



The Directors hereby present to the shareholders their report, together with the audited accounts of the Group for the year ended 31st December, 2003.

PRINCIPAL ACTIVITIES AND GEOGRAPHICAL ANALYSIS OF OPERATIONS

The principal activity of the Company is investment holding. The principal activities of its subsidiaries and principal associated companies are airline operations and aviation related businesses which are set out in notes 13 and 14 to the accounts respectively.

An analysis of the Group's performance for the year by business and geographical segments is set out in note 2 to the accounts.

RESULTS AND APPROPRIATIONS

The results of the Group for the year ended 31st December, 2003 and the state of the Group's affairs as at that date are set out in the accounts on pages 43 to 87.

The Directors have declared an interim dividend of HK0.3 cent per share, totalling HK\$9,938,000, which was paid on 15th October, 2003.

The Directors recommend the payment of a final dividend of HK0.6 cent per share, totalling HK\$19,876,000.

RESERVES

Movements in the reserves of the Group and of the Company during the year are set out in note 19 to the accounts.

FIXED ASSETS

Details of the movements in fixed assets of the Group are set out in note 11 to the accounts.

SHARE CAPITAL

Details of the movements in share capital of the Company are set out in note 18 to the accounts.



DISTRIBUTABLE RESERVES

Distributable reserves of the Company at 31st December, 2003, calculated under Section 79B of the Hong Kong Companies Ordinance, amounted to HK\$655,050,000 (2002: HK\$660,641,000).

FINANCIAL SUMMARY

A summary of the results and of the assets and liabilities of the Group for the last five financial years is set out on page 88.

PURCHASE, SALE OR REDEMPTION OF SHARES

In April 2003, the Company repurchased a total of 6,628,000 ordinary shares of the Company of HK\$0.1 each at an aggregate consideration of HK\$5,325,000. The highest and lowest prices per share paid were HK\$0.83 and HK\$0.77 respectively. All of the shares repurchased were subsequently cancelled.

At 31st December, 2003, 3,312,680,000 shares were in issue (31st December, 2002: 3,319,308,000 shares).

SHARE OPTIONS

To comply with the requirements for share option schemes under the Rules Governing 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 (the "Old Share Option Scheme") was terminated and replaced by a new share option scheme ("New Share Option Scheme") which was adopted by the Company on 29th May, 2002. Upon termination of the Old Share Option Scheme, no further options could be granted thereunder but in all other respects, the provisions of the Old Share Option Scheme shall remain in force and all options granted prior to termination shall continue to be valid and exercisable in accordance therewith. As at 31st December, 2003, there were 32,351,800 share options outstanding under the Old Share Option Scheme and 104,378,000 share options outstanding under the New Share Option Scheme.

The major terms of the New Share Option Scheme are as follows;

1. The purpose of the New Share Option Scheme is to provide incentives to participants to contribute to the prosperity, business development or growth of the Group and/or to enable the Group to recruit and/or retain high-calibre employees and attract resources that are valuable to the Group.
2. The participants of the New Share Option Scheme are any Director, employee, supplier, customer or other relevant business partners of the Group as invited by the Board.



SHARE OPTIONS (CONT'D)

3. The subscription price determined by the Board will be the higher of (i) the closing price of the Company's share as stated in The Stock Exchange of Hong Kong Limited's ("Stock Exchange") daily quotations sheet on the date of grant; (ii) the average closing price of the Company's share as stated in the Stock Exchange's daily quotations sheets for the five business days immediately preceding the date of grant; and (iii) the nominal value of the Company's shares.
4. The acceptance of grant of share options must be made within 28 days from the date of grant with a non-refundable payment of HK\$1.00 from the grantee.
5. The maximum number of shares over which options may be granted under the New Share Option Scheme shall not exceed 30% of the issued share capital of the Company from time to time.

As at the date of this report, the maximum number of shares available for issue under the New Share Option Scheme is 331,268,000, being 10% of the number of issued share capital of the Company.

6. The maximum number of shares issuable upon exercise of the options granted under the New Share Option Scheme and any other share option scheme(s) of the Company (whether exercised or outstanding options) to each eligible participant in any 12-month period must not exceed 1% of the shares of the Company in issue. Where any further grant of share options to any eligible participant would result in the shares issued and to be issued upon exercise of all options granted or to be granted to such participant (including exercised, cancelled and outstanding options) in the 12-month period representing in aggregate over 1% of the shares of the Company in issue, such further grant shall be subject to the issue of a circular by the Company and the shareholders' approval of the Company at a general meeting with the relevant eligible participant and his/her associates abstaining from voting.
7. The exercise period of any option granted under the New Share Option Scheme must not exceed six years commencing on the date falling three months after the date of grant and expiring on the last day of the said period.
8. The New Share Option Scheme shall be valid and effective till 28th May, 2012.

During the year under review, the Company has granted 104,378,000 options under the New Share Option Scheme,


SHARE OPTIONS (CONT'D)

Details of the share options outstanding as at 31st December, 2003 under both share option schemes are as follows:

Name of grantee	Options held at 1st January, 2003	Options granted during the year	Options exercised during the year	Options lapsed during the year	Options held at 31st December, 2003	Exercise price HK\$	Grant date	Exercise period
Kong Dong	32,351,800 ¹	-	-	-	32,351,800 ¹	0.82	24/09/2001	25/03/2002 to 24/03/2004
Chuang Shih Ping	38,236,000 ¹	-	-	38,236,000 ¹	-	1.04	04/01/2001	12/07/2001 to 11/07/2003
	-	33,126,000 ²	-	-	33,126,000 ²	1.14	25/07/2003	26/10/2003 to 25/10/2009
Zhang Xianlin	38,236,000 ¹	-	-	38,236,000 ¹	-	1.04	04/01/2001	12/07/2001 to 11/07/2003
	-	33,126,000 ²	-	-	33,126,000 ²	1.14	25/07/2003	26/10/2003 to 25/10/2009
Tsang Hing Kwong, Thomas	38,236,000 ¹	-	-	38,236,000 ¹	-	1.04	04/01/2001	12/07/2001 to 11/07/2003
	-	33,126,000 ²	-	-	33,126,000 ²	1.14	25/07/2003	26/10/2003 to 25/10/2009
Gu Tiefei	-	5,000,000 ²	-	-	5,000,000 ²	1.14	25/07/2003	26/10/2003 to 25/10/2009
Total:	147,059,800	104,378,000	-	114,708,000	136,729,800			

Note:

- Share options that have been granted under the Old Share Option Scheme.
- Share options that have been granted under the New Share Option Scheme. At the date before the options were granted, 24th July, 2003, the market value per share was HK\$1.11. The market value of the options granted to the respective Director is as follows:

Directors	HK\$'000
Chuang Shih Ping	36,770
Zhang Xianlin	36,770
Tsang Hing Kwong Thomas	36,770
Gu Tiefei	5,550



SHARE OPTIONS (CONT'D)

The Board considers that it is not appropriate to state the value of all options that have been granted under the Share Option Scheme as a number of variables which are crucial for the calculation of the option value have not been determined. Such variables include the subscription price, the exercise period, the projected trading prices of the Shares during the exercise period, the vesting period (if any) and other relevant factors. The Board believes that any calculation of the value of any option would be based on a number of speculative assumptions and therefore not only would such calculation not be meaningful or representative, but it could also potentially be misleading to the shareholders.

During the year no share options has been exercised.

DIRECTORS

The Directors during the year and up to the date of this report are:

Kong Dong
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*

In accordance with Article 98 of the Company's Articles of Association, Messrs. Zhang Xianlin, Tsang Hing Kwong, Thomas and Gu Tiefei retire by rotation at the forthcoming annual general meeting and, being eligible, offer themselves for re-election.

DIRECTORS' SERVICE CONTRACTS

None of the Directors who are proposed for re-election at the forthcoming annual general meeting has a service contract with the Company or any of its subsidiaries which is not determinable within one year without payment of compensation, other than statutory compensation.



DIRECTORS' INTERESTS IN CONTRACTS

No contracts of significance in relation to the Group's business to which the Company, its fellow subsidiaries, its subsidiaries or its holding company was a party and in which a Director of the Company had a material interest, whether directly or indirectly, subsisted at the end of the year or at any time during the year.

BIOGRAPHICAL DETAILS OF DIRECTORS AND SENIOR MANAGEMENT

Brief biographical details of Directors and senior management are set out on pages 29 to 31.

DIRECTORS AND CHIEF EXECUTIVE'S INTEREST AND SHORT POSITIONS IN SHARES, UNDERLYING SHARES AND DEBENTURES

Apart from the interests of the Directors in the share options of the Company are separately disclosed in the "Share Options" above, as at 31st December, 2003, none of the directors and the chief executive of the Company and/or any of their respective associates had any interest or deemed interest in the long and short position in the shares, underlying shares and debentures of the Company or any of its associated corporation (within the meaning of Part XV of the Securities and Future Ordinance ("SFO")) as recorded in the register required to be kept by the Company under Section 352 of the SFO; or as otherwise notified to the Company and the Stock Exchange pursuant to Part XV of the SFO or the Model Code for Securities Transaction by Directors of Listed Companies.

DIRECTORS' INTEREST IN COMPETING BUSINESS

Set out below is information disclosed pursuant to paragraph 8.10(2) of the Listing Rules.

Mr. Kong Dong is the Deputy General Manager of CNAH, which is the ultimate holding company of the Company and Air China International Corporation ("Air China"), both CNAH and Air China are state-owned enterprises established in the PRC. Air China is engaged in the business of passenger and cargo air transportation services and airport ground handling services and CNAH is its ultimate holding company. As such the business activities of CNAH contribute competing business to the Group.

Mr. Kong is not directly involved in managing Air China's business. The Group is therefore capable of carrying on such business independently of, and at arm's length from the said competing business.



SUBSTANTIAL SHAREHOLDERS

As at 31st December, 2003, the register of substantial shareholders and short positions maintained under Part XV of the SFO shows that the following shareholders' with interests representing 5% or more of the Company's issued share capital:

Name	Number of Shares	Approximate percentage of issued capital	Note
China National Aviation Holding Company	2,286,988,000	69.0	1
China National Aviation Corporation	2,286,988,000	69.0	1
China National Aviation Corporation (Group) Limited	2,286,988,000	69.0	1
Best Strikes Limited	187,656,000	5.6	
On Ling Investments Limited	322,856,000	9.7	2
Novel Investments Holdings Limited	322,856,000	9.7	2
Novel Enterprises (BVI) Limited	322,856,000	9.7	2
Novel Credit Limited	322,856,000	9.7	2
Novel Holdings (BVI) Limited	322,856,000	9.7	2
Westleigh Limited	322,856,000	9.7	2

Note 1: The entire issued share capital of China National Aviation Corporation (Group) Limited is beneficially owned by China National Aviation Corporation. China National Aviation Corporation is in turn wholly-owned by China National Aviation Holding Company, a state-owned enterprise established in the People's Republic of China. Accordingly, the interests of China National Aviation Corporation (Group) Limited, China National Aviation Corporation and China National Aviation Holding Company in the Company duplicate to each other.

Note 2: 5.6% of which duplicates with Best Strikes Limited's interest.

Save as disclosed above, as at 31st December, 2003, no other person had an interest in the long and short position in the shares or underlying shares of the Company as recorded in the register required to be kept by the Company under section 336 of the SFO.

MANAGEMENT CONTRACTS

There exist agreements for general management services, in respect of which CNACG and CNAC (Macau) Aviation provide secretarial, personnel, accounting and general office administrative services to the Company and CNAC Macau on monthly fees of HK\$500,000 and HK\$300,000 respectively. Details of which are set out in note 28(i) and (ii) to the accounts.

Save as disclosed above, no contracts concerning the management and administration of the whole or any substantial part of the business of the Company were entered into or existed during the year.



MAJOR CUSTOMERS AND SUPPLIERS

As set out in the section headed "Principal Activities" above, the Group's turnover and operating profit are mainly derived from its airline operations.

During the year, the Group sold less than 10 per cent of its goods and services to its 5 largest customers.

The largest supplier and the five largest suppliers combined represented 23 per cent and 52 per cent respectively of the Group's total purchases for the year.

During the year, none of the Directors, their associates or any shareholder (which to the knowledge of the directors owns more than 5 per cent of the company's share capital) had an interest in the major suppliers or customers noted above except that the Company owns 33.65 per cent effective interests in one of the five largest suppliers and the Company's immediate holding company effectively owns 51 per cent effective interests in another one of the five largest suppliers, which together contributed 14 per cent of the Group's total purchases.

CONNECTED TRANSACTIONS

Connected transactions disclosed in accordance with Chapter 14 of the Listing Rules are as follows:

1. The Company and CNAC entered into a licence agreement dated 18th October, 1997 pursuant to which CNAC has agreed to grant a licence 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 CNACG. The Company has applied for a waiver for strict compliance with the Listing Rules. The independent Non-Executive Directors have reviewed the transaction and are of the opinion that it had been entered into by the Group in the ordinary course of business; in accordance with the terms of the agreement governing such transaction; and on terms that were fair and reasonable so far as the shareholders of the Company were concerned.
2. On 3rd August, 2001, the Company and CNACG entered into a management services agreement pursuant to which CNACG has agreed to provide secretarial, personnel, accounting and general office administrative services to the Group for a period of two years from 1st July, 2001 to 30th June, 2003 and CNACG would be paid by the Company in respect of the services a monthly fee of HK\$500,000.

The management services agreement was renewed on 27th August, 2003 with same terms for a period of two years commencing 1st July, 2003. Total management fee paid during the year amounted to HK\$6,000,000.



CONNECTED TRANSACTIONS (CONT'D)

3. Upon completion of the acquisition of the entire equity interest in CNAC Macau consisting, inter alia, 51 per cent of Air Macau on 25th March, 2002, certain on-going transactions constituted connected transactions of the Company for the purpose of the Listing Rules, details of which are as follows:

- (a) Airport charges and airport fees that invoiced and collected by ADA – Administration of Airports Limited (“ADA”), a 51 per cent owned subsidiary of CNAC (Macau) Aviation (a wholly-owned subsidiary of CNACG), on behalf of Macau International Airport Company (“MIAC”), the developer and owner of Macau International Airport. Since the Company and CNAC (Macau) Aviation are both subsidiaries of CNACG, ADA is a connected person (as defined under the Listing Rules) of the Group. Further, Sociedade de Turismo e Diversões de Macau (“STDM”), which has a 15 per cent shareholding interest in Air Macau, has an approximately 33 per cent shareholding in MIAC and hence, MIAC is also a connected person of the Group. As a result, the payment of airport charges and airport fees constitutes connected transactions under the Listing Rules.

The airport charges and airport fees paid to ADA for the year ended 31st December, 2003 totalling HK\$51,927,000 did not exceed 10 per cent of the consolidated turnover of the Company for the year ended 31st December, 2003.

- (b) Air Macau continues to purchase in-flight meals from Macau Catering Services Company Limited (“MCS”), an associate of STDM, pursuant to a catering services agreement that took effect from 1st November, 2001.

The aggregate of the in-flight meal services expenses paid to MCS for the year ended 31st December, 2003 totalling HK\$40,637,000 did not exceed 5 per cent of the consolidated turnover of the Company for the year ended 31st December, 2003.

- (c) CNAC Macau and CNAC (Macau) Aviation entered into a three-year management services agreement pursuant to which CNAC (Macau) Aviation provides general management services including secretarial, personnel, accounting and general office administrative services, to CNAC Macau, at a monthly fee of HK\$300,000.

The aggregate of the services fees paid during the year ended 31st December, 2003 totalling HK\$3,600,000 did not exceed the higher of either (i) HK\$10 million; or (ii) 3 per cent of the consolidated net tangible assets of the Company as at 31st December, 2003.

- (d) Air Macau has entered into sales arrangement with certain ticket sales agents, the number of which may be varied from time to time according to the business needs of Air Macau, for the sale of air tickets (including cargo transport). During the year, Air Macau either sold the air tickets to the ultimate consumers through the ticket sales agents and paid to the ticket sales agents commission fees at rates of 7 per cent to 9 per cent of the value of tickets sold; or sold the air tickets to the ticket sales agents at fixed prices, so that the ticket sales agents might on-sale the same to ultimate consumers at prices determined by the ticket sales agents. Such ticket sales agents include those who are also associates of CNACG or CNAC, the immediate holding company of CNACG.

The aggregate of the commission paid or payable to, and value of tickets sold to those agents for the year ended 31st December, 2003 totalling HK\$19,725,000 did not exceed the higher of either (i) HK\$10 million; or (ii) 3 per cent of the consolidated net tangible assets of the Company as at 31st December, 2003.



CONNECTED TRANSACTIONS (CONT'D)

The Company has obtained a waiver from the Stock Exchange for strict compliance with the requirements under Chapter 14 of the Listing Rules on the above-mentioned on-going connected transactions.

The independent Non-Executive Directors have reviewed these transactions and confirmed that in their opinion, these transactions were carried out:

- (i) in the ordinary and usual course of business;
- (ii) 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 Company than terms available to or from (as appropriate) independent third parties; and
- (iii) in accordance with the relevant agreement (if applicable) on terms that are fair and reasonable and in the interests of the independent shareholders of the Company as whole.

CORPORATE GOVERNANCE

None of the Directors of the Company is aware of any information that would reasonably indicate that the Company is not, or was not at any time during the year ended 31st December, 2003, in compliance with the Code of Best Practice as set out in Appendix 14 to the Listing Rules, except that the 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 Company's Articles of Association.

In compliance of the Code of Best Practice, 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 had held three meetings to review and consider the Group's interim and annual results for the year.

AUDITORS

The accounts have been audited by PricewaterhouseCoopers who retire and, being eligible, offer themselves for re-appointment.

On behalf of the Board

Kong Dong
Chairman

Hong Kong, 26th March, 2004