenger service.



During the period, Dragonair operates passenger services to 27 destinations in Asia, of which 18 are in China mainland, the frequencies to Beijing and Shanghai have increased to 42 and 56 per week respectively from March 2002 onwards. Weekly frequencies to Chengdu, Chongqing, Dalian, Hangzhou, Kunming, Nanjing, Ningbo and Xiamen have also increased during the period. Dragonair has also extended the Shanghai freighter service to co-terminate with Xiamen effective from mid-May 2002 onwards.

The air traffic arrangement between Hong Kong and Taiwan was completed at the end of June 2002 under which Dragonair was authorised to operate 22 passenger flights a week to Taipei, and to convert the daily extra services to Kaohsiung into scheduled services from July 2002 onwards. Dragonair was also authorised to operate twice weekly freighter services to Taipei. These passenger and freighter services to Taipei commenced on 22nd and 23rd July 2002 respectively. The further relaxation of entry permit requirement for Hong Kong residents to enter into Taiwan and for Taiwan residents to enter into Hong Kong would stimulate the air traffic demand between the two cities.

In line with the strong economic growth of China as a result of accession to the World Trade Organisation and the relaxation of the entry quota system for China mainlanders' short-term visit to Hong Kong, it is expected that the demand for air services between Hong Kong and China mainland will continue to increase. The management remains optimistic about the outlook of the airline and expects better result for the second half of this year.

Jardine Airport Services Limited ("JASL")

In the six months period, the consolidated turnover of JASL decreased by 5.8 percent. JASL handled 24,448 aircraft movements, a decrease of 3.7 percent over that of 2001, and maintained approximately 40 percent of the third party market at the Hong Kong International Airport ("HK Airport"). Jardine Air Terminal Services Limited ("JATS") handled 34,844 aircraft movements, a decrease of 9.1 percent, representing an approximately 60 percent share of the third party market at the HK Airport.

The service contracts of Jardine Skyporters Limited ("JSL"), a wholly owned subsidiary company of JATS, with the Hong Kong Airport Authority expired in July 2002. Whilst JSL was awarded a 3-year service contract by the Airport Authority to provide airside baggage trolley management at the HK Airport, this contract will not replace the earnings from those recently expired. JSL is now looking for other business opportunities beyond the HK Airport.

With the strong support and business connections of its shareholders, JASL is actively pursuing new business ventures in China mainland and is confident of successfully securing these opportunities.

Menzies Macau Airport Services Limited

MASC/Ogden-Aviation Services (Macau), Limited, CNAC Macau's 26 percent directly owned ground handling services provider at the Macau International Airport ("Macau Airport"), has changed its name to Menzies Macau Airport Services Limited on 1st August 2002.

For the six months period, Menzies Macau provided ground services to 7,983 passenger aircraft, an increase of 17.0 percent compared to same period last year.



Menzies Macau was accredited the quality measurement and control standards of ISO9001:2000 for ramp services, ISO9002:1994 for cargo services and AHS1000 for passenger services for its high quality of service. Menzies Macau will continue to strive for service excellence and provide outstanding ground handling services in the region.

Tradeport Hong Kong Limited (“Tradeport”)

The construction of the logistics centre has been progressing on schedule. Topping out of the building was performed by the end of August 2002 and the centre is expected to become operational in early 2003.

During the period under review, a strong management team was formed and marketing campaigns have rolled out. A number of multi-national customers have already shown keen interest in the business model of Tradeport and negotiations are in progress.

OUTLOOK

Given the expanded operations of the airline segment of the Group and traditionally a stronger demand in the industry in the months ahead, the Group anticipates a better result for the second half of 2002.

The PRC State Government has in early 2002 approved the merger of the Group’s ultimate holding company with Air China and China Southwest Airlines. The Group with its strong balance sheet is well-poised to capture new investment or acquisition opportunities that may arise in aviation or aviation-related businesses.

LIQUIDITY AND FINANCIAL RESOURCES

As at 30th June 2002, the Group had cash and bank balances of a total amount of approximately HK\$1,001 million and net current assets of approximately HK\$785 million. The Group has consistently maintained a strong working capital base during the period under review. As at 30th June 2002, the current liabilities of the Group was approximately HK\$417 million whilst the Group had no outstanding borrowings.

CONTINGENT LIABILITIES

As at 30th June 2002, the Group had given a guarantee of HK\$75 million to a bank for banking facilities to an associated company, and in February 2001, the Group together with the logistics centre consortium partners had jointly given a guarantee to the Hong Kong Airport Authority in respect of their obligations to provide sufficient funding for the development of the logistics centre. 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\$131 million, would have been approximately HK\$780 million.



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 immediate holding company, CNAC Group. Likewise CNAC Macau also concluded a management services agreement with CNAC (Macau) Aviation Limited. Both agreements were negotiated under normal commercial terms and conditions.

Air Macau employs about 700 staff, of which about 84 are based outside Macau. The employees are remunerated in accordance with the current legislation, industry practices, market environment, work performance and professional experiences.

DIRECTORS' INTERESTS IN EQUITY OR DEBT SECURITIES

As at 30th June 2002, none of the Directors nor the chief executive had any interest in shares in the Company according to the register maintained under Section 29 of the Securities (Disclosure of Interests) Ordinance.

The interests of the Directors in the share options of the Company are separately disclosed in the "Share Options" below.

Apart from the disclosed under the headings "Share Options" below, at no time during the period was the Company, its fellow subsidiaries, its subsidiaries or its holding company a party to any arrangement to enable any Director or chief executive of the Company or his spouse or children under 18 years of age to acquire benefits by means of acquisition of shares in, or debentures of, the Company or any other body corporate.

SHARE OPTIONS

To comply with the requirements for share option schemes under the Listing of Securities on The Stock Exchange of Hong Kong Limited (the "Listing Rules"), the share option scheme previously adopted by the Company on 22nd October 1997 was replaced by a new share option scheme ("Share Option Scheme") which was approved and adopted by the Company's annual general meeting held on 29th May 2002.

The amended terms and conditions within the new Share Option Scheme are as follows:

- The subscription price for ordinary share(s) of HK\$0.10 each in the share capital of the Company ("Shares") under the Share Option Scheme will be the higher of the closing price of the Shares on The Stock Exchange of Hong Kong Limited (the "Stock Exchange") on the date of grant and the average closing prices of the Shares on the Stock Exchange for the five trading days immediately preceding the date of grant.
- The Share Option Scheme would remain in force for a period of ten years commencing on the date on which it was adopted.

Up to the date of this report, the Company has not granted any options on or after 29th May, 2002.



Details of the share options outstanding as at 30th June 2002 under the Share Option Scheme are as follows:

	Options held at 1st January 2002	Options granted during the period	Options exercised during the period	Options held at 30th June 2002	Exercise price HK\$	Grant Date	Exercisable from until	
Directors:								
Kong Dong	32,351,800	–	–	32,351,800	0.82	24/09/2001	25/03/2002	24/03/2004
Chuang Shih Ping	38,236,000	–	–	38,236,000	1.04	04/01/2001	12/07/2001	11/07/2003
Zhang Xianlin	38,236,000	–	–	38,236,000	1.04	04/01/2001	12/07/2001	11/07/2003
Tsang Hing Kwong, Thomas	38,236,000	–	–	38,236,000	1.04	04/01/2001	12/07/2001	11/07/2003
Continuous contract employees in aggregate:								
	84,126,000	–	84,126,000 ¹	–	1.04	04/01/2001	12/07/2001	11/07/2003
Total:	231,185,800	–	84,126,000 ¹	147,059,800				

Note:

1. Exercise date was 4th April 2002. At the date before the options were exercised, the market value per share was HK\$1.56.

PURCHASE, SALE OR REDEMPTION OF SHARES

The Company has not redeemed any of its shares during the period. Save for share options exercised as mentioned above, neither the Company nor any of its subsidiaries has purchased or sold any of the Company's shares during the period.

SUBSTANTIAL SHAREHOLDERS

At 30th June 2002, the register of substantial shareholders maintained under Section 16(1) of the Securities (Disclosure of Interests) Ordinance shows that the Company has been notified of the following substantial shareholder's interests, being 10% or more of the Company's issued share capital:

Name		Number of ordinary shares
China National Aviation Corporation (Group) Limited	68.5%	2,275,244,000 (note)
China National Aviation Corporation	68.5%	2,275,244,000 (note)

Note: The entire issued share capital of China National Aviation Corporation (Group) Limited ("CNAC Group") is beneficially owned by China National Aviation Corporation ("CNAC"). Accordingly, the interests of CNAC Group and CNAC in the Company duplicate each other.



INTERIM DIVIDEND

The Directors have declared an interim dividend of HK0.6 cent per share for the six months ended 30th June 2002 (six months ended 30th June 2001: HK0.6 cent per share) payable to the shareholders (“Eligible Shareholders”) whose names appear on the Register of Members of the Company on Friday, 20th September 2002. Dividend warrants will be despatched to the Eligible Shareholders on or about Thursday, 3rd October 2002.

CLOSURE OF REGISTER OF MEMBERS

The Register of Members will be closed from Tuesday, 17th September 2002 to Friday, 20th September 2002 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, 19th Floor, Hopewell Centre, 183 Queen’s Road East, Hong Kong not later than 4:00 p.m. on Monday, 16th September 2002.

CORPORATE GOVERNANCE

None of the Directors of the Company is aware of any information that would reasonably indicate that the Company is or was not for any part of the six months under review in compliance with the Code of Best Practice (the “Code”) as set out in Appendix 14 to the Listing Rules, except that the independent Non-Executive Directors were not appointed for specific terms but appointed to their offices for such terms and subject to retirement by rotation in accordance with Article 98 of the Articles of Association of the Company.

In compliance of the Code, the Company has established an audit committee and has adopted the terms of reference governing the authority and duties of the audit committee. The audit committee has reviewed with management the accounting principles and practices adopted by the Company and discussed internal controls and financial reporting matters including a review of the unaudited condensed interim results for the six months ended 30th June 2002.

**CONDENSED CONSOLIDATED PROFIT AND LOSS ACCOUNT**
FOR THE SIX MONTHS ENDED 30TH JUNE 2002

		Unaudited Six months ended 30th June	
	Note	2002 HK\$'000	2001 HK\$'000
Turnover	2	486,186	12,316
Other revenues		18,006	16,454
Total revenues		<u>504,192</u>	<u>28,770</u>
Staff costs	3	69,992	3,316
Passenger catering and service costs		31,576	–
Fuel costs		46,566	–
Route operating costs		99,117	–
Aircraft maintenance costs		49,390	–
Aircraft equipment costs		94,483	–
Other operating costs		67,538	6,936
Total operating expenses		<u>458,662</u>	<u>10,252</u>
Operating profit	4	45,530	18,518
Finance costs		(914)	–
Share of profits less losses of associated companies		153,535	134,889
Profit before taxation		198,151	153,407
Taxation	5	(36,733)	(24,509)
Profit after taxation		161,418	128,898
Minority interests		(24,189)	–
Profit attributable to shareholders		<u>137,229</u>	<u>128,898</u>
Proposed interim dividends	6	19,916	19,411
Basic earnings per share	7	<u>HK4.21 cents</u>	<u>HK3.98 cents</u>
Diluted earnings per share	7	<u>HK4.14 cents</u>	<u>HK3.93 cents</u>

**CONDENSED CONSOLIDATED BALANCE SHEET**
AS AT 30TH JUNE 2002 AND 31ST DECEMBER 2001

		Unaudited 30th June 2002 HK\$'000	31st December 2001 HK\$'000
Non-current assets			
Intangible assets	8	334,757	–
Fixed assets	9	447,397	600,000
Investments in associated companies	10	1,235,915	1,071,702
Lease and equipment deposits		82,081	–
		<u>2,100,150</u>	<u>1,671,702</u>
Total non-current assets			
Current assets			
Inventories, at cost		45,322	–
Trade and other receivables	11	156,036	7,285
Tax recoverable		–	724
Bank balances and cash		1,000,549	677,922
		<u>1,201,907</u>	<u>685,931</u>
Current liabilities			
Trade and other payables	12	289,461	18,439
Sales in advance of carriage		109,422	–
Taxation payable		18,357	–
		<u>417,240</u>	<u>18,439</u>
Net current assets		<u>784,667</u>	<u>667,492</u>
Total assets less current liabilities		<u>2,884,817</u>	<u>2,339,194</u>
Financed by:			
Share capital	13	331,931	323,518
Reserves		2,190,533	1,996,265
Proposed dividend		19,916	19,411
Shareholders' funds		<u>2,542,380</u>	<u>2,339,194</u>
Minority interests		300,867	–
Non-current liabilities			
Provision for aircraft maintenance and overhaul		41,570	–
		<u>2,884,817</u>	<u>2,339,194</u>

On behalf of the Board

Zhang Xianlin
Director**Tsang Hing Kwong, Thomas**
Director

**CONDENSED CONSOLIDATED CASH FLOW STATEMENT**
FOR THE SIX MONTHS ENDED 30TH JUNE 2002

	Unaudited	
	Six months ended	
	30th June	
	2002	2001
	HK\$'000	HK\$'000
Net cash inflow/(outflow) from operating activities	86,984	(1,983)
Net cash inflow from investing activities	381,632	18,734
Net cash outflow from financing activities	(154,021)	—
Increase in cash and cash equivalents	314,595	16,751
Cash and cash equivalents at 1st January	677,922	666,735
Cash and cash equivalents at 30th June	<u>992,517</u>	<u>683,486</u>
Analysis of balances of cash and cash equivalents:		
Bank balances and cash	1,000,549	683,486
Pledged deposits	(8,032)	—
Cash and cash equivalents in the cash flow statement	<u>992,517</u>	<u>683,486</u>



CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN EQUITY
FOR THE SIX MONTHS ENDED 30TH JUNE 2002

	Unaudited Six months ended 30th June 2002				
	Share capital HK\$'000	Share premium HK\$'000	Investments revaluation reserve HK\$'000	Retained earnings HK\$'000	Total HK\$'000
At 1st January 2002	323,518	1,355,480	6,324	653,872	2,339,194
Share of exchange differences of an associated company	-	-	-	1,336	1,336
Share of deficit on revaluation of investments in securities of an associated company	-	-	(2,954)	-	(2,954)
Net gains or losses not recognised in the consolidated profit and loss account	-	-	(2,954)	1,336	(1,618)
Issue of shares	8,413	79,078	-	-	87,491
Profit for the period	-	-	-	137,229	137,229
Dividends	-	-	-	(19,916)	(19,916)
At 30th June 2002	<u>331,931</u>	<u>1,434,558</u>	<u>3,370</u>	<u>772,521</u>	<u>2,542,380</u>
	Unaudited Six months ended 30th June 2001				
	Share capital HK\$'000	Share premium HK\$'000	Investments revaluation reserve HK\$'000	Retained earnings HK\$'000	Total HK\$'000
At 1st January 2001	323,518	1,355,480	6,893	478,374	2,164,265
Share of exchange differences of an associated company	-	-	-	(1,121)	(1,121)
Share of surplus on revaluation of investments in securities of an associated company	-	-	187	-	187
Net gains or losses not recognised in the consolidated profit and loss account	-	-	187	(1,121)	(934)
Profit for the period	-	-	-	128,898	128,898
Dividends	-	-	-	(19,411)	(19,411)
At 30th June 2001	<u>323,518</u>	<u>1,355,480</u>	<u>7,080</u>	<u>586,740</u>	<u>2,272,818</u>



NOTES TO THE CONDENSED ACCOUNTS

1. Basis of preparation and accounting policies

These unaudited consolidated condensed accounts are prepared in accordance with Hong Kong Statement of Standard Accounting Practice (“SSAP”) 25 “Interim Financial Reporting” issued by the Hong Kong Society of Accountants (“HKSA”) and complied with the disclosure requirements of Appendix 16 of the Listing Rules.

These condensed accounts should be read in conjunction with the 2001 annual financial statements.

The accounting policies and methods of computation used in the preparation of these condensed accounts are consistent with those used in the annual accounts for the year ended 31st December 2001 except that the Group has changed certain of its accounting policies following its adoption of the following SSAPs issued by the HKSA which are effective for accounting periods commencing on or after 1st January 2002:

SSAP 1 (revised)	:	Presentation of financial statements
SSAP 15 (revised)	:	Cash flow statements
SSAP 25 (revised)	:	Interim financial reporting
SSAP 33	:	Discontinuing operations
SSAP 34	:	Employee benefits

The changes to the Group’s accounting policies do not have any significant financial effect to the condensed accounts.

In addition, the Group has adopted certain new accounting policies following its acquisition of CNAC Macau during the period (note 14). Details of new accounting policies adopted by the Group as a result of the acquisition of CNAC Macau are set out below:

(a) Fixed assets other than investment properties

Fixed assets, comprising leasehold improvements, aircraft and engines, flight equipment and rotatable spares and machinery, other equipment, furniture and motor vehicles, are stated at cost less accumulated depreciation and impairment losses.

Fixed assets are depreciated at rates sufficient to write off their cost less accumulated impairment losses over their estimated useful lives on a straight-line basis, after taking into account their estimated residual values. The principal annual rates are as follows:

Leasehold improvements	16.67%
Aircraft	5% to 10% with 10% residual value
Engines	5% to 33%
Flight equipment and rotatable spares	10% to 14.28%
Machinery, other equipment, furniture and motor vehicles	10% to 33%



Expenditure incurred to replace a component of an item of fixed assets that is accounted for separately, including major inspection and overhaul expenditure, is capitalised. Other subsequent expenditure is capitalised only when it increases the future economic benefits embodied in the item of fixed assets. All other expenditure is expensed as incurred.

At each balance sheet date, both internal and external sources of information are considered to assess whether there is any indication that the fixed assets are impaired. If any such indication exists, the recoverable amount of the asset is estimated and where relevant, an impairment loss is recognised to reduce the assets to its recoverable amount. Such impairment losses are recognised in the profit and loss account.

The gain or loss on disposal of a fixed asset other than investment properties is the difference between the net sales proceeds and the carrying amount of the relevant asset, and is recognised in the profit and loss account.

(b) Intangibles assets

(i) Trademark

Expenditure on trademark is carried at historical cost less accumulated amortisation and impairment losses and is amortised on a straight-line basis at an annual rate of 16.66%.

(ii) Deferred expenditure

Transaction fees and transportation charges in relation to placing the leased aircraft into operation are deferred and amortised over the terms of the related leases.

(iii) Impairment of intangible assets

Where an indication of impairment exists, the carrying amount of any intangible assets is assessed and written down immediately to its recoverable amount.

(c) Inventories

Inventories comprise expendable spare parts and suppliers, are stated at the lower of cost or net realisable value, and are expensed when used in operations. Cost is calculated on the average cost basis except for aircraft spare parts, cost of which is calculated on the first-in-first-out basis. Net realisable value is determined on the basis of anticipated sales proceeds less estimated selling expenses.



(d) Revenue recognition

(i) Traffic revenue

Passenger, cargo and mail revenues are recognised when the transportation is provided. Ticket sales for transportation not yet provided are included in current liabilities as sales in advance of carriage.

(ii) Other aviation related revenues

Other aviation related revenues mainly comprise manufacturers' credits earned, royalty income and inflight sales commission.

Manufacturers' credits received in the form of a reduction of the acquisition cost of flight equipment and spares are deferred and amortised as income.

Royalty income is recognised on an accrual basis.

Inflight sales commission is recognised when services are rendered.

(e) Maintenance and overhaul costs

Costs of major checks and overhauls performed on owned aircraft to replace a component of an item of fixed assets are capitalised and amortised over a period of three years. Other maintenance and major overhaul costs incurred for owned aircraft are expensed as and when incurred.

In respect of aircraft under operating leases, a provision is made for the estimated costs of major checks and overhauls required to be conducted to fulfill the requirements under the relevant leases based on the maintenance cycle of each aircraft.

(f) Segment reporting

The analysis of turnover and operating profit by geographical segments is based on the following criteria:

- (i) Traffic revenue from inbound and outbound services between Macau and overseas markets is attributed to the geographical area in which the relevant overseas origin/destination lies.
- (ii) Revenues from gross rental income from investment properties and other aviation related services are attributed on the basis of where the services are performed.



2. Segment information

The Group is principally engaged in the provision of aviation related services.

An analysis of the Group's revenues and results for the period by business segments is as follows:

	Unaudited Six months ended 30th June 2002				Group HK\$'000
	Property holding (note) HK\$'000	Airline operation HK\$'000	Airport ground handling HK\$'000	Logistics and other businesses HK\$'000	
Segment revenues	<u>5,644</u>	<u>491,875</u>	<u>-</u>	<u>-</u>	<u>497,519</u>
Segment results	<u>4,719</u>	<u>48,681</u>	<u>-</u>	<u>-</u>	<u>53,400</u>
Interest income					6,673
Unallocated costs					(14,543)
Operating profit					45,530
Finance costs					(914)
Share of profits less losses of associated companies	-	109,908	45,311	(1,684)	153,535
Profit before taxation					198,151
Taxation					(36,733)
Profit after taxation					161,418
Minority interests					(24,189)
Profit attributable to shareholders					<u>137,229</u>
	Unaudited Six months ended 30th June 2001				Group HK\$'000
	Property holding (note) HK\$'000	Airline operation HK\$'000	Airport ground handling HK\$'000	Logistics and other businesses HK\$'000	
Segment revenues	<u>12,316</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>12,316</u>
Segment results	<u>9,507</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>9,507</u>
Interest income					16,454
Unallocated costs					(7,443)
Operating profit					18,518
Share of profits less losses of associated companies	-	114,301	20,819	(231)	134,889
Profit before taxation					153,407
Taxation					(24,509)
Profit attributable to shareholders					<u>128,898</u>

Note: The property holding business of the Group was vested in CNAC Group on 25th March 2002 (note 14).



An analysis of the Group's turnover and contribution to operating profit for the period by geographical segments is as follows:

	Unaudited Six months ended 30th June			
	Turnover		Operating profit	
	2002	2001	2002	2001
	HK\$'000	HK\$'000	HK\$'000	HK\$'000
China mainland	191,690	–	(4,240)	–
Taiwan	261,934	–	52,121	–
Hong Kong	5,644	12,316	(2,832)	18,518
Others (<i>note</i>)	26,918	–	481	–
Total	<u>486,186</u>	<u>12,316</u>	<u>45,530</u>	<u>18,518</u>

Note: Others mainly include Macau, Thailand and Philippines.

3. Staff costs

	Unaudited Six months ended 30th June	
	2002	2001
	HK\$'000	HK\$'000
Wages, salaries and directors' emoluments	67,645	3,310
Pension costs – defined contribution plan	2,347	6
	<u>69,992</u>	<u>3,316</u>



4. Operating profit

Operating profit is stated after charging the following:

	Unaudited Six months ended 30th June	
	2002 HK\$'000	2001 HK\$'000
Amortisation of intangible assets		
– Goodwill	4,709	–
– Trademarks	11	–
– Deferred expenditure	114	–
Cost of inventories expensed	7,987	–
Depreciation of fixed assets	16,534	–
Operating lease rentals		
– Aircraft and related equipments	83,254	–
– Land and buildings	5,064	–
Outgoings in respect of investment properties	925	2,809

5. Taxation

Hong Kong profits tax has been provided at the rate of 16% (six months ended 30th June 2001: 16%) 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 2001: Nil) on the estimated assessable profit for the period. Taxation on overseas profits 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.

The amount of taxation charged to the condensed consolidated profit and loss account represents:

	Unaudited Six months ended 30th June	
	2002 HK\$'000	2001 HK\$'000
Company and subsidiaries:		
Hong Kong profits tax	379	795
Macau Complementary Tax	6,203	–
Overseas taxation	209	–
Deferred taxation	2,757	–
	9,548	795
Share of taxation attributable to associated companies	27,185	23,714
	36,733	24,509



6. Proposed interim dividends

	Unaudited Six months ended 30th June	
	2002 HK\$'000	2001 HK\$'000
Interim, proposed, of HK0.6 cent (2001:HK0.6 cent) per ordinary share (note)	<u>19,916</u>	<u>19,411</u>

Note: At a meeting held on 2nd September 2002, the Directors declared an interim dividend of HK\$0.6 cent per share for the year ending 31st December 2002. This proposed dividend is not reflected as a dividend payable in these condensed accounts, but will be reflected as an appropriation of retained earnings for the year ending 31st December 2002.

7. Earnings per share

The calculations of basic and diluted earnings per share are based on the Group's profit attributable to shareholders of HK\$137,229,000 (six months ended 30th June 2001: HK\$128,898,000).

The basic earnings per share is based on the weighted average of 3,261,674,714 (six months ended 30th June 2001: 3,235,182,000) ordinary shares in issue during the period. The diluted earnings per share is based on 3,318,075,642 (six months ended 30th June 2001: 3,278,618,570) ordinary shares which is the number of ordinary shares in issue during the period plus the weighted average of 56,400,928 (six months ended 30th June 2001: 43,436,570) ordinary shares which would be issued at no consideration on the exercise of all dilutive options.

8. Intangible assets

	Unaudited			Total HK\$'000
	Goodwill HK\$'000	Trademarks HK\$'000	Deferred expenditures HK\$'000	
Cost				
Acquisition of subsidiaries and at 30th June 2002	339,111	928	2,733	342,772
Accumulated amortisation				
Acquisition of subsidiaries	–	(910)	(2,271)	(3,181)
Charge for the period	(4,709)	(11)	(114)	(4,834)
As at 30th June 2002	<u>(4,709)</u>	<u>(921)</u>	<u>(2,385)</u>	<u>(8,015)</u>
Net book value				
As at 30th June 2002	<u>334,402</u>	<u>7</u>	<u>348</u>	<u>334,757</u>
As at 31st December 2001	<u>–</u>	<u>–</u>	<u>–</u>	<u>–</u>

**9. Fixed assets**

	Unaudited					Total HK\$'000
	Investment properties HK\$'000	Leasehold improvements HK\$'000	Aircraft and engines HK\$'000	Flight equipment and rotatable spares HK\$'000	Machinery, other equipment, furniture, and motor vehicles HK\$'000	
Cost or valuation						
As at 1st January 2002	600,000	-	-	-	-	600,000
Acquisition of subsidiaries	-	24,659	418,782	212,138	42,327	697,906
Additions	-	505	-	2,563	1,599	4,667
Disposals	-	-	-	(972)	(600)	(1,572)
Disposal of subsidiaries	(600,000)	-	-	-	-	(600,000)
As at 30th June 2002	-	25,164	418,782	213,729	43,326	701,001
Accumulated depreciation						
As at 1st January 2002	-	-	-	-	-	-
Acquisition of subsidiaries	-	20,354	81,298	108,125	28,707	238,484
Charge for the period	-	470	8,168	6,533	1,363	16,534
Disposals	-	-	-	(854)	(560)	(1,414)
As at 30th June 2002	-	20,824	89,466	113,804	29,510	253,604
Net book value						
As at 30th June 2002	-	4,340	329,316	99,925	13,816	447,397
As at 31st December 2001	600,000	-	-	-	-	600,000

10. Investments in associated companies

	Unaudited 30th June 2002 HK\$'000	31st December 2001 HK\$'000
Hong Kong Dragon Airlines Limited	1,081,893	994,097
Jardine Airport Services Limited	54,391	58,396
Menzies Macau Airport Services Limited (formerly known as MASC/Ogden – Aviation Services (Macau), Limited)	63,104	-
Tradeport Hong Kong Limited	36,194	19,209
Macau Aircraft Repair and Conversion Company Limited	333	-
	1,235,915	1,071,702



The investments in associated companies above also include loans to JASL, Tradeport and MARCCO of HK\$55,060,000 (31st December 2001: HK\$55,060,000), HK\$38,847,000 (31st December 2001: HK\$20,186,000) and HK\$446,000 (31st December 2001: Nil) respectively.

11. Trade and other receivables

Included in trade and other receivables are trade receivables of HK\$100,467,000 (31st December 2001: HK\$212,000).

The credit terms granted to sales agents and other trade customers are generally half month.

At 30th June 2002 and 31st December 2001, the aging analysis of the trade receivables is as follows:

	Unaudited 30th June 2002 HK\$'000	31st December 2001 HK\$'000
Within 31 days	98,827	100
31 – 60 days	–	100
61 – 90 days	1,283	–
Over 90 days	357	12
	<u>100,467</u>	<u>212</u>

12. Trade and other payables

Included in trade and other payables are trade payables of HK\$120,594,000 (31st December 2001: Nil). At 30th June 2002 and 31st December 2001, the aging analysis of the trade payables is as follows:

	Unaudited 30th June 2002 HK\$'000	31st December 2001 HK\$'000
Within 31 days	57,290	–
31 – 60 days	34,188	–
61 – 90 days	16,207	–
Over 90 days	12,909	–
	<u>120,594</u>	<u>–</u>



13. Share capital

	Unaudited Ordinary shares of HK\$0.10 each	
	Number of shares	HK\$'000
Authorised:		
At 1st January 2001, 2002 and 30th June 2002	<u>4,000,000,000</u>	<u>400,000</u>
Issued and fully paid:		
At 1st January 2001 and 2002	3,235,182,000	323,518
Exercise of share options	<u>84,126,000</u>	<u>8,413</u>
At 30th June 2002	<u>3,319,308,000</u>	<u>331,931</u>

At an Annual General Meeting of the Company held on 29th May 2002, a new share option scheme was approved and adopted to replace the old share option scheme which was approved by the shareholders of the Company on 22nd October 1997.

During the period, 84,126,000 options were exercised and 84,126,000 ordinary shares were issued at a subscription price of HK\$1.04 and 147,059,800 options remained outstanding at 30th June 2002.

14. Acquisition of CNAC Macau and discontinuing operation of property holding business

On 8th February 2002, the Group entered into an agreement ("Acquisition Agreement") with CNAC Group for the acquisition of the entire equity interest in, and the shareholder's loan of approximately MOP134,300,000 (approximately HK\$130,391,000) due from, CNAC Macau, at an aggregate consideration of HK\$665,000,000 (the "Acquisition"). CNAC Macau's assets consist of (i) a 51% interest in Air Macau, a Macau-based airline; (ii) a 26% direct interest in Menzies Macau, a ground handling service company which operates at the Macau Airport; and (iii) a 20% direct interest in MARCCO, a company with an intention to engage in the provision of aircraft conversion and maintenance services at the Macau Airport.

Pursuant to the Acquisition Agreement, Sinobest and Prospered Property Corp. (collectively "Sinobest Group"), wholly owned subsidiaries of the Group, underwent a capital restructuring so that the entire effective interest in the share capital of Sinobest was vested in CNAC Group and the shareholder's loans owing from Sinobest Group totaled approximately HK\$307,117,000 were assigned to CNAC Group (the "Restructuring"). The Sinobest Group held the entire investment property portfolio of the Group, which was valued at HK\$600,000,000 as at 31st December 2001. The consideration paid to CNAC Group for the Acquisition of HK\$665,000,000 was partially offset by the consideration of HK\$600,000,000 paid for the Restructuring. The balance of HK\$65,000,000 was satisfied by a cash payment by the Group.



(i) *Acquisition of CNAC Macau*

The net assets of CNAC Macau and its subsidiary at the date of acquisition was HK\$200,101,000. The resulting goodwill of HK\$339,111,000 is amortised on a straight-line basis over 18 years, being the unexpired period of Air Macau's exclusive rights to operate as Macau's home based carrier. The acquired business contributed revenues of HK\$492,526,000 and operating profit of HK\$48,365,000 to the Group for the period from 25th March 2002 to 30th June 2002.

The assets and liabilities arising from the Acquisition at the date of acquisition are as follows:

	Unaudited 30th June 2002 HK\$'000
Fixed assets	459,422
Cash and cash equivalents	466,041
Other assets less liabilities	<u>(725,362)</u>
Net assets acquired	200,101
Add: Shareholder's loan assigned to the Group	<u>130,391</u>
	330,492
Goodwill (<i>note 9</i>)	<u>339,111</u>
Total cost of Acquisition	<u>669,603</u>
Analysis of total cost of Acquisition:	
Purchase consideration	665,000
Direct costs relating to the Acquisition	<u>4,603</u>
Total cost of Acquisition	<u>669,603</u>



(ii) *Discontinuing operation of property holding business*

The entire property holding business segment of the Group was vested in CNAC Group on 25th March 2002. Sinobest Group comprising the segment was sold and is reported in the condensed accounts as a discontinuing operation. The turnover, results, cash flows and net assets of the property holding business segment were as follows:

	Unaudited	
	Six months ended	
	30th June	
	2002	2001
	HK\$'000	HK\$'000
Turnover	5,644	12,316
Other revenue	10	138
Administrative expenses	(1,334)	(2,822)
Profit before taxation	4,320	9,632
Taxation	(379)	(795)
Profit after taxation	3,941	8,837
Operating cash inflow/(outflow)	4,667	(2,648)

	Unaudited	
	25th March	31st December
	2002	2001
	HK\$'000	HK\$'000
Investment properties	600,000	600,000
Current assets	17,264	12,211
Total assets	617,264	612,211
Total liabilities	(324,381)	(313,364)
Net assets	292,883	298,847



Unaudited
25th March
2002
HK\$'000

The loss on discontinuing operation recognised in the condensed accounts for the six months ended 30th June 2002 was determined as follows:

Net assets of the property holding business segment	292,883
Add: Shareholder's loans assigned to CNAC Group	<u>307,117</u>
	600,000
Consideration for the Restructuring	<u>(600,000)</u>
Loss on discontinuing operation	<u>–</u>
The net cash outflow on discontinuing operation is determined as follows:	
Cash and cash equivalents in subsidiaries sold	<u>10,140</u>

15. Commitments

- (i) On 15th May 2000, the Group entered into a memorandum of understanding with a third party for the establishment of a joint venture company (the "JV"), of which the Group will own 55% equity interest, to provide aviation related internet based services. The initial investment of the Group in the JV amounts to approximately HK\$42,900,000 (31st December 2001: HK\$42,900,000). As at 30th June 2002, no investment was contributed by the Group to the JV (31st December 2001: Nil).
- (ii) On 16th February 2001, the Group entered into an agreement with third parties (the "Consortium Partners") for the joint development and operation of the logistics centre at the South Commercial District of the HK Airport (the "Project"). The Group has 25% interest in the Project. The Directors estimate that the Group's attributable share of capital commitments in respect of the Project is approximately HK\$130,650,000 (31st December 2001: HK\$130,650,000), of which HK\$38,847,000 was advanced to project as at 30th June 2002 (31st December 2001: HK\$20,186,000).

In the event of default of any of the Consortium Partners, the Group will be required to provide additional funds for the Project. The Group and the Consortium Partners have jointly given an unlimited guarantee to the Airport Authority in respect of their obligations to provide sufficient funding for the Project. Had the Group been required to perform its obligations under the guarantee in the event of default of all of the Consortium Partners, the maximum amount of the additional liabilities assumed, in addition to the Group's estimated share of capital commitments as disclosed above, would have been approximately HK\$649,350,000 (31st December 2001: HK\$649,350,000).

**16. Contingent liabilities**

	Unaudited 30th June 2002 HK\$'000	31st December 2001 HK\$'000
Guarantee for banking facilities granted by bank to an associated company	<u>75,000</u>	<u>–</u>

17. Related party transactions

In addition to those disclosed elsewhere in the accounts, significant related party transactions, which were carried out in the normal course of the Group's business, are as follows:

	Unaudited Six months ended 30th June	
	2002 HK\$'000	2001 HK\$'000
Management fee paid to:		
– Immediate holding company (<i>note i</i>)	3,000	3,060
– A fellow subsidiary (<i>note ii</i>)	968	–
Rental income from:		
– Immediate holding company	–	3,073
– Fellow subsidiaries (<i>note iii</i>)	265	2,878
Landing, loading, parking and other airport charges paid to a fellow subsidiary (<i>note iv</i>)	29,046	–
Ground handling costs paid to an associated company (<i>note v</i>)	31,007	–
Inflight meal services expenses paid to a related company (<i>note vi</i>)	14,124	–
Over-riding commission paid to a related company (<i>note vii</i>)	<u>10,123</u>	<u>–</u>

Notes:

- (i) On 3rd August 2001, the Company and CNAC Group entered into a management services agreement pursuant to which CNAC Group has agreed to provide secretarial, personnel, accounting and general office administrative services (the "Services") to the Group for a period of two years from 1st July 2001 to 30th June 2003 and CNAC Group would be paid by the Company in respect of the Services a monthly fee of HK\$500,000.
- (ii) The Group entered into a management services agreement with CNAC (Macau) Aviation Limited pursuant to which CNAC (Macau) Aviation Limited will provide general management services including but not limited to secretarial, personnel, accounting and general office administrative services to CNAC Macau at a monthly fee of HK\$300,000.



- (iii) On 30th November 2001, the Group entered into two lease agreements (the "Lease Agreements") with China National Aviation Corporation (Hong Kong) Limited ("CNAC HK"), pursuant to which the Group agreed to lease certain of its properties to CNAC HK. The Lease Agreements were entered into on normal commercial terms and the rent of each lease is determined based on the prevailing market rental values of these leased properties as advised by DTZ Debenham Tie Leung Limited. The aforesaid properties were vested to CNAC Group on 25th March 2002.
- (iv) The airport related charges paid to ADA-Administrative Airport Limited ("ADA") were mainly charged at terms pursuant to the tariff published by the Macau Airport. Other airport charges were charged at terms pursuant to agreements entered into by the Group with ADA or the Macau Airport.
- (v) The ground handling services rendered were charged at terms pursuant to agreements entered into by the Group with Menzies Macau.
- (vi) The inflight meal services rendered were charged at terms pursuant to agreements entered into by the Group with Macau Catering Services Company Limited, a 34.5% owned associated company held by a minority shareholder of Air Macau.
- (vii) Over-riding commission was charged at a fixed rate of 3% on the passenger flown revenue generated in Taiwan area.

In addition to the above, on 18th October 1997, the Company entered into a license agreement with CNAC pursuant to which CNAC agreed to grant a license to the Company, free of royalty, for the use of certain trademarks in Hong Kong, the Taiwan region and Macau so long as the Company is a subsidiary of CNAC Group. No royalty charge was levied in respect of the use of these trademarks during the period (six months ended 30th June 2001: Nil).

18. Comparative figures

Certain comparative figures in the condensed consolidated profit and loss account including staff costs, administrative expenses and other operating costs have been reclassified or extended to conform to the current period's presentation.

19. Approval of the condensed accounts

The condensed accounts were approved by the Directors on 2nd September 2002.

On behalf of the Board
KONG DONG
Chairman

Hong Kong, 2nd September 2002