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If you are in any doubt as to any aspect of this circular or as to the action to be taken, you should consult your stockbroker or other registered dealer in securities, bank manager, solicitor, professional accountant or other professional adviser.

If you have sold or transferred all of your ordinary shares in China National Aviation Company Limited, you should immediately hand this circular and the accompanying form of proxy to the purchaser or transferee or to the bank, stockbroker or other agent through whom the sale or transfer was effected for transmission to the purchaser or transferee.

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中航興業有限公司

CHINA NATIONAL AVIATION COMPANY LIMITED

(incorporated in Hong Kong with limited liability)

(Stock Code: 1110)

**DISCLOSEABLE AND CONNECTED TRANSACTIONS
ACQUISITION OF BACL AND SWACL
AND
ACQUISITION OF LLSHK AND ITS TERMINATION**

Independent financial adviser to the Independent Board Committee



Kingsway Capital Limited

A letter from the Independent Board Committee dated 15 May, 2004 is set out on page 18 of this circular. A letter from Kingsway Capital Limited containing its advice to the Independent Board Committee and the independent Shareholders dated 15 May, 2004 is set out on pages 19 to 30 of this circular.

A notice convening an extraordinary general meeting of China National Aviation Company Limited to be held at Salon 5 (Level 3), JW Marriott Hong Kong, Pacific Place, 88 Queensway, Hong Kong at 4:00 p.m. on Monday, 31 May, 2004 or immediately after its annual general meeting to be held at 3:00 p.m. of the same date, is set out on pages 37 to 38 of this circular. Whether or not you are able to attend the meeting, you are requested to complete and return the enclosed form of proxy in accordance with the instructions printed thereon as soon as possible but in any event not later than 48 hours before the time appointed for the holding of the extraordinary general meeting. Completion and return of the form of proxy will not preclude you from attending and voting at the extraordinary general meeting if you so wish.

15 May, 2004

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DEFINITIONS

In this circular, the following expressions have the following meanings unless the context requires otherwise:

“Acquisition Agreements”	the Beijing Contract and the Chengdu Contract
“Acquisitions”	the Beijing Acquisition and the Chengdu Acquisition
“Air China”	Air China International Corporation, a company established in the PRC
“Air Macau”	Air Macau Company Limited, a company incorporated in Macau with limited liability and a 51% indirectly owned subsidiary of the Company
“associate(s)”	has the meaning ascribed thereto in the Listing Rules
“BACL”	Beijing Air Catering Co., Ltd., a company established in the PRC
“Beijing Acquisition”	the acquisition of 60% of the equity interest in BACL from Air China
“Beijing Contract”	the share transfer contract dated 21 April, 2004, and supplemented on 26 April, 2004, between Fly Top and Air China in relation to the Beijing Acquisition
“Board”	the board of Directors
“CAAC”	the Civil Administration of China
“Chengdu Acquisition”	the acquisition of 60% of the equity interest in SWACL from Air China
“Chengdu Contract”	the share transfer contract dated 21 April, 2004, and supplemented on 26 April, 2004, between Fly Top and Air China in relation to the Chengdu Acquisition
“CNACG”	China National Aviation Corporation (Group) Limited, a company incorporated in Hong Kong with limited liability and which holds approximately 69.1% in the issued share capital of the Company
“CNAH”	China National Aviation Holding Company, a state-owned enterprise established in the PRC and the ultimate holding company of the Company, CNACG and Air China

DEFINITIONS

“Company”	China National Aviation Company Limited, a company incorporated in Hong Kong with limited liability and the shares of which are listed on the Stock Exchange
“connected person”	has the meaning ascribed thereto in the Listing Rules
“Directors”	the directors of the Company
“Dragonair”	Hong Kong Dragon Airlines Limited, an airline operator incorporated in Hong Kong with limited liability and a 43.29% owned associated company of the Company
“EGM”	the extraordinary general meeting of the Company to be held at Salon 5 (Level 3), JW Marriott Hong Kong, Pacific Place, 88 Queensway, Hong Kong at 4:00 p.m. on Monday, 31 May, 2004 or immediately after its annual general meeting to be held at 3:00 p.m. of the same date, to approve the Acquisitions, a notice of which is set out on pages 37 to 38
“Fly Top”	Fly Top Limited, a company incorporated in the British Virgin Islands with limited liability and a wholly-owned subsidiary of the Company
“Group”	the Company and its subsidiaries
“HKBACL”	Hongkong Beijing Air Catering Limited, a company incorporated in Hong Kong and, as at the Latest Practicable Date, not a connected person of the Company
“HKSACL”	Hongkong Southwest Air Catering Limited, a company incorporated in Hong Kong and, as at the Latest Practicable Date, not a connected person of the Company
“HKSSAP”	Statements of Standard Accounting Practice issued by the Hong Kong Society of Accountants
“Hong Kong”	the Hong Kong Special Administrative Region of the PRC
“Hong Kong Agreement”	the sale and purchase agreement dated 21 April, 2004 between Fly Top and CNACG in relation to the Hong Kong Transaction, which agreement was terminated on 26 April, 2004

DEFINITIONS

“Hong Kong Transaction”	the proposed, but later terminated, acquisition of approximately 16% of the issued share capital of LLSHK from CNACG
“Independent Board Committee”	the independent board committee, comprising Messrs. Lok Kung Nam, Hu Hung Lick, Henry, Ho Tsu Kwok, Charles and Li Kwok Heem, John appointed to advise the independent Shareholders in respect of the Acquisitions
“Kingsway Capital”	Kingsway Capital Limited, a corporation licensed in respect of Types 4, 6 and 9 regulated activities under the SFO and the independent financial adviser to the Independent Board Committee and the independent Shareholders in respect of the Acquisitions
“Latest Practicable Date”	11 May, 2004, being the latest practicable date prior to the printing of this circular for ascertaining certain information contained herein
“Listing Rules”	The Rules Governing the Listing of Securities on the Main Board of The Stock Exchange of Hong Kong Limited
“LLSHK”	LSG Lufthansa Service Hong Kong Limited, a company incorporated in Hong Kong
“Macau”	the Macau Special Administrative Region of the PRC
“PRC”	The People’s Republic of China
“PRC Accounting Regulations”	Accounting Standards for Business Enterprises and Accounting System for Business Enterprises in the PRC
“SARS”	Severe Acute Respiratory Syndrome
“SFO”	the Securities and Futures Ordinance (Chapter 571 of the Laws of Hong Kong)
“Shareholders”	shareholders of the Company
“Stock Exchange”	The Stock Exchange of Hong Kong Limited
“SWACL”	Southwest Air Catering Company Limited, a company established in the PRC
“HK\$”	Hong Kong dollars, the lawful currency of Hong Kong

DEFINITIONS

“RMB”	Renminbi, the lawful currency of the PRC
“US\$”	United States dollars, the lawful currency of the United States of America

In this circular, except as otherwise indicated, RMB has been translated into HK\$ at the rate of HK\$1.00 = RMB1.06 for reference purpose only.



中航興業有限公司

CHINA NATIONAL AVIATION COMPANY LIMITED

(incorporated in Hong Kong with limited liability)

(Stock Code: 1110)

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*

Registered Office:

5th Floor, CNAC House

12 Tung Fai Road

Hong Kong International Airport

Lantau

Hong Kong

* *Independent Non-executive Directors*

15 May, 2004

**DISCLOSEABLE AND CONNECTED TRANSACTIONS
ACQUISITION OF BACL AND SWACL
AND
ACQUISITION OF LLSHK AND ITS TERMINATION**

To the Shareholders

Dear Sir/Madam,

INTRODUCTION

On 26 April, 2004, the Board announced that Fly Top, a wholly-owned subsidiary of the Company, entered into the following Acquisition Agreements on 21 April, 2004 which were supplemented on 26 April, 2004:

- (i) the Beijing Contract with Air China in relation to the acquisition of 60% of the equity interest in BACL for a consideration of RMB294 million (equivalent to approximately HK\$277.4 million); and
- (ii) the Chengdu Contract with Air China in relation to the acquisition of 60% of the equity interest in SWACL for a consideration of RMB67 million (equivalent to approximately HK\$63.2 million).

The aggregate consideration of approximately RMB361 million (equivalent to approximately HK\$340.6 million) under the Acquisition Agreements will be paid in cash which will be funded by the Group's internal resources.

LETTER FROM THE BOARD

The Company is owned as to approximately 69.1% by CNACG, which in turn is a wholly-owned subsidiary of CNAH. Air China is also a wholly-owned subsidiary of CNAH. Since Air China is an associate of CNAH, which is an indirect controlling shareholder of the Company, the Acquisitions constitute connected transactions for the Company under the Listing Rules and require independent Shareholders' approval at the EGM. CNACG and its associates will abstain from voting in relation to the Acquisitions. The vote of the independent Shareholders at the EGM shall be taken by poll.

In addition, the Acquisitions in aggregate constitute discloseable transactions for the Company under the Listing Rules.

Fly Top also entered into the Hong Kong Agreement on 21 April, 2004 with CNACG in relation to the acquisition of approximately 16% of the issued share capital of LLSHK for a consideration of HK\$89 million. The Hong Kong Agreement was terminated by the parties on 26 April, 2004. Since the Company is owned as to approximately 69.1% by CNACG, the Hong Kong Transaction would have constituted a connected transaction for the Company under the Listing Rules.

The Independent Board Committee has been established to advise the independent Shareholders in relation to the Acquisitions. Kingsway Capital has been appointed as the independent financial adviser to advise the Independent Board Committee and the independent Shareholders in relation to the Acquisitions.

The purpose of this circular is to provide you with further information relating to the Acquisitions and to seek your approval of the resolutions set out in the notice of EGM. The recommendation of the Independent Board Committee to the independent Shareholders regarding the Acquisitions is set out on page 18 of this circular. A copy of the letter from Kingsway Capital to the Independent Board Committee and the independent Shareholders is set out on pages 19 to 30, which follows the letter from the Independent Board Committee in this circular.

THE ACQUISITION AGREEMENTS

The Beijing Acquisition

Principal Terms of the Beijing Contract

Date:	21 April, 2004, supplemented on 26 April, 2004
Purchaser:	Fly Top, a wholly-owned subsidiary of the Company
Vendor:	Air China
Assets to be acquired:	60% of the equity interest in BACL

LETTER FROM THE BOARD

Consideration and payment terms

The total consideration payable by Fly Top under the Beijing Contract is RMB294 million, to be paid in cash upon completion of the Beijing Acquisition. The consideration will be funded by the Group's internal resources.

The consideration for the Beijing Acquisition has been arrived at after arm's length negotiation between the parties taking into consideration the value and financial position of BACL and represents a price earnings multiple of approximately 10.6 times of the unaudited net profit of BACL for the year ended 31 December, 2002 after tax and after taking into account the effect of disposal of BACL's investment in the finance company to CNAH (as referred to in paragraph (d) of the section headed "Pre-Completion Undertakings under the Beijing Contract" below). The Company believes that it is not appropriate to determine the consideration based on the profit figures for the year 2003 because of the impact of the outbreak of SARS on the financial performance of companies in the aviation-related businesses.

Effective Date of the Beijing Contract

The Beijing Contract will only take effect upon completion of the following matters:

- (a) the PRC Ministry of Commerce having approved the Beijing Contract; and
- (b) the PRC State-owned Assets Supervision and Administration Commission or its local counterpart having confirmed the valuation of the 60% equity interest in BACL as prepared by a qualified state-owned asset valuer and having recorded the equity transfer.

If the PRC Ministry of Commerce approval is not obtained within 75 days after the date of the Beijing Contract (or such later date as the parties may agree), Fly Top has the right to terminate the Beijing Contract. As at the Latest Practicable Date, none of the above matters have been completed.

Pre-Completion Undertakings under the Beijing Contract

The parties agree that the following matters must be completed before completion of the Beijing Acquisition:

- (a) Fly Top having notified Air China in writing that it is satisfied with the due diligence investigation with respect to BACL;
- (b) the passing by the independent Shareholders in an extraordinary general meeting of the Company of an ordinary resolution approving the Beijing Acquisition in accordance with the requirements of the Listing Rules;
- (c) the receipt of a satisfactory legal opinion by a PRC law firm in relation to, inter alia, the establishment and operation of BACL and the approvals required for the Beijing Acquisition;

LETTER FROM THE BOARD

- (d) BACL having disposed of its investment in a finance company, being a company engaged in financing and investment activities and hence unrelated to the main business operated by BACL, to CNAH and having received the consideration for such a disposal; and
- (e) the China Securities Regulatory Commission having approved, or having indicated no objection to, the Beijing Contract and the Beijing Acquisition.

The Beijing Contract does not provide for a long stop date for completion of the above matters. At the Latest Practicable Date, none of the above matters have been completed.

Completion of the Beijing Acquisition

Completion of the Beijing Acquisition will take place 7 days after the latest of the occurrence or waiver of the following matters:

- (a) the Beijing Contract having become effective (as referred to in the section headed “Effective Date of the Beijing Contract” above) and all the pre-completion undertakings under the Beijing Contract having been satisfied (as referred to in the section headed “Pre-Completion Undertakings under the Beijing Contract” above); and
- (b) the Chengdu Contract having become effective (as referred to in the section headed “Effective Date of the Chengdu Contract” below) and all the pre-completion undertakings under the Chengdu Contract having been satisfied (as referred to in the section headed “Pre-Completion Undertakings under the Chengdu Contract” below).

The parties agree that completion of the Beijing Acquisition and the Chengdu Acquisition shall take place simultaneously.

Other Major Terms

In relation to the land currently used by BACL for its production facilities, Air China has undertaken under the Beijing Contract to complete, at its expense, the formal procedures for obtaining the land use rights with respect to the authorized operation of the land within 6 months of the date of the Beijing Contract (or such later time as the parties may agree), and to lease such land to BACL for a term of up to 30 April, 2023 at a rent to be calculated on the basis of the original costs for obtaining such land use rights once the land use rights certificate is obtained. Until such time, Air China has agreed that BACL may continue to use such land at nominal consideration. Such lease arrangement will constitute an ongoing connected transaction of the Company under the Listing Rules. The Company will ensure compliance with the Listing Rules in this regard. Further details of such arrangement will be set out in a further announcement to be made by the Company.

LETTER FROM THE BOARD

Air China has further agreed to complete, at its expense, the formal procedures for transferring the building ownership rights of part of the production facilities from Air China to BACL within 6 months of the date of the Beijing Contract (or such later time as the parties may agree). Such part of the production facilities relate to the production facilities agreed to be injected by Air China into BACL as part of its initial capital contribution when BACL was established. Please refer to the section headed "Information on BACL" below for information relating to the status of contribution by Air China into the registered capital of BACL.

The above matters will not affect the completion of the Beijing Acquisition.

Information on BACL

BACL was established as a sino-foreign joint venture in May 1988. BACL is now owned as to 60% by Air China and as to 40% by HKBACL. Upon completion of the Beijing Acquisition, BACL will become a wholly foreign owned enterprise in the PRC, which will be owned as to 60% by the Company and as to 40% by HKBACL. At present, the total investment of BACL is US\$20 million and the registered capital is US\$8 million. As at the Latest Practicable Date, there is no outstanding shareholder's loan owing from BACL to Air China. Based on the capital verification report for BACL, both Air China and HKBACL have contributed the registered capital of BACL in full. As at the date of completion of the Beijing Acquisition, Fly Top will not be subject to any commitment to make additional capital contribution into BACL.

BACL is principally engaged in the provision of inflight catering services and other related inflight food and beverage services, and the production of Chinese and western snacks and beverages. It is capable of handling 60,000 inflight meals per day.

The table below sets out the unaudited results of BACL for the two years ended 31 December, 2002 and 2003 and the unaudited net asset value of BACL as at 31 December, 2002 and 2003 which are based on the audited accounts of BACL for the years ended 31 December, 2002 and 2003 prepared in accordance with PRC Accounting Regulations, after making adjustments to comply with HKSSAP:

	Year ended 31 December,	
	2003	2002
	RMB'000	RMB'000
Unaudited profit before taxation	<u>26,438</u>	<u>67,599</u>
Unaudited profit after taxation	<u>18,612</u>	<u>47,616</u>

LETTER FROM THE BOARD

	As at 31 December,	
	2003	2002
	<i>RMB'000</i>	<i>RMB'000</i>
Unaudited net asset value	<u>133,926</u>	<u>151,074</u>

Upon completion of the Beijing Acquisition, BACL will become a subsidiary of the Company. Since the Company does not have unilateral control over BACL, the financial results and positions of BACL will be equity accounted for (i.e., not consolidated) in the consolidated accounts of the Company in accordance with HKSSAP.

There are currently 9 directors on the board of directors of BACL, of which 5 are nominated by Air China. Upon completion of the Beijing Acquisition, the Company will nominate 5 persons as directors of BACL in substitution of the existing directors nominated by Air China. Under the Articles of Association of BACL, other than certain material matters that require unanimous board approval, all other matters requiring board approval must be approved by at least two-thirds of the directors present at the board meeting.

For illustrative purpose only, the table below sets out the unaudited financial information of BACL for each of the two years ended 31 December, 2002 and 2003 which is based on the audited accounts of BACL for the years ended 31 December, 2002 and 2003 prepared in accordance with PRC Accounting Regulations, after making adjustments to comply with HKSSAP and to reflect the effect of disposal of BACL's investment in the finance company to CNAH (as referred to in paragraph (d) of the section headed "Pre-Completion Undertakings under the Beijing Contract" above) as if the disposal had been completed prior to the periods presented below:

	(For illustrative purpose only)	
	Year ended 31 December,	
	2003	2002
	<i>RMB'000</i>	<i>RMB'000</i>
Unaudited illustrative profit before taxation	<u>26,438</u>	<u>66,028</u>
Unaudited illustrative profit after taxation	<u>18,612</u>	<u>46,045</u>
	(For illustrative purpose only)	
	As at 31 December,	
	2003	2002
	<i>RMB'000</i>	<i>RMB'000</i>
Unaudited illustrative net asset value	<u>135,148</u>	<u>152,297</u>

LETTER FROM THE BOARD

The Chengdu Acquisition

Principal Terms of the Chengdu Contract

Date:	21 April, 2004, supplemented on 26 April, 2004
Purchaser:	Fly Top, a wholly-owned subsidiary of the Company
Vendor:	Air China
Assets to be acquired:	60% of the equity interest in SWACL

Consideration and payment terms

The total consideration payable by Fly Top under the Chengdu Contract is RMB67 million, to be paid in cash upon completion of the Chengdu Acquisition. The consideration will be funded by the Group's internal resources.

The consideration for the Chengdu Acquisition has been arrived at after arm's length negotiation between the parties taking into consideration the value and financial position of SWACL and represents a price earnings multiple of approximately 8.4 times of the unaudited net profit after tax of SWACL for the year ended 31 December, 2002.

Effective Date of the Chengdu Contract

The Chengdu Contract will only take effect upon completion of the following matters:

- (a) the PRC Ministry of Commerce having approved the Chengdu Contract;
- (b) the PRC State-owned Assets Supervision and Administration Commission or its local counterpart having confirmed the valuation of the 60% equity interest in SWACL as prepared by a qualified state-owned asset valuer and having recorded the equity transfer; and
- (c) the completion of all relevant registration showing Air China as the shareholder of SWACL.

If the PRC Ministry of Commerce approval is not obtained within 75 days after the date of the Chengdu Contract (or such later date as the parties may agree), Fly Top has the right to terminate the Chengdu Contract. As at the Latest Practicable Date, none of the above matters have been completed.

LETTER FROM THE BOARD

Pre-Completion Undertakings under the Chengdu Contract

The parties agree that the following matters must be completed before completion of the Chengdu Acquisition:

- (a) Fly Top having notified Air China in writing that it is satisfied with the due diligence investigation with respect to SWACL;
- (b) the passing by the independent Shareholders in an extraordinary general meeting of the Company of an ordinary resolution approving the Chengdu Acquisition in accordance with the requirements of the Listing Rules;
- (c) the receipt of a satisfactory legal opinion by a PRC legal adviser in relation to, inter alia, the establishment and operation of SWACL and the approvals required for the Chengdu Acquisition;
- (d) the China Securities Regulatory Commission having approved, or having indicated no objection to, the Chengdu Contract and the Chengdu Acquisition; and
- (e) SWACL having executed labour contracts directly with those employees who are presently being supplied by Air China to SWACL.

The Chengdu Contract does not provide for a long stop date for completion of the above matters. As at the Latest Practicable Date, none of the above matters have been completed.

Completion of the Chengdu Acquisition

Completion of the Chengdu Acquisition will take place simultaneously with the completion of the Beijing Acquisition. Please refer to the section headed "Completion of the Beijing Acquisition" for further details.

Other Major Terms

Air China has agreed, at its expense, to complete the formal procedures for transferring the land use rights of certain land and the building ownership rights of certain production facilities from Air China to SWACL within 6 months of the date of the Chengdu Contract (or such later time as the parties may agree). Such land and production facilities relate to land and production facilities agreed to be injected by Air China into SWACL as part of its initial capital contribution when SWACL was established. Please refer to the section headed "Information on SWACL" below for information relating to the status of contribution by Air China into the registered capital of SWACL.

The above matter will not affect the completion of the Chengdu Acquisition.

LETTER FROM THE BOARD

Information on SWACL

SWACL was established as a sino-foreign joint venture in July 1993. SWACL is now owned as to 75% by Air China and as to 25% by HKSACL. The Company understands that Air China has agreed to transfer 15% of the equity interest in SWACL to HKSACL, and the completion of such a transfer is pending approval from the relevant PRC authorities. Upon completion of the Chengdu Acquisition and the transfer of the abovementioned 15% equity interest in SWACL, SWACL will become a wholly foreign owned enterprise in the PRC, and will be owned as to 60% by the Company and as to 40% by HKSACL. At present, the total investment of SWACL is RMB30 million and the registered capital is RMB20 million. As at the Latest Practicable Date, there is no outstanding shareholder's loan owing from SWACL to Air China. Based on the capital verification report for SWACL, both Air China and HKSACL have contributed the registered capital of SWACL in full. As at the date of completion of the Chengdu Acquisition, Fly Top will not be subject to any commitment to make additional capital contribution into SWACL.

SWACL is principally engaged in the production of food, beverages and other inflight service products, the provision of other related services and the sale of its own products.

The table below sets out the unaudited results of SWACL for each of the two years ended 31 December, 2002 and 2003 and unaudited net asset value of SWACL as at 31 December, 2002 and 2003 which are based on the audited accounts of SWACL for the years ended 31 December, 2002 and 2003 prepared in accordance with PRC Accounting Regulations, after making adjustments to comply with HKSSAP:

	Year ended 31 December,	
	2003	2002
	<i>RMB'000</i>	<i>RMB'000</i>
Unaudited profit before taxation	<u>5,857</u>	<u>14,183</u>
Unaudited profit after taxation	<u>5,157</u>	<u>13,317</u>
	As at 31 December,	
	2003	2002
	<i>RMB'000</i>	<i>RMB'000</i>
Unaudited net asset value	<u>53,085</u>	<u>57,703</u>

Upon completion of the Chengdu Acquisition, SWACL will become a subsidiary of the Company. Since the Company does not have unilateral control over SWACL, the financial results and positions of SWACL will be equity accounted for (i.e., not consolidated) in the consolidated accounts of the Company in accordance with HKSSAP.

LETTER FROM THE BOARD

There are currently 5 directors on the board of directors of SWACL, of which 3 are nominated by Air China. Upon completion of the Chengdu Acquisition, the Company will nominate 3 persons as directors of SWACL in substitution of the existing directors nominated by Air China. Under the Articles of Association of SWACL, other than certain material matters that require unanimous board approval, all other matters requiring board approval must be approved by more than two-thirds of the directors present at the board meeting.

The Hong Kong Transaction

Principal Terms of the Hong Kong Agreement

Fly Top also entered into the Hong Kong Agreement with CNACG on 21 April 2004 in relation to the acquisition of approximately 16% of the issued share capital of LLSHK for a cash consideration of HK\$89 million. The consideration has been arrived at after arm's length negotiation between the parties taking into consideration the value and financial position of LLSHK.

Since the Company is owned as to approximately 69.1% by CNACG, the Hong Kong Transaction would have constituted a connected transaction for the Company under the Listing Rules.

Termination of the Hong Kong Agreement

The Hong Kong Agreement was terminated by the parties on 26 April, 2004. Under Rule 14A.56 of the Listing Rules, the Company would have been required to disclose the value of, and the financial information attributable to, LLSHK in the announcement issued by the Company on 26 April, 2004 and in this circular. However, as at the date of the announcement, the Company had not obtained the formal consents of LLSHK and its shareholders in relation to such disclosure. Since the Company could not fulfill the disclosure requirements under the Listing Rules, the parties agreed to terminate the Hong Kong Agreement as of 26 April, 2004. The Board understands that it is the intention of the parties that, once the relevant consents are obtained, the parties will seek to pursue the transaction again. The termination of the Hong Kong Agreement does not have any adverse consequential impact on the legal position or business of the Group.

Information on LLSHK

LLSHK is principally engaged in the provision of inflight catering services, laundry services and the operation of airport lounges and an airport restaurant.

The asset of approximately 16% of the issued share capital in LLSHK was initially acquired by CNACG in 1996 at a consideration of approximately HK\$101.8 million.

LETTER FROM THE BOARD

REASONS FOR AND BENEFITS OF THE ACQUISITIONS

The Directors believe that the Acquisitions are in line with the Group's long-term expansion strategy and will further enhance the Group's position as a major conglomerate in the Asia Pacific region for aviation and related businesses. The Acquisitions will diversify the Group's investment portfolio as well as to broaden its income base.

With the future expansion of the Beijing Capital International Airport and the Chengdu Shuangliu International Airport, as well as the coming 2008 Beijing Olympic Games, the demand for aviation-catering service is expected to increase in the next few years. The Directors are optimistic about the growth potential of these acquired companies.

The Group maintains prudent financial and risk management policies in pursuing its business development, and the Directors consider it is a good opportunity to utilize the Group's funds to acquire assets that offer long-term stable return and good growth potential.

Following the Acquisitions, the Group will become one of the biggest aviation-catering groups within mainland China. The efficiency of the aviation-catering companies being acquired will also be improved by future cooperation and sharing of more effective management techniques.

The Group, with its extensive experience in operating international flights and airport-related services for multi-national carriers, is well prepared for further expansion into major aviation hubs in mainland China and in the Asia Pacific region.

Upon completion of the Acquisitions, the financial results and positions of BACL and SWACL will be equity account for (i.e., not consolidated) in the consolidated accounts of the Company in accordance with HKSSAP. The Directors estimate that the net tangible asset value of the Group will decrease by approximately 10.4% due to goodwill arising from the Acquisitions. However, based on the proven track record and the growth potential of BACL and SWACL, the Directors believe the Acquisitions would immediately contribute to the earnings of the Group as well as to facilitate the long-term growth of the Group's businesses.

The Company does not have any present intention to acquire any further equity interests in BACL or SWACL.

INFORMATION ON THE GROUP

The Group is principally engaged in the provision of air transportation services through Dragonair and Air Macau, airport ground handling services and logistic services. For the two years ended 31 December, 2002 and 2003, the Group recorded an audited profit attributable to Shareholders of approximately HK\$317,417,000 and an audited loss attributable to Shareholders of approximately HK\$18,747,000, respectively. The audited net asset value of the Group as at 31 December, 2003 was approximately HK\$2,642,331,000.

LETTER FROM THE BOARD

INFORMATION ON AIR CHINA

Air China is principally engaged in the provision of air transportation services and investment in aviation-related businesses. Air China is the flag carrier of the PRC and has a fleet size of over 130 aircraft, of which about 40 are wide-body aircraft.

RELATIONSHIP WITH AIR CHINA AND CONNECTED TRANSACTIONS

The Company is owned as to approximately 69.1% by CNACG, which in turn is a wholly-owned subsidiary of CNAH. Air China is also a wholly-owned subsidiary of CNAH. Since Air China is an associate of CNAH, which is an indirect controlling shareholder of the Company, the Acquisitions constitute connected transactions for the Company under the Listing Rules and require independent Shareholders' approval at the EGM. The vote of the independent Shareholders at the EGM shall be taken by poll. CNACG and its associates will abstain from voting in relation to the Acquisitions.

CONTINUING CONNECTED TRANSACTIONS

Upon completion of the Beijing Acquisition and the Chengdu Acquisition, certain transactions entered into between each of BACL and SWACL and connected persons of the Company will constitute continuing connected transactions for the Company under the Listing Rules. It is expected that some of the transactions will be subject to reporting, announcement and independent Shareholders' approval requirements under the Listing Rules. Under the Listing Rules, in respect of each such connected transaction, the parties must enter into a written agreement setting out the basis of the calculation of the payments to be made and the period of the agreement. Since BACL and SWACL would need more time to discuss and enter into agreements which fulfill the requirements of the Listing Rules, the Company is at this stage not in a position to include information relating to such transactions in this circular. A further announcement in respect of such transactions will be made separately prior to completion of the Beijing Acquisition and the Chengdu Acquisition. The Company will ensure compliance with the Listing Rules in respect of continuing connected transactions.

EGM

There is set out on pages 37 to 38 a notice convening the EGM to be held at Salon 5 (Level 3), JW Marriott Hong Kong, Pacific Place, 88 Queensway, Hong Kong at 4:00 p.m. on Monday, 31 May, 2004 or immediately after its annual general meeting to be held at 3:00 p.m. of the same date, at which resolutions will be proposed to the independent Shareholders to approve the Acquisitions. The vote of the independent Shareholders at the EGM shall be taken by poll.

In accordance with the Listing Rules, CNACG which holds approximately 69.1% of the entire issued share capital of the Company as at the Latest Practical Date and which controls the voting right in respect of all such shares in the Company, will abstain from voting on the resolutions to approve the Acquisitions at the EGM.

LETTER FROM THE BOARD

A form of proxy for use at the EGM is enclosed. Whether or not you are able to attend the EGM in person, you are requested to complete and return the form of proxy in accordance with the instructions printed thereon as soon as possible but in any event not later than 48 hours before the time appointed for the holding of the EGM. Completion and return of the form of proxy will not preclude you from attending and voting at the EGM.

RECOMMENDATIONS

Kingsway Capital has been appointed as the independent financial adviser to advise the Independent Board Committee and the independent Shareholders in respect of the Acquisitions. Kingsway Capital considers that the terms of the Acquisitions on the whole are fair and reasonable so far as the independent Shareholders are concerned and the Acquisitions are in the interests of the Company and the Shareholders as a whole. The text of the letter from Kingsway Capital containing its recommendation to the Independent Board Committee and the independent Shareholders in relation to the Acquisitions and the principal factors and reasons considered by Kingsway Capital in arriving at its recommendation is set out on pages 19 to 30 of this circular.

The Independent Board Committee, having taken into account the advice of Kingsway Capital, considers that the terms of the Acquisitions on the whole are fair and reasonable so far as the independent Shareholders are concerned and the Acquisitions are in the interests of the Company and the Shareholders as a whole. Accordingly, the Independent Board Committee recommends the independent Shareholders to vote in favour of the resolutions to be proposed at the EGM to approve the Acquisitions. The text of the letter from the Independent Board Committee is set out on page 18 of this circular.

The Directors believe that the terms of the Acquisitions on the whole are fair and reasonable and the Acquisitions are in the interests of the Company and the Shareholders as a whole. Accordingly, the Directors recommend the Shareholders to vote in favour of the resolutions to be proposed at the EGM to approve the Acquisitions.

ADDITIONAL INFORMATION

Your attention is also drawn to the information set out in the appendices to this circular.

Yours faithfully,
For and on behalf of the Board
Kong Dong
Chairman



中航興業有限公司

CHINA NATIONAL AVIATION COMPANY LIMITED

(incorporated in Hong Kong with limited liability)

(Stock Code: 1110)

15 May, 2004

Dear independent Shareholders,

ACQUISITION OF BACL AND SWACL

We refer to the circular issued by the Company on 15 May, 2004, of which this letter forms a part. Terms defined in this circular shall have the same meanings when used herein.

We have been appointed by the Board as the Independent Board Committee, established to consider the Acquisitions, and to advise you as to whether the terms of the Acquisitions are fair and reasonable and whether the Acquisitions are in the interests of the Company and the Shareholders as a whole.

Kingsway Capital has been appointed as the independent financial adviser to advise us and the independent Shareholders regarding the Acquisitions. Details of the advice of Kingsway Capital, together with the principal factors and reasons taken into consideration in arriving at such advice, are set out in its letter. Your attention is also drawn to the letter from the Board and the additional information set out in the appendices to this circular.

The Independent Board Committee considers that the terms of the Acquisitions on the whole are fair and reasonable so far as the independent Shareholders are concerned and the Acquisitions are in the interests of the Company and the Shareholders as a whole and has been so advised by Kingsway Capital, the independent financial adviser. The Independent Board Committee recommends you to vote in favour of the resolutions to approve the Acquisitions. You are therefore strongly urged to complete your proxy form and vote in favour of the Acquisitions.

Yours faithfully,

For and on behalf of the Independent Board Committee

Lok Kung Nam

Independent Non-Executive Director

LETTER FROM KINGSWAY CAPITAL

The following is the full text of the letter of advice to the Independent Board Committee and the independent Shareholders from Kingsway Capital dated 15 May, 2004 prepared for incorporation in this circular.



Kingsway Capital Limited
5/F, Hutchison House,
10 Harcourt Road, Central, Hong Kong

15 May, 2004

The Independent Board Committee and
the independent Shareholders
China National Aviation Company Limited
5/F CNAC House
12 Tung Fai Road
Hong Kong International Airport
Lantau, Hong Kong

Dear Sirs,

**DISCLOSEABLE AND CONNECTED TRANSACTIONS:
PROPOSED ACQUISITION OF A 60% EQUITY INTEREST IN EACH OF BACL
AND SWACL FROM AIR CHINA**

INTRODUCTION

We refer to our engagement as the independent financial adviser to advise the Independent Board Committee and the independent Shareholders as to whether or not the terms of the proposed acquisitions by the Company of a 60% equity interest in each of BACL and SWACL ("Target Companies") are fair and reasonable so far as the independent Shareholders are concerned, and whether or not the Acquisitions are in the interests of the Company and the Shareholders as a whole. Details of the Acquisitions are set out in the circular of the Company dated 15 May, 2004 ("Circular"), of which this letter forms part. Terms used in this letter shall have the same meanings as defined in the Circular unless the context requires otherwise.

Given that Air China is regarded as a connected person of the Company within the meanings of the Listing Rules as described in the "Letter from the Board", the Acquisitions constitute connected transactions for the Company under the Listing Rules, which will be subject to, inter alia, the independent Shareholders' approval at the EGM. In addition, the Acquisitions in aggregate constitute discloseable transactions for the Company under the Listing Rules.

The Independent Board Committee, comprising all the independent non-executive Directors, namely, Mr. Lok Kung Nam, Dr. Hu Hung Lick, Henry, Mr. Ho Tsu Kwok, Charles and Mr. Li Kwok Heem, John has been constituted to make a recommendation to

LETTER FROM KINGSWAY CAPITAL

the independent Shareholders as regards the Acquisitions. We have been appointed as the independent financial adviser to advise the Independent Board Committee and the independent Shareholders in this regard.

In formulating our opinion with regard to the Acquisitions, we have relied on the information supplied, representation made and opinion expressed by the Company and the Directors. We have assumed that all such information and representations and those contained or referred to in the Circular were true, accurate and complete at the time they were made and continue to be so at the date of this letter. We have also assumed that all statements of belief, opinion and intention made by the Directors as set out in the Circular were reasonably made after due and careful enquiry. We have been advised by the Company that no material facts have been omitted and we are not aware of any facts or circumstances which would render the information provided and representations made to us untrue, inaccurate or misleading in every material respect. We have no reason to doubt the truth, accuracy and completeness of the information and representations provided to us by the Company and the Directors. The Directors have collectively and individually accepted full responsibility for the accuracy of the information contained in the Circular and have confirmed, having made all reasonable enquires, that to the best of their knowledge and belief, there are no other facts the omission of which would make any statement in the Circular misleading.

We consider that we have reviewed sufficient information to reach an informed view in order to provide a reasonable basis for our advice. We have not, however, carried out any independent verification of the information provided by the Company and the Directors, nor have we conducted any independent in-depth investigation into the business affairs of the Company, the Target Companies or any of their respective subsidiaries and associated companies.

PRINCIPAL FACTORS AND REASONS CONSIDERED

In considering whether the terms of the Acquisitions are fair and reasonable and whether the Acquisitions are in the interest of the Company and the Shareholders as a whole, we have taken into consideration the principal factors and reasons set out below. Our views are based on the results of all analysis taken as a whole.

(1) Overview

As stated in the announcement dated 26 April, 2004, on 21 April, 2004, Fly Top, a wholly-owned subsidiary of the Company, entered into the Acquisition Agreements which were supplemented on 26 April, 2004 pursuant to which Fly Top has conditionally agreed to acquire from Air China a 60% equity interest in both BACL and SWACL for a consideration of RMB294 million (equivalent to approximately HK\$277.4 million) and RMB67 million (equivalent to approximately HK\$63.2 million) respectively. Completion of the Acquisitions are subject to the occurrence of certain matters and the satisfaction of certain pre-completion undertakings, further details of which are set out in the sections headed "The Beijing Acquisition" and "The Chengdu Acquisition" in the "Letter from the Board" of this circular.

LETTER FROM KINGSWAY CAPITAL

(2) Assets to be acquired under the Acquisition Agreements

(i) BACL

BACL was established as a sino-foreign joint venture in May 1988. BACL is now owned as to 60% by Air China and as to 40% by HKBACL. Upon completion of the Beijing Acquisition, BACL will be owned as to 60% by the Company and as to 40% by HKBACL, and will become a wholly foreign owned enterprise in the PRC.

BACL is the largest aircraft caterer in Beijing Capital International Airport, and principally engaged in the provision of inflight catering services and other related inflight food and beverages services, and the production of Chinese and western snacks and beverages. As set out in the section headed "Information of BACL" in the "Letter from the Board" of this circular. BACL is capable of handling 60,000 inflight meals per day.

Set out below is the top ten busiest airports in the PRC (excluding airports in Hong Kong and Macau) in terms of passenger traffic for each of the two years ended 31 December, 2002 and 2003.

2002			2003		
Rank	Airport	Total Passengers	Rank	Airport	Total Passengers
1	Beijing Capital International Airport	27,159,665	1	Beijing Capital International Airport	24,283,818
2	Guangzhou Baiyun International Airport	16,014,411	2	Shanghai Pudong International Airport	15,063,622
3	Shanghai Hong Qiao International Airport	13,667,094	3	Guangzhou Baiyun International Airport	15,012,696
4	Shanghai Pudong International Airport	11,047,695	4	Shenzhen Huangtian International Airport	10,842,652
5	Shenzhen Huangtian International Airport	9,352,662	5	Shanghai Hong Qiao International Airport	9,692,386
6	Chengdu Shuangliu International Airport	7,548,680	6	Chengdu Shuangliu International Airport	8,196,742
7	Kunming – Wujiaaba International Airport	7,087,156	7	Kunming – Wujiaaba International Airport	7,432,596
8	Haikou Meilan Airport	5,600,511	8	Haikou Meilan Airport	6,029,249
9	Xi'an – Xianyang International Airport	4,433,604	9	Xi'an – Xianyang International Airport	4,397,991
10	Xiamen – Gaoqi International Airport	4,258,635	10	Hangzhou Xiao Shan Airport	4,352,301

Source: CAAC

LETTER FROM KINGSWAY CAPITAL

As illustrated above, Beijing Capital International Airport is the busiest airport in the PRC (excluding airports in Hong Kong and Macau) in terms of passenger traffic for the years 2002 and 2003. In March 2004, the expansion plan of Beijing Capital International Airport was approved by the State Development and Restructuring Commission. According to the expansion plan, the annual passenger capacity of Beijing Capital International Airport will increase from 35 million to 60 million after the completion of the expansion plan in year 2007. Having considered the expansion plan of Beijing Capital International Airport and the coming 2008 Beijing Olympic Games, we concur with the Directors' view on the rising demand for airline catering services in Beijing Capital International Airport and the growth potential of BACL in the next few years.

The table below sets out the total number of inflight meals handled by BACL and certain unaudited financial information of BACL for the two years ended 31 December, 2002 and 2003:

	Year ended	
	31 December,	
	2003	2002
Total number of inflight meals handled by BACL	9,138,999	10,880,508
	<i>RMB'000</i>	<i>RMB'000</i>
Unaudited turnover (<i>Note</i>)	264,152	322,512
Unaudited profit before taxation (<i>Note</i>)	26,438	66,028
Unaudited profit after taxation (<i>Note</i>)	18,612	46,045
	As at 31 December,	
	2003	2002
	<i>RMB'000</i>	<i>RMB'000</i>
Unaudited net asset value (<i>Note</i>)	135,148	152,297

Note: Based on the audited accounts of BACL for the years ended 31 December, 2002 and 2003 prepared in accordance with PRC Accounting Regulations, after making adjustments to comply with HKSSAP and to reflect the effect of disposal of BACL's investment in the finance company to CNAH as if the disposal had been completed prior to the periods presented above.

As advised by the Company, the significant decrease of net profit of BACL for year 2003 was mainly attributable to the negative impact of the outbreak of SARS which adversely affected the passenger traffic of Beijing Capital International Airport, which in turn reduced the demand for airline catering services. According to the information provided by the Company, we note that the number of inflight meals handled by BACL had returned by September 2003 to normal and reached the pre-SARS level.

LETTER FROM KINGSWAY CAPITAL

Currently, there are 9 directors on the board of directors of BACL, of which 5 are nominated by Air China. Upon completion of the Beijing Acquisition, the Company will nominate 5 persons as directors of BACL in substitution of the existing directors nominated by Air China. Under the Articles of Association of BACL, other than certain material matters that require unanimous board approval, all other matters requiring board approval must be approved by at least two-thirds of the directors present at the board meeting. Although the Company will not have control of BACL under the above arrangement, the Company will nominate 5 persons as directors of BACL, and therefore the Company will have significant representation in the management of BACL and the interest of the Company in BACL will be protected through the aforesaid arrangement.

(ii) *SWACL*

SWACL was established as a sino-foreign joint venture in July 1993. SWACL is now owned as to 75% by Air China and as to 25% by HKSACL. The Company understands that Air China has agreed to transfer a 15% equity interest in SWACL to HKSACL, and the completion of such a transfer is pending approval from the relevant PRC authorities. Upon completion of the Chengdu Acquisition and the 15% equity transfer, SWACL will be owned as to 60% by the Company and as to 40% by HKSACL, and will become a wholly foreign owned enterprise in the PRC.

SWACL is the largest aircraft caterer in Chengdu Shuangliu International Airport, and principally engaged in the production of food, beverages and inflight services products, the provision of other related services and the sale of its own products. As informed by the Company, SWACL currently handles around 10,000 inflight meals per day, which is over the intended production capacity of its existing production facilities. Therefore, SWACL started to construct a new inflight meals production building in year 2003. After the new inflight meals production building has commenced its operation in May 2004, SWACL will be capable of handling 30,000 inflight meals per day.

According to the statistics issued by CAAC, Chengdu Shuangliu International Airport is the sixth busiest airport in the PRC (excluding airports in Hong Kong and Macau) in terms of passenger traffic for the years 2002 and 2003. The passenger traffic of Chengdu Shuangliu International Airport increased by approximately 8.6% from 7,548,680 in year 2002 to 8,196,742 in year 2003 despite the negative impact of the outbreak of SARS on the aviation-related industries in the PRC in general.

Currently, the annual passenger capacity of Chengdu Shuangliu International Airport is around 12 million. As advised by the Company, Chengdu Shuangliu International Airport has implemented a series of expansion plans of its passenger terminal and has applied for the requisite approvals from relevant government authority in the PRC for the construction of the second runway in 2008. It is expected that the annual passenger capacity of Chengdu Shuangliu International Airport will be further increased after the completion of the aforesaid expansion plans and the construction of the second runway.

LETTER FROM KINGSWAY CAPITAL

According to CAAC, the PRC aviation industry is expected to grow at the rate of 10% annually until year 2010. Taking into account that (1) the central government of the PRC has been implementing the western growth policy to spur development in western part of the PRC; and (2) Chengdu Shuangliu International Airport is the busiest airport in western part of the PRC in terms of passenger traffic, we concur with the Directors' view on the growth potential of passenger traffic of Chengdu Shuangliu International Airport and its rising demand for airline catering services.

The table below sets out the total number of inflight meals handled by SWACL and certain unaudited financial information of SWACL for the two years ended 31 December, 2002 and 2003:

	Year ended	
	31 December,	
	2003	2002
Total number of inflight meals handled by SWACL	3,107,387	3,254,684
	<i>RMB'000</i>	<i>RMB'000</i>
Unaudited turnover (<i>Note</i>)	63,847	67,338
Unaudited profits before taxation (<i>Note</i>)	5,857	14,183
Unaudited profits after taxation (<i>Note</i>)	5,157	13,317
	As at 31 December,	
	2003	
	<i>RMB'000</i>	<i>RMB'000</i>
Unaudited net asset value (<i>Note</i>)	53,085	57,703

Note: Based on the audited accounts of SWACL for the years ended 31 December, 2002 and 2003 prepared in accordance with PRC Accounting Regulations, after making adjustments to comply with HKSSAP.

We understand from the Directors that the decrease in the net profit of SWACL for the year 2003 was principally attributable to (1) the decrease of turnover and gross profit in airline catering services as a result of the outbreak of SARS; (2) the increase in other selling and administration expense of approximately RMB4.1 million which mainly related to increased marketing efforts and business development costs following the end of SARS outbreak; and (3) the construction of the new inflight meals production building in 2003 which incurred the finance costs of approximately RMB1.1 million. According to information provided by the Company, we note that the number of inflight meals handled by SWACL had returned by August 2003 to normal and reached the pre-SARS level. Further, the Directors consider that the commencement of operation of the new inflight meals production building of SWACL in May 2004 will strengthen the production capacity of SWACL and enable SWACL

LETTER FROM KINGSWAY CAPITAL

to capitalise on the increasing business expected to be bought about by the expansion of the Chengdu Shuangliu International Airport in future.

Independent Shareholders should note that SWACL recorded a net current liabilities of approximately RMB65.8 million as at 31 December, 2003. The Directors advised that the net current liabilities was principally attributable to a short term bank loan of RMB76.1 million (“Loan”) which was mainly used for the construction of the new inflight meals production building. As advised by the Directors, they currently do not foresee any refinancing problems for SWACL. However, in the event that SWACL is unable to refinance the Loan from the relevant bank as and when it becomes due, it is expected that the Company and the other shareholder of SWACL will provide refinancing in proportion to their respective shareholding in SWACL for the repayment of the Loan. We consider that such possibility exists and given that the Loan is principally to finance the expansion of production capacity of SWACL which is to the benefit of SWACL in the long run, we concur with the Directors’ view that the provision of refinancing by the Company (and the other shareholder of SWACL) to SWACL, if materialized, is fair and reasonable and in the interest of the Company.

Currently, there are 5 directors on the board of directors of SWACL, of which 3 are nominated by Air China. Upon completion of the Chengdu Acquisition, the Company will nominate 3 persons as directors of SWACL in substitution of the existing directors nominated by Air China. Under the Articles of Association of SWACL, other than certain material matters that require unanimous board approval, all other matters requiring board approval must be approved by more than two-thirds of the directors present at the board meeting. Although the Company will not have control of the SWACL under the above arrangement, the Company will nominate 3 persons as directors of SWACL, and therefore the Company will have significant representation in the management of SWACL and the interest of the Company in the SWACL will be protected through the aforesaid arrangement.

(3) Reasons for the Acquisitions

The Group is principally engaged in the provision of air transportation services through Dragonair and Air Macau, airport ground handling services and logistics services.

We note from the 2003 annual report of the Company that it was the intention of the Company to actively seek for valued investments and joint venture opportunities in aviation related businesses in the PRC. As advised by the Directors, the Group will become one of the biggest aviation-catering groups within the PRC after completion of the Acquisitions. As set out in the section headed “Reasons for and Benefits of the Acquisitions” in the “Letter from the Board” of this circular, the Directors consider that (1) the Acquisitions are in line with the Group’s long-term expansion strategy; (2) the Acquisitions will further enhance the Group’s position as a major aviation conglomerate in the Asia Pacific region; (3) the Acquisitions will diversify the Group’s investment portfolio as well as to broaden the income base; and (4) the Acquisitions represent excellent opportunities for the Group to utilize its fund to acquire assets that offer long-term stable return and with good growth potential.

LETTER FROM KINGSWAY CAPITAL

On the basis of the above, in particular, (1) the profitable track record of the Target Companies; (2) the ranking of Beijing Capital International Airport and Chengdu Shuangliu International Airport among the top ten busiest airports in the PRC; and (3) the business prospects of the Target Companies in light of future growth rate of the PRC aviation industry and further expansion of Beijing Capital International Airport and Chengdu Shuangliu International Airport, we are of the view that the Acquisitions are in line with the Group's principal businesses and concur with the Directors' view that the Acquisitions will further enhance the Group's position as a major aviation conglomerate in the Asia Pacific region, and ultimately create value for Shareholders.

(4) Consideration and valuation

The Group has conditionally agreed to acquire from Air China a 60% equity interest in both BACL and SWACL for a consideration of RMB294 million (equivalent to approximately HK\$277.4 million) and RMB67 million (equivalent to approximately HK\$63.2 million) respectively ("Consideration").

The Directors advised us that the Consideration has been arrived at after arm's length negotiations between the parties taking into consideration the prospects and financial position of the Target Companies, in particular, the profit figures of the Target Companies for the year 2002. The Directors consider that it is not appropriate to determine the Consideration based on the profit figures for the year 2003 because of the impact of the outbreak of SARS on the financial performance of the Target Companies.

In assessing the reasonableness of the Consideration, we have made reference to the price-earning multiples ("P/E Multiples") of comparables in the Asia Pacific region whose principal business is similar to that of the Target Companies. We have identified two listed companies, namely Singapore Airport Terminal Services Limited and Macroasia Corporation ("Comparable Companies") as similar comparable. We are not aware of any direct or close comparable companies listed in Hong Kong which have similar businesses as those of the Target Companies. Set out below are the P/E Multiples of the Target Companies and the Comparable Companies based on their respective market price as at the Latest Practicable Date (in case of the Comparable Companies) and their latest publicly available financial information. The financial information applied in calculating the P/E Multiples of the Target Companies was derived from the audited accounts of the Target Companies for the year ended 31 December, 2002 prepared in accordance with PRC Accounting Regulations, after making adjustments to comply with HKSSAP and in the case of BACL, to reflect the effect of disposal of BACL's investment in the finance company to CNAH as if the disposal had been completed prior to 1 January, 2002.

LETTER FROM KINGSWAY CAPITAL

Company	Country	Market capitalization as at the Latest Practicable Date <i>(HK\$ million)</i>	P/E Multiples (X)
Singapore Airport Terminal Services Limited	Singapore	9,417.4	9.6 <i>(Note 1)</i>
Macroasia Corporation	The Philippines	87.2	8.3 <i>(Note 2)</i>
BACL			10.6 <i>(Note 3)</i>
SWACL			8.4 <i>(Note 4)</i>

Sources: Bloomberg

Notes:

1. Based on the earning per share of Singapore Airport Terminal Services Limited during the year ended 31 March, 2003 and based on its market price as at the Latest Practicable Date
2. Based on the earning per share of Macroasia Corporation during the year ended 31 December, 2003 and based on its market price as at the Latest Practicable Date
3. Based on the net profit of BACL for the year ended 31 December, 2002 and the consideration for the Beijing Acquisition
4. Based on the net profit of SWACL for the year ended 31 December, 2002 and the consideration for the Chengdu Acquisition

In assessing the reasonableness of the Consideration, we have compared the P/E Multiples of the Target Companies based on their 2002 profit figures (“2002 Multiples”) and the P/E Multiples of the Comparable Companies based on their respective net profit for the year ended 31 March, 2003 (in the case of Singapore Airport Terminal Services Limited) and 31 December, 2003 (in the case of Macroasia Corporation), on the basis that the 2003 profit of the Target Companies were adversely affected by the SARS outbreak and that the 2003 profit of SWACL was also adversely affected by the construction of the new inflight meals production building which has yet to bring in any economic benefit.

As illustrated above, the 2002 Multiples of BACL implied under the Consideration is slightly above the range of the P/E Multiples of the Comparable Companies. Taking into account the growth potential of BACL arising from the further expansion of Beijing Capital International Airport and the coming 2008 Beijing Olympic Games, we consider that the consideration for the Beijing Acquisition is acceptable, although the 2002 Multiples of BACL is slightly above the range of the P/E Multiples of the Comparable Companies. In respect with SWACL, the 2002 Multiples of SWACL implied under the Consideration is within the range of the P/E Multiples of the Comparable Companies.

LETTER FROM KINGSWAY CAPITAL

Having regard to the above P/E Multiples analysis on the Comparable Companies, we consider the Consideration to be fair and reasonable so far as the Company and the independent Shareholders are concerned.

For information of the Shareholders, the P/E Multiples of Macroasia Corporation is approximately 250 times (based on the earning per share of Macroasia Corporation during the year ended 31 December, 2002 and its market price as at the Latest Practicable Date).

(5) Other major terms of the Beijing Contract

In relation to the land currently used by BACL for its production facilities, Air China has undertaken under the Beijing Contract to complete, at its expense, the formal procedures for obtaining the land use rights with respect to the authorized operation of the land within 6 months of the date of the Beijing Contract (or such later time as the parties may agree), and to lease such land to BACL for a term of up to 30 April, 2023 at a rent to be calculated on the basis of the original costs for obtaining such land use rights once the land use rights certificate is obtained. Until such time, Air China has agreed that BACL may continue to use such land at nominal consideration. Such lease arrangement will constitute an ongoing connected transaction of the Company under the Listing Rules.

(6) Estimated financial effects of the Acquisitions on the Group

(i) Earnings

Upon completion of the Acquisitions, each of the Target Companies will become a subsidiary of the Company. Since the Company does not have unilateral control over the Target Companies, the financial results and positions of the Target Companies will be equity accounted for (i.e., not consolidated) in the consolidated accounts of the Company in accordance with HKSSAP.

The Directors advised that the amount of goodwill ("Goodwill") arising from the Acquisitions is estimated to be approximately RMB258.7 million (equivalent to approximately HK\$244 million) based on the unaudited illustrative net asset value of BACL and unaudited net asset value of SWACL as at 31 December, 2003 as if the Acquisitions had been completed on 31 December, 2003. We understand that, according to the current accounting policy of the Group, the Goodwill will be amortized on a straight-line basis over the remaining years of the venture period granted to the Target Companies. According to the Beijing Contract and the Chengdu Contract, the corresponding venture period granted to BACL and SWACL will expire in April 2023 and July 2013 respectively. Based on the aforesaid accounting treatment, the amount of goodwill arising from the Beijing Acquisition and the Chengdu Acquisition will be amortised over a period of 19 years and 9 years respectively. Approximately HK\$14.9 million will be charged to the profit and loss account of the Group on an annual basis after the completion of the Acquisitions.

LETTER FROM KINGSWAY CAPITAL

Based on the profitable track record and growth potential of the Target Companies, the Directors are of the view that the Acquisitions will have a positive effect on the earnings base of the Group taking into account the effect of amortisation of the Goodwill. We consider such enhancement on the earnings base of the Group to be in the interest of the Company and the Shareholders as a whole.

(ii) Net tangible asset value

As at 31 December, 2003, the audited consolidated net tangible asset value of the Group amounted to approximately HK\$2,336.1 million. Upon the completion of the Acquisitions, the illustrative net tangible asset value of the Group will decrease by approximately 10.4% to approximately HK\$2,092.1 million. The reduction of HK\$244 million in the net tangible asset value of the Group is due to the Goodwill arising from the Acquisitions.

Although the Acquisitions will reduce the net tangible asset value of the Group after the Acquisitions, we consider that the earning potential of the Target Companies is a core factor in considering the fairness and reasonableness of the Consideration given the business nature of the Target Companies. On the basis of the above and the benefits arising from the Acquisitions as set out in the section headed "Reasons for and Benefits of the Acquisition" in the "Letter from the Board" of this circular, we consider that such reduction in net tangible asset value of the Group is acceptable.

(iii) Working capital

As set out in the "Letter from the Board", the Consideration of approximately RMB361 million (equivalent to approximately HK\$340.6 million) will be paid in cash which will be funded by the Group's internal resources. As mentioned earlier, in the event that SWACL is unable to refinance the Loan from the relevant bank as and when it becomes due, it is expected that the Company and the other shareholder of SWACL will provide refinancing in proportion to their respective shareholding in SWACL for the repayment of the Loan. The Directors consider that there will not be any significant negative impact on the working capital of the Group. Save for the above, upon completion of the Acquisitions, Fly Top will not be subject to any commitment to make additional capital contribution into the Target Companies.

Based on the audited consolidated balance sheet of the Group as at 31 December, 2003, the Group has cash and bank balances of a total amount of approximately HK\$1,063 million and net current assets of approximately HK\$850 million. The Group had no outstanding borrowings as at 31 December, 2003.

As stated in the 2003 annual report of the Company, all of the Group's aviation related businesses are expected to resume normal operations in 2004. As advised by the Company, it is expected that the Group will generate positive cash flow from its operating activities in year 2004, compared with a net cash outflow from operating activities in year 2003 due to the outbreak of SARS.

LETTER FROM KINGSWAY CAPITAL

Given that (1) the Consideration only represents approximately 32% of the Group's cash and bank balances; and (2) the Group is expected to generate positive net cash inflow from its operating activities in year 2004, we concur with the Directors' view that the Acquisitions will not have significant negative impact on the working capital of the Group. Given the above and that the Loan amounted to approximately RMB76.1 million, representing 6.8% of the Group's cash and bank balances only, and the Group will be interested in approximately 60% in SWACL after the Chengdu Acquisition, we concur with the Directors' view that the possible refinancing provided by the Group to SWACL will not have significant negative impact on the working capital of the Group.

RECOMMENDATION

Having considered the principal factors and reasons discussed above, we are of the opinion that the terms of the Acquisitions as mentioned in the "Letter from the Board", on the whole, are fair and reasonable so far as the independent Shareholders are concerned and the Acquisitions are in the interest of the Company and the Shareholders as a whole. Accordingly, we advise the Independent Board Committee and the independent Shareholders that the independent Shareholders should vote in favour of the ordinary resolutions to approve the Acquisitions, as detailed in the notice of the EGM set out at the end of this circular.

Yours faithfully,
For and on behalf of
Kingsway Capital Limited
Chu Tat Hoi
Director

RESPONSIBILITY STATEMENT

This circular includes particulars given in compliance with the Listing Rules for the purposes of giving information with regard to the Company. The Directors collectively and individually accept full responsibility for the accuracy of the information contained in this circular and confirm, having made all reasonable enquiries, that to the best of their knowledge and belief there are no other facts, the omission of which would make any statement herein misleading.

DISCLOSURE OF INTERESTS

- (a) Apart from the interests of the Directors in the share options of the Company which are separately disclosed in (b) below, as at the Latest Practicable Date, none of the directors and the chief executive of the Company had any interests and short positions in the shares, underlying shares and debentures of the Company or any of its associated corporation (within the meaning of Part XV of the SFO) which are required to be notified to the Company and the Stock Exchange pursuant to Divisions 7 and 8 of Part XV of the SFO (including interests and short positions which he is taken or deemed to have under such provisions of the SFO); or are required pursuant to section 352 of the SFO to be entered in the register referred to therein; or as otherwise notified to the Company and the Stock Exchange pursuant to the Model Code for Securities Transaction by Directors of Listed Companies (together the "Discloseable Interest").
- (b) As at the Latest Practicable Date, the Directors had personal interests in share options granted under the Company's employee share option scheme as follows:

Directors	Number of share options	Exercise period	Exercise price HK\$
Chuang Shih Ping	33,126,000	26 October, 2003 to 25 October, 2009	1.14
Zhang Xianlin	33,126,000	26 October, 2003 to 25 October, 2009	1.14
Tsang Hing Kwong, Thomas	33,126,000	26 October, 2003 to 25 October, 2009	1.14
Gu Tiefei	5,000,000	26 October, 2003 to 25 October, 2009	1.14

Save as disclosed in (a) and (b) above, as at the Latest Practicable Date, none of the Directors had any Discloseable Interest.

- (c) There is no contract or arrangement subsisting at the date of this circular in which any of the Directors is materially interested and which is significant in relation to the business of the Group.
- (d) As at the Latest Practicable Date, none of the Directors and the expert whose name is referred to in the paragraph headed "Consent" in this appendix has or has had any interest, direct or indirect, in any assets which have been, since 31 December, 2003, being the date to which the latest published audited account of the Group were made up, acquired or disposed of by or leased to any member of the Group, or are proposed to be acquired or disposed of by or leased to any member of the Group.
- (e) None of the Directors has a service contract with any member of the Group which is not determinable within one year without payment of compensation (other than statutory compensation).
- (f) Save for the fact that the fellow subsidiaries of Kingsway Capital own in aggregate less than approximately 1% of the entire issued share capital of the Company, Kingsway Capital, the expert whose name is referred to in the paragraph headed "Consent" in this appendix does not have any shareholding in any member of the Group or the right (whether legally enforceable or not) to subscribe for or to nominate persons to subscribe for securities in any member of the Group.

DIRECTORS' INTEREST IN COMPETING BUSINESS

Mr. Kong Dong, an executive Director and Chairman of the Company, is the Deputy General Manager of CNAH, which is the ultimate holding company of the Company and Air China. Both CNAH and Air China are state-owned enterprises established in the PRC. Air China is engaged in the provision of air transportation services and investment in aviation-related businesses and CNAH is its ultimate holding company. As such the business activities of CNAH constitute 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.

INTERESTS OF SHAREHOLDERS

Save as disclosed herein, as at the Latest Practicable Date, as far as is known to the Directors and the chief executive of the Company, the following persons have an interest or short position in the shares or underlying shares of the Company which would fall to be disclosed to the Company under Divisions 2 and 3 of Part XV of the SFO or who are

directly or indirectly interested in 10% or more of the nominal value of any class of share capital carrying rights to vote in all circumstances at general meetings of any member of the Group:–

Interest in the Company

	Capacity	Number of ordinary shares	Percentage of the issued share capital
Substantial Shareholders			
CNAH	Attributable interest	2,290,276,000 (note 1)	69.1%
China National Aviation Corporation	Attributable interest	2,290,276,000 (note 1)	69.1%
CNACG	Beneficial owner	2,290,276,000 (note 1)	69.1%
Other Persons			
Best Strikes Limited	Beneficial owner	187,656,000	5.6%
On Ling Investments Limited	Attributable interest	322,856,000 (note 2)	9.7%
Novel Investments Holdings Limited	Attributable interest	322,856,000 (note 2)	9.7%
Novel Enterprises (BVI) Limited	Attributable interest	322,856,000 (note 2)	9.7%
Novel Credit Limited	Attributable interest	322,856,000 (note 2)	9.7%
Novel Holdings (BVI) Limited	Attributable interest	322,856,000 (note 2)	9.7%
Westleigh Limited	Attributable interest	322,856,000 (note 2)	9.7%

Note 1: The entire issued share capital of CNACG is beneficially owned by China National Aviation Corporation. China National Aviation Corporation is in turn wholly-owned by CNAH, a state-owned enterprise established in the PRC. Accordingly, the interests of CNACG, China National Aviation Corporation and CNAH in the Company duplicate each other.

Note 2: 5.6% of the interest held by these companies in the Company duplicates with Best Strikes Limited's interest in the Company. The interest of these companies in the Company also duplicate each other.

Interest in Air Macau

	Percentage of the issued share capital
Servicos, Administracao e Participacoes, Lda.	20%
Sociedade de Turismo e Diversoes de Macau	14%

Save as disclosed above, as at the Latest Practicable Date, no other person has an interest or short position in the shares or underlying shares of the Company which would fall to be disclosed to the Company under Divisions 2 and 3 of Part XV of the SFO or who is directly or indirectly interested in 10% or more of the nominal value of any class of share capital carrying rights to vote in all circumstances at general meetings of any member of the Group.

CONSENT

Kingsway Capital has given and has not withdrawn its written consent to the issue of this circular with the inclusion of its opinion and/or references to its name in the form and context in which it is included.

LITIGATION

Neither the Company nor any of its subsidiaries is engaged in any litigation or claim of material importance and, so far as the Directors are aware, no litigation or claim of material importance is pending or threatened against the Company or any of its subsidiaries.

MATERIAL ADVERSE CHANGE

The Directors are not aware of any material adverse change in the financial or trading position of the Group since 31 December, 2003, the date to which the latest published audited financial statements of the Group were made up.

LEGAL EFFECT

This circular and the enclosed proxy form are governed by and shall be construed in accordance with the laws of Hong Kong.

QUALIFICATIONS OF EXPERTS

The following are the qualifications of the expert who has given its opinions or advice which are contained in this circular:

Name	Qualifications
Kingsway Capital Limited	a corporation licensed in respect of Types 4, 6 and 9 regulated activities under the SFO

GENERAL

- (i) The English language text of this document shall prevail over the Chinese language text.

- (ii) The Secretary of the Company is Mr. Li Man Kit, ACIS, ACS.
- (iii) The qualified accountant of the Company appointed pursuant to Rule 3.24 of the Listing Rules is Mr. Wan Lui, ACCA.
- (iv) The Company's share registrars and transfer office is Computershare Hong Kong Investor Services Limited, 19th Floor, Hopewell Centre, 183 Queen's Road East, Wanchai, Hong Kong.
- (v) The registered office of the Company is at 5th Floor, CNAC House, 12 Tung Fai Road, Hong Kong International Airport, Lantau, Hong Kong.

DOCUMENTS AVAILABLE FOR INSPECTION

Copies of the following documents are available for inspection at the offices of Baker & McKenzie at Room 1401, Hutchison House, 10 Harcourt Road, Central, Hong Kong during normal business hours up to and including Monday, 31 May, 2004:

- (i) the Acquisition Agreements; and
- (ii) the letter of advice from Kingsway Capital to the Independent Board Committee and the independent Shareholders set out on pages 19 to 30 of this circular.

PROCEDURES FOR DEMANDING A POLL AT EGM

Under Articles of Association of the Company, at the EGM, a poll may be demanded, before or on the declaration of the result of a show of hands by:

- (a) the chairman of the EGM; or
- (b) at least three Shareholders present in person or by proxy or by duly authorised corporate representative for the time being entitled to vote at the EGM; or
- (c) any Shareholder or Shareholders present in person or by proxy or by duly authorised corporate representative and representing not less than one-tenth of the total voting rights of all Shareholders having the right to vote at the EGM; or
- (d) any Shareholder or Shareholders present in person or by proxy and or by duly authorised corporate representative and holding shares in the Company conferring a right to vote at the EGM being shares on which an aggregate sum has been paid up equal to not less than one-tenth of the total sum paid up on all shares in the Company conferring that right.

NOTICE OF EXTRAORDINARY GENERAL MEETING



中航興業有限公司

CHINA NATIONAL AVIATION COMPANY LIMITED

(incorporated in Hong Kong with limited liability)

(Stock Code: 1110)

NOTICE IS HEREBY GIVEN that an extraordinary general meeting of China National Aviation Company Limited (the “Company”) will be held at Salon 5 (Level 3), JW Marriott Hong Kong, Pacific Place, 88 Queensway, Hong Kong at 4:00 p.m. on Monday, 31 May, 2004 or immediately after its annual general meeting to be held at 3:00 p.m. of the same date, for the purpose of considering and, if thought fit, passing the following resolutions with or without modification as ordinary resolutions:

ORDINARY RESOLUTIONS

1. **“THAT** the contract dated 21 April, 2004 entered into between Fly Top Limited (“Fly Top”), a wholly-owned subsidiary of the Company, and Air China International Corporation (“Air China”), and which was supplemented by Fly Top and Air China on 26 April, 2004 (the “Beijing Contract”), pursuant to which Fly Top has conditionally agreed to acquire from Air China 60% of the equity interest in Beijing Air Catering Co., Ltd. (the “Beijing Acquisition”) for a cash consideration of RMB294 million (a copy of the Beijing Contract has been produced to this meeting marked “A” and initialed by the chairman of this meeting for the purpose of identification), the Beijing Acquisition and the transactions contemplated under the Beijing Contract, each be and is hereby approved and ratified, and that the directors of the Company be and are hereby authorised to do all such further acts and things and execute such further documents and take all such steps which in their opinion may be necessary, desirable or expedient to implement and/or give effect to the terms of the Beijing Contract; and
2. **“THAT** the contract dated 21 April, 2004 entered into between Fly Top and Air China, and which was supplemented by Fly Top and Air China on 26 April, 2004 (the “Chengdu Contract”), pursuant to which Fly Top has conditionally agreed to acquire from Air China 60% of the equity interest in Southwest Air Catering Company Limited (the “Chengdu Acquisition”) for a cash consideration of RMB67 million (a copy of the Chengdu Contract has been produced to this meeting marked “B” and initialed by the chairman of this meeting for the purpose of identification), the Chengdu Acquisition and the transactions contemplated under the Chengdu Contract, each be and is hereby approved and ratified, and that the directors of the Company be and are hereby authorised to do all such further acts and things and execute such

NOTICE OF EXTRAORDINARY GENERAL MEETING

further documents and take all such steps which in their opinion may be necessary, desirable or expedient to implement and/or give effect to the terms of the Chengdu Contract.”

By Order of the Board
Li Man Kit
Company Secretary

Hong Kong, 15 May, 2004

Registered office:

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

Notes:

- (1) Any member of the Company entitled to attend and vote at the meeting convened by the above notice is entitled to appoint one or more proxies to attend and vote instead of him. A proxy need not be a member of the Company but must attend the meeting in person.
- (2) The form of proxy for the above meeting is enclosed. To be valid, the form of proxy, together with the power of attorney or other authority (if any) under which it is signed or a notarially certified copy thereof must be returned to the Company's share registrar, Computershare Hong Kong Investor Services Limited at 19th Floor, Hopewell Centre, 183 Queen's Road East, Wanchai, Hong Kong, not less than 48 hours before the time appointed for the holding of the meeting or any adjournment thereof.