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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 a stockbroker or other registered dealer in securities, bank manager, solicitor, professional accountant or other professional adviser.

If you have sold all your shares in China National Aviation Company Limited, you should at once hand this circular, together with the enclosed form of proxy to the purchaser or to the bank, stockbroker or other agent through whom the sale was effected for transmission to the purchaser.

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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)

CONNECTED TRANSACTIONS:

ACQUISITIONS OF LLSHK AND ONGOING CONNECTED TRANSACTIONS

Independent financial adviser to the Independent Board Committee



Kingsway Capital Limited

A letter from the Independent Board Committee dated 2 September 2004 is set out on page 21 of this circular. A letter from Kingsway Capital Limited containing its advice to the Independent Board Committee and the independent Shareholders is set out on pages 22 to 36 of this circular.

A notice convening an extraordinary general meeting of China National Aviation Company Limited to be held at Salon 6 (Level 3), JW Marriott Hong Kong, Pacific Place, 88 Queensway, Hong Kong at 4:00 p.m. on Monday, 20 September 2004 is set out on pages 43 to 45 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 and in any event not later than 48 hours before the time appointed for holding the extraordinary general meeting. Completion and return of the form of proxy shall not preclude you from attending and voting in person at the meeting or any adjourned meeting should you so desire.

2 September 2004

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DEFINITIONS

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

“Acquisition Agreements”	the CNACG Agreement and the HKIAC Agreement
“Acquisitions”	the CNACG Acquisition and the HKIAC Acquisition
“Air China”	Air China International Corporation, a company established in the PRC
“Air China Branch Companies”	Southwest, Zhejiang, Chongqing, Inner Mongolia and Tianjin branch companies and cargo companies of Air China
“Air China Southwest”	Southwest branch company of Air China
“Air China Zhejiang”	Zhejiang branch company of Air China
“Air Macau”	Air Macau Company Limited, a company incorporated in Macau with limited liability and a 51% indirectly owned subsidiary of the Company
“Airport Authority”	the Airport Authority of Hong Kong established under the Airport Authority Ordinance (Chapter 483 of the Laws of Hong Kong)
“Announcement”	the announcement of the Company dated 26 April 2004
“associates”	has the meaning ascribed under the Listing Rules
“BACL”	Beijing Air Catering Co., Ltd., a company established in the PRC, which will become a subsidiary of the Company upon completion of the Beijing Contract
“BACL Contract”	the catering contract dated 5 August 2004 entered into between BACL and Air China for the provision of Inflight Catering Services by BACL to Air China in respect of all Beijing CA Flights
“Beijing Acquisition”	the acquisition of 60% of the equity interest in BACL from Air China, as more particularly described in the Announcement and the Circular

DEFINITIONS

“Beijing CA Flights”	Air China’s inbound and outbound flights and Air China Branch Companies’ inbound and outbound flights with flight numbers carrying the prefix of CA to and from Beijing Capital International Airport
“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 of the Company
“Business Day”	a day (other than a Saturday or Sunday) on which banks are open for business in Hong Kong
“CA”	the code name for Air China flights
“Chengdu Acquisition”	the acquisition of 60% of the equity interest in SWACL from Air China, as more particularly described in the Announcement and the Circular
“Chengdu CA Flights”	the inbound and outbound flights with flight numbers carrying the prefix of CA to and from Chengdu Shuangliu International Airport
“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
“Circular”	the circular of the Company dated 15 May 2004
“CNACG”	China National Aviation Corporation (Group) Limited, a company incorporated in Hong Kong with limited liability and which holds approximately 69.5% of the shares in the issued share capital of the Company and is an investment holding company
“CNACG Acquisition”	the acquisition of the CNACG Sale Shares from CNACG
“CNACG Agreement”	the sale and purchase agreement dated 19 August 2004 between Fly Top and CNACG in relation to the CNACG Acquisition
“CNACG Sale Shares”	80 shares of HK\$1.00 each in LLSHK to be disposed of by CNACG under the CNACG Agreement

DEFINITIONS

“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
“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
“Directors”	the directors of the Company
“Dragonair”	Hong Kong Dragon Airlines Limited, an airline operator incorporated in Hong Kong with limited liability, a 43.29% owned associated company of the Company and not a connected person of the Company as defined in the Listing Rules
“EGM”	the extraordinary general meeting of the Company to be held at Salon 6 (Level 3), JW Marriott Hong Kong, Pacific Place, 88 Queensway, Hong Kong at 4:00 p.m. on Monday, 20 September 2004 to approve the Acquisitions, the Ongoing Connected Transactions and the Proposed Caps, a notice of which is set out on pages 43 to 45
“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
“HKIAC”	Hong Kong International Air Catering Limited, a company incorporated in Hong Kong with limited liability and both HKIAC and its ultimate beneficial owners (apart from Air China which is interested in 25% of the issued share capital of HKIAC) are Independent Third Parties and, to the best knowledge of the Directors, neither HKIAC nor its associates holds any interest in the Company
“HKIAC Acquisition”	the acquisition of the HKIAC Sale Shares from HKIAC
“HKIAC Agreement”	the sale and purchase agreement dated 19 August 2004 between Fly Top and HKIAC in relation to the HKIAC Acquisition

DEFINITIONS

“HKIAC Sale Shares”	21 shares of HK\$1.00 each in LLSHK to be disposed of by HKIAC under the HKIAC Agreement
“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
“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, the Ongoing Connected Transactions and the Proposed Caps
“Independent Third Party(ies)”	party(ies) who is/are not connected with the directors, chief executive and substantial shareholders of the Company or any of its subsidiaries or any of their respective associates and not connected person(s) of the Company as defined in the Listing Rules
“Inflight Catering Services”	inflight catering services and other related inflight food and beverages services which include among other things, (a) the preparation and assembly of aircraft meals, beverages and other consumable items for delivery onto aircraft; (b) storage, retrieval, washing, cleaning and sanitizing of catering equipment supplied by aircraft carrier; and (c) loading, unloading and transportation of meals and other supplies to and from the aircraft
“Kingsway Capital”	Kingsway Capital Limited, a licensed corporation holding a licence under the Securities and Futures Commission of Hong Kong to conduct type 6 (advising on corporate finance) of the regulated activity under the SFO and the independent financial adviser to the Independent Board Committee and the independent Shareholders in respect of the Acquisitions, the Ongoing Connected Transactions and the Proposed Caps
“Latest Practicable Date”	30 August 2004, being the latest practicable date prior to the printing of this circular for ascertaining certain information contain herein

DEFINITIONS

“Listing Rules”	the Rules Governing the Listing of Securities on the Stock Exchange
“LLSHK”	LSG Lufthansa Service Hong Kong Limited, a company incorporated in Hong Kong
“Ongoing Connected Transactions”	the connected transactions to be entered into or to be continued between the Group and Air China, Air China Zhejiang or Air China Southwest on an on-going basis after completion of the Beijing Contract and the Chengdu Contract and as described in the section headed “Ongoing Connected Transactions” in this circular
“Percentage Ratios”	the percentage ratios under Rule 14.07 of the Listing Rules, other than the equity capital ratio and profits ratio, adopted by the Company on 19 August 2004
“PRC”	The People’s Republic of China
“PRC Accounting Regulations”	Accounting Standards for Business Enterprises and Accounting System for Business Enterprises in the PRC
“Proposed Cap(s)”	the proposed maximum annual aggregate value of the transactions (excluding and net of tax) to be contemplated under the BAACL Contract and the SWACL Contracts in respect of each of the period ended 31 December for the year of completion of the Beijing Acquisition and Chengdu Acquisition and two years thereafter
“SARS”	Severe Acute Respiratory Syndrome
“SFO”	the Securities and Futures Ordinance (Chapter 571 of the Laws of Hong Kong)
“SWACL”	Southwest Air Catering Company Limited, a company established in the PRC, which will become a subsidiary of the Company upon completion of the Chengdu Contract
“SWACL Air China Catering Contract”	the catering contract dated 13 March 2003 entered into between SWACL and Air China for the provision of Inflight Catering Services by SWACL to Air China in respect of all Chengdu CA Flights operated by Air China

DEFINITIONS

“SWACL Air China Southwest Catering Contract”	the catering contract dated 25 June 2002 entered into between SWACL and Air China Southwest (formerly known as Southwest Airlines Corporation) for the provision of Inflight Catering Services by SWACL to Air China Southwest in respect of all Chengdu CA Flights operated by Air China Southwest
“SWACL Air China Zhejiang Catering Contract”	the catering contract dated 15 December 2003 entered into between SWACL and Air China Zhejiang for the provision of Inflight Catering Services by SWACL to Air China Zhejiang in respect of all Chengdu CA Flights operated by Air China Zhejiang
“SWACL Catering Contracts”	the SWACL Air China Catering Contract, the SWACL Air China Zhejiang Catering Contract and the SWACL Air China Southwest Catering Contract
“SWACL Contracts”	the SWACL Catering Contracts and the SWACL Supply Contract
“SWACL Supply Contract”	the supply contract dated 25 June 2002 entered into between SWACL and Air China Southwest (formerly known as Southwest Airlines Corporation) for the provision of inflight accessories, consumable items and recycling services by SWACL to Air China Southwest in respect of all Chengdu CA Flights operated by Air China Southwest
“Shareholders”	shareholders of the Company
“Stock Exchange”	The Stock Exchange of Hong Kong Limited
“HK\$”	Hong Kong dollars, the lawful currency of Hong Kong
“RMB”	Renminbi, the lawful currency of the PRC

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
Zhao Xiaohang
Lok Kung Nam*
Hu Hung Lick, Henry*
Ho Tsu Kwok, Charles*
Li Kwok Heem, John*
Chan Ching Har, Eliza*

Registered office:

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

* *independent non-executive directors*

2 September 2004

To the Shareholders

Dear Sir or Madam,

CONNECTED TRANSACTIONS:

ACQUISITION OF LLSHK AND ONGOING CONNECTED TRANSACTIONS

INTRODUCTION

On 19 August 2004, the Board announced the following transactions.

The Acquisitions

On 19 August 2004, Fly Top, a wholly-owned subsidiary of the Company entered into the following Acquisition Agreements:

1. the CNACG Agreement with CNACG in relation to the acquisition of approximately 16% of the issued share capital of LLSHK for a consideration of HK\$89 million; and
2. the HKIAC Agreement with HKIAC in relation to the acquisition of approximately 4.2% of the issued share capital of LLSHK for a consideration of HK\$24.5 million.

LETTER FROM THE BOARD

The aggregate consideration of approximately HK\$113.5 million under the Acquisition Agreements will be paid in cash which will be funded by the Group's internal resources.

The Company is owned as to approximately 69.5% by CNACG. Since CNACG is a substantial shareholder of the Company, the CNACG Acquisition constitutes a connected transaction for the Company under the Listing Rules.

Since the HKIAC Acquisition involves the Company acquiring the HKIAC Sale Shares from HKIAC, where CNACG, being a substantial shareholder of LLSHK, is also a controlling shareholder (as defined under the Listing Rules) of the Company, the HKIAC Acquisition constitutes a connected transaction for the Company under Rule 14A.13(1)(b)(i) of the Listing Rules.

Both the CNACG Agreement and the HKIAC Agreement therefore require independent Shareholders' approval at the EGM.

Ongoing Connected Transactions

Following completion of the Beijing Contract and the Chengdu Contract, the Ongoing Connected Transactions will constitute connected transactions for the Company for the purpose of the Listing Rules.

BACL has entered into the BACL Contract with Air China in relation to the provision of Inflight Catering Services to Air China in respect of all Beijing CA Flights. SWACL has entered into (a) the SWACL Catering Contracts with Air China, Air China Southwest and Air China Zhejiang; and (b) the SWACL Supply Contract with Air China Southwest in relation to the provision of Inflight Catering Services and other ancillary services to Air China, Air China Southwest and Air China Zhejiang in respect of all Chengdu CA Flights operated by Air China, Air China Southwest and Air China Zhejiang.

The Company is owned as to approximately 69.5% 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 (within the meaning of the Listing Rules) of CNAH, which is an indirect controlling shareholder of the Company, upon completion of the Beijing Acquisition and the Chengdu Acquisition, the Ongoing Connected Transactions will constitute continuing connected transactions for the Company under the Listing Rules. It is expected that the Ongoing Connected Transactions will be subject to reporting, announcement and independent Shareholders' approval requirements under the Listing Rules. Considering that the Ongoing Connected Transactions are conducted on a regular basis, the Directors would like to seek independent Shareholders' approval for the BACL Contract and the SWACL Contracts and the Proposed Caps.

CNACG and its associates will abstain from voting in relation to the Acquisitions, the Ongoing Connected Transactions and the Proposed Caps. The vote of the independent Shareholders at the EGM shall be taken by poll.

LETTER FROM THE BOARD

The Independent Board Committee has been established to advise the independent Shareholders in relation to the Acquisitions, the Ongoing Connected Transactions and the Proposed Caps. 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 Ongoing Connected Transactions and the Proposed Caps.

The purpose of this circular is to provide you with further information in relation to the Acquisitions, the Ongoing Connected Transactions and the Proposed Caps 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, the Ongoing Connected Transactions and the Proposed Caps is set out on page 21 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 22 to 36, which follows the letter from the Independent Board Committee in this circular.

THE CNACG ACQUISITION

Principal Terms of the CNACG Agreement

Date:	19 August 2004
Purchaser:	Fly Top, a wholly-owned subsidiary of the Company
Vendor:	CNACG
Assets to be acquired:	the CNACG Sale Shares, representing approximately 16% of the issued share capital of LLSHK

Consideration and payment terms

The consideration payable by Fly Top under the CNACG Agreement is HK\$89 million, to be paid in cash upon completion of the CNACG Agreement. The consideration will be funded by the Group's internal resources.

The consideration for the CNACG Acquisition has been arrived at after arm's length negotiation between the parties taking into consideration the value and financial position of LLSHK and represents a price earnings multiple of approximately 10.5 times of the audited net profit after tax of LLSHK for the year ended 31 December 2002. The Company believes that it is not appropriate to determine the consideration based on the profit figures for the year ended 31 December 2003 because of the impact of the outbreak of SARS on the financial performance of companies in the aviation-related businesses.

LETTER FROM THE BOARD

Conditions under the CNACG Agreement

The parties agree that, among other things, the following conditions must be fulfilled (or waived by Fly Top on such terms that may be reasonably prescribed) on or before 30 October 2004 or such other date as may be agreed between CNACG and Fly Top:

- (a) Fly Top having notified CNACG in writing that it is satisfied with the due diligence investigation with respect to LLSHK;
- (b) the passing by the independent Shareholders in an extraordinary general meeting of the Company of the ordinary resolution approving the CNACG Acquisition in accordance with the requirements of the Listing Rules;
- (c) the obtaining of consents from the other shareholders of LLSHK and the Airport Authority in relation to the CNACG Acquisition; and
- (d) any notification or consent being made to or being obtained from the banks, financial institutions and other lenders in respect of any banking or other loan facilities granted to LLSHK that is required as a consequence of the transfer of the CNACG Sale Shares.

Completion of the CNACG Agreement

Completion of the CNACG Agreement will take place 7 Business Days after the latest of the occurrence of:-

- (a) the Beijing Contract having become effective (as referred to in the section headed "Effective Date of the Beijing Contract" in the Announcement and the Circular) 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" in the Announcement and the Circular);
- (b) the Chengdu Contract having become effective (as referred to in the section headed "Effective Date of the Chengdu Contract" in the Announcement and the Circular) 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" in the Announcement and the Circular); and
- (c) all the conditions under the CNACG Agreement having been fulfilled or waived (as referred to in the section headed "Conditions under the CNACG Agreement" above).

The parties agree that completion of the Beijing Contract, the Chengdu Contract and the CNACG Agreement shall take place simultaneously and completion of the CNACG Agreement is not conditional upon completion of the HKIAC Agreement.

LETTER FROM THE BOARD

THE HKIAC ACQUISITION

Principal Terms of the HKIAC Agreement

Date:	19 August 2004
Purchaser:	Fly Top, a wholly-owned subsidiary of the Company
Vendor:	HKIAC
Assets to be acquired:	the HKIAC Sale Shares, representing approximately 4.2% of the issued share capital of LLSHK

Consideration and payment terms

The consideration payable by Fly Top under the HKIAC Agreement is HK\$24.5 million, to be paid in cash upon completion of the HKIAC Agreement. The consideration will be funded by the Group's internal resources.

The consideration for the HKIAC Acquisition has been arrived at after arm's length negotiation between the parties taking into consideration the value and financial position of LLSHK and represents a price earnings multiple of approximately 11 times of the audited net profit after tax of LLSHK for the year ended 31 December 2002.

Conditions under the HKIAC Agreement

The parties agree that, among other things, the following conditions must be fulfilled (or waived by Fly Top on such terms that may reasonably prescribed) on or before 30 October 2004 or such other date as may be agreed between HKIAC and Fly Top:

- (a) the passing by the independent Shareholders in an extraordinary general meeting of the Company of the ordinary resolution approving the HKIAC Acquisition in accordance with the requirements of the Listing Rules;
- (b) the obtaining of consents from the other shareholders of LLSHK and the Airport Authority in relation to the HKIAC Acquisition;
- (c) any notification or consent being made to or being obtained from the banks, financial institutions and other lenders in respect of any banking or other loan facilities granted to LLSHK that is required as a consequence of the transfer of the HKIAC Sale Shares; and
- (d) all the conditions under the CNACG Agreement having been fulfilled or waived.

LETTER FROM THE BOARD

Completion of the HKIAC Agreement

The parties agree that completion of the HKIAC Agreement will take place simultaneously with or after the completion of the Beijing Contract, the Chengdu Contract and the CNACG Agreement.

INFORMATION ON LLSHK

LLSHK was incorporated with limited liability in Hong Kong on 2 December 1977 and is owned as to approximately 38.1% by LSG Catering Hong Kong Ltd., an Independent Third Party, approximately 31.9% by Dragonair, approximately 14.0% by HKIAC and approximately 16.0% by CNACG. At present, the authorized share capital of LLSHK is HK\$1,000 divided into 1,000 shares of HK\$1.00 each, of which 501 shares of HK\$1.00 each have been issued and fully paid up. As at the date hereof, there is no outstanding shareholders' loan owing from LLSHK to each of CNACG and HKIAC.

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

The table below sets out the audited results of LLSHK for the two years ended 31 December 2002 and 2003 and the audited net asset value of LLSHK as at 31 December 2002 and 2003 which are based on the audited accounts of LLSHK for the years ended 31 December 2002 and 2003 prepared in accordance with HKSSAP:

	Year ended	
	31 December,	
	2003	2002
	<i>HK\$'000</i>	<i>HK\$'000</i>
Audited profit before taxation	5,470	60,033
Audited profit after taxation	1,233	52,985
	As at 31 December,	
	2003	2002
	<i>HK\$'000</i>	<i>HK\$'000</i>
Audited net asset value	286,288	305,055

Upon completion of the Acquisitions, the Company will indirectly be interested in approximately 20.2% of the issued share capital of LLSHK. The financial results and positions of LLSHK will be equity accounted for in the consolidated accounts of the Company in accordance with HKSSAP.

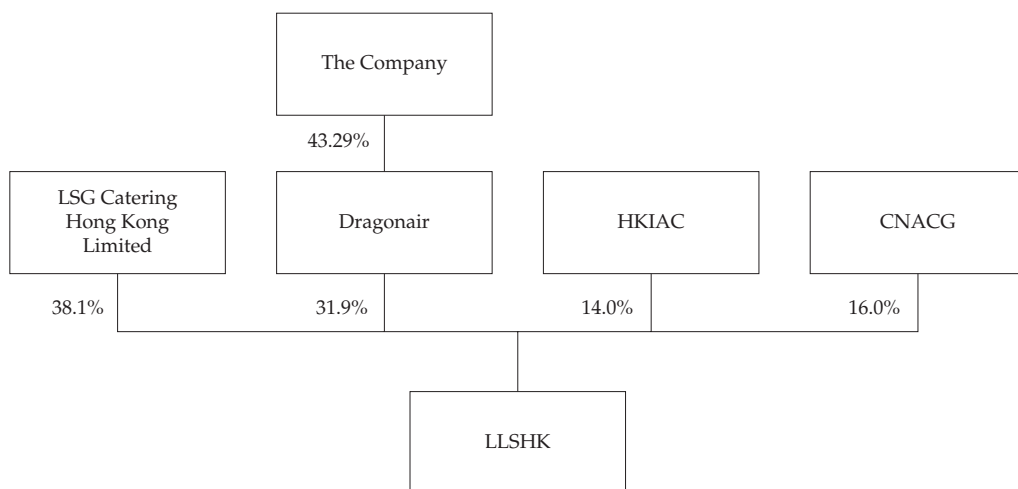
There are currently seven directors on the board of directors of LLSHK, of which one is nominated by CNACG and one is nominated by HKIAC. Upon completion of the Acquisition Agreements, the board of directors of LLSHK shall continue to be comprised of seven persons, the Company will have the right to nominate one person as a director of LLSHK.

LETTER FROM THE BOARD

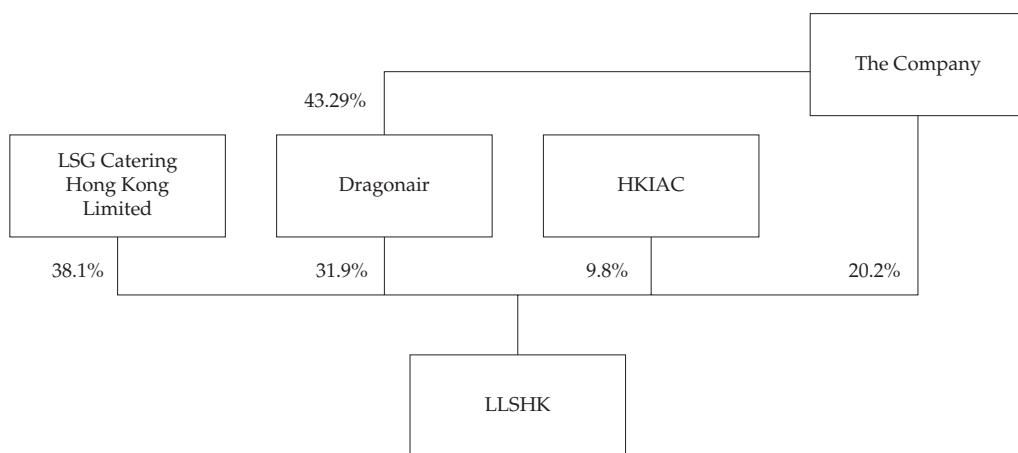
The CNACG Sale Shares was initially acquired by CNACG in 1996 at a consideration of approximately HK\$101.8 million.

SHAREHOLDING STRUCTURE OF LLSHK BEFORE AND AFTER THE ACQUISITIONS

Prior to the Acquisitions, the shareholding structure of LLSHK is as follows:



After the Acquisitions, the shareholding structure of LLSHK will be as follows:



REASONS FOR 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.

With the growing economic ties and increasing number of tourists between Hong Kong and the PRC as well as the opening of a major theme park in Hong Kong in the near future, the demand for aviation-catering service is expected to increase in the next few years. The Directors are optimistic about the growth potential of LLSHK.

LETTER FROM THE BOARD

Following the Acquisitions, the Directors are of the view that the Group will be interested in one of the biggest aviation-catering groups in Greater China.

The Directors, including the independent non-executive Directors, believe that the terms of the Acquisitions are fair and reasonable and in the interests of the Company and the Shareholders as a whole.

The Company does not have any present intention to acquire any further equity interests in LLSHK.

ONGOING CONNECTED TRANSACTIONS

Following completion of the Beijing Contract and the Chengdu Contract, the Ongoing Connected Transactions will constitute connected transactions for the Company under the Listing Rules. As at the date of this circular, both the Beijing Contract and the Chengdu Contract have not yet been completed. Applications have already been submitted to the relevant governmental authority in the PRC for obtaining an approval in respect of the Beijing Contract and Chengdu Contract and such approvals are still pending.

Prior to the completion of the Beijing Contract, BACL is a sino-foreign joint venture, owned as to 60% by Air China and as to 40% by Hongkong Beijing Air Catering Limited ("HKBACL"), an Independent Third Party. Upon completion of the Beijing Contract, BACL will become a wholly foreign owned enterprise in the PRC and a subsidiary of the Company, which will be owned as to 60% by the Company and 40% by HKBACL.

Prior to the completion of the Chengdu Contract, SWACL is a sino-foreign joint venture, owned as to 75% by Air China and as to 25% by Hongkong Southwest Air Catering Limited ("HKSACL"), an Independent Third Party. Upon completion of the Chengdu Contract, SWACL will become a wholly foreign owned enterprise in the PRC and a subsidiary of the Company, which will be owned as to 60% by the Company and 40% by HKSACL.

BACL has entered into the BACL Contract with Air China. SWACL has entered into (a) the SWACL Catering Contracts with Air China, Air China Zhejiang and Air China Southwest; and (b) the SWACL Supply Contract with Air China Southwest. Brief details of the BACL Contract and the SWACL Contracts are set out below.

BACL Contract

Date: 5 August 2004

Parties: BACL and Air China

Pursuant to the BACL Contract, BACL agrees to provide Inflight Catering Services to Air China in respect of all Beijing CA Flights for a term of three years commencing on 5 August 2004. Unless the terms of the BACL Contract are amended or the BACL Contract is terminated by either party by way of 30 days prior written notice after the expiry of its

LETTER FROM THE BOARD

term, the BACL Contract shall continue for another three years until it is terminated by either party by way of 30 days prior written notice. If the BACL Contract will continue or be renewed after the initial 3 years term, the Company will comply with the relevant requirements under the Listing Rules upon its renewal.

In accordance with the terms of the BACL Contract, BACL will charge a service fee for the Inflight Catering Services which is determined by reference to the number and type of meals being provided and the type of aircraft to which service is being provided by BACL to Air China in respect of all Beijing CA Flights.

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.

The amounts received by BACL for the provision of Inflight Catering Services to Air China in respect of all Beijing CA Flights for the three years ended 31 December 2001, 2002 and 2003 in accordance with PRC Accounting Regulations are set out below:

	Year ended 31 December		
	2001	2002	2003
Provision of Inflight Catering Services to Air China in respect of all Beijing CA Flights (net/excluding tax)			
– RMB million	100	139	119
– equivalent to HK\$ million	94	131	112
Percentage of BACL's audited turnover for provision of Inflight Catering Services to Air China in respect of all Beijing CA Flights for the relevant year	37%	43%	45%

SWACL Catering Contracts

SWACL Air China Catering Contract

Date: 7 March 2003

Parties: SWACL and Air China

SWACL Air China Zhejiang Catering Contract

Date: 15 December 2003

Parties: SWACL and Air China Zhejiang

LETTER FROM THE BOARD

SWACL Air China Southwest Catering Contract

Date: 25 June 2002

Parties: SWACL and Air China Southwest

Pursuant to the SWACL Catering Contracts, SWACL agrees to provide Inflight Catering Services to Air China, Air China Zhejiang and Air China Southwest in respect of all Chengdu CA Flights operated by Air China, Air China Zhejiang and Air China Southwest. Apart from the SWACL Air China Zhejiang Catering Contract which has a term of one year that had commenced on 15 December 2003 and shall continue for another year until it is being terminated by either party by way of 30 days prior written notice, the term for each of the other SWACL Catering Contracts has already been renewed and shall continue for another year until it is terminated by either party by way of 30 days prior written notice. The Company undertakes that upon completion of the Chengdu Contract, the Company shall procure SWACL to revise the term of each of the SWACL Catering Contracts to a fixed term of not more than 3 years in compliance with the relevant requirements under the Listing Rules and the Company will issue a further announcement in compliance with the Listing Rules upon the revision of the terms of any of the SWACL Catering Contract. If any of the SWACL Catering Contract will continue or be renewed after such 3 years term, the Company will comply with the relevant requirements under the Listing Rules upon its renewal.

In accordance with the terms of the SWACL Catering Contracts, SWACL will charge a service fee for the Inflight Catering Services which is determined by reference to the number and type of meals being provided and the type of aircraft to which service is being provided by SWACL to Air China, Air China Zhejiang and Air China Southwest in respect of all Chengdu CA Flights operated by Air China, Air China Zhejiang and Air China Southwest.

SWACL Supply Contract

Date: 25 June 2002

Parties: SWACL and Air China Southwest

Pursuant to the SWACL Supply Contract, SWACL agrees to supply inflight accessories and other consumable items, magazines and newspapers and souvenirs and provide any ancillary and recycling services to Air China Southwest in respect of all Chengdu CA Flights operated by Air China Southwest. The term for the SWACL Supply Contract has already been renewed and shall continue for another year until it is terminated by either party by way of 30 days prior written notice. The Company undertakes that upon completion of the Chengdu Contract, the Company shall procure SWACL to revise the term of the SWACL Supply Contract to a fixed term of not more than 3 years in compliance with the relevant requirements under the Listing Rules and the Company will issue a further announcement in compliance with the Listing Rules upon the revision of the terms

LETTER FROM THE BOARD

of the SWACL Supply Contract. If the SWACL Supply Contract will continue or be renewed after such 3 years term, the Company will comply with the relevant requirements under the Listing Rules upon its renewal.

In accordance with the terms of the SWACL Supply Contract, SWACL will charge a fee which is determined by reference to the type of aircraft to which service is being provided by SWACL to Air China Southwest in respect of all Chengdu CA Flights operated by Air China Southwest.

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.

Turnover under the SWACL Contracts

The amounts received by SWACL for the provision of Inflight Catering Services and other ancillary services to Air China, Air China Zhejiang and Air China Southwest in respect of all Chengdu CA Flights operated by Air China, Air China Zhejiang and Air China Southwest for the three years ended 31 December 2001, 2002 and 2003 in accordance with PRC Accounting Regulations are set out below:

	Year ended 31 December,		
	2001	2002	2003
Provision of Inflight Catering Services and other ancillary services (including inflight accessories, other consumable items and recycling services under SWACL Supply Contract) to Air China, Air China Zhejiang and Air China Southwest in respect of all Chengdu CA Flights operated by Air China, Air China Zhejiang and Air China Southwest (net/excluding tax)			
– RMB million	43	56	45
– equivalent to HK\$ million	41	53	42
Percentage of SWACL's audited turnover for provision of Inflight Catering Services and other ancillary services to Air China, Air China Zhejiang and Air China Southwest in respect of all Chengdu CA Flights operated by Air China, Air China Zhejiang and Air China Southwest for the relevant year			
	70%	83%	70%

LETTER FROM THE BOARD

Reasons for and benefits of the BACL Contract and the SWACL Contracts

The terms of each of the BACL Contract and the SWACL Contracts have been determined after arm's length negotiations between the parties thereto and will be no less favourable to BACL and SWACL than terms available to and from Independent Third Parties provided that the volume and scope of services to be provided by BACL and/or SWACL to such Independent Third Party are similar to those provided to Air China, Air China Zhejiang and Air China Southwest, as the case may be. The Directors, including the independent non-executive Directors, are of the view that the terms of each of the BACL Contract and the SWACL Contracts are fair and reasonable so far as the independent Shareholders are concerned and each of the BACL Contract and the SWACL Contracts is on normal commercial terms and in the interest of the Company and the Shareholders as a whole.

The Directors consider it to be in the interest of BACL and SWACL to engage in the Ongoing Connected Transactions as these transactions and the service fees to be received by BACL and SWACL under the BACL Contract and the SWACL Contracts will generate a steady stream of income for BACL and SWACL.

Proposed Caps

By reference to (a) the growth in passenger uplift as projected by the management of the Company; (b) historic percentage of Inflight Catering Services provided to Air China in respect of all Beijing CA Flights over BACL's annual audited turnover; and (c) historic percentage of Inflight Catering Services and other ancillary services provided to Air China, Air China Zhejiang and Air China Southwest in respect of all Chengdu CA Flights operated by Air China, Air China Zhejiang and Air China Southwest over SWACL's annual audited turnover, the Directors propose to set the Proposed Cap for the transactions under the BACL Contract and the SWACL Contracts as follows:

Agreement	Proposed Cap
BACL Contract	RMB200 million (net/excluding tax) (equivalent to approximately HK\$189 million)
SWACL Contracts	RMB70 million (net/excluding tax) (equivalent to approximately HK\$66 million)

There is a substantial increment between Proposed Caps and (a) the turnover for the year ended 31 December 2003 on the provision of Inflight Catering Services by BACL to Air China in respect of all Beijing CA Flights; and (b) the turnover for the year ended 31 December 2003 on the provision of Inflight Catering Services and other ancillary services by SWACL to Air China, Air China Zhejiang and Air China Southwest in respect of all Chengdu CA Flights operated by them because of:

- (a) the outbreak of SARS in 2003 has had a material adverse impact on the financial performance of companies in the aviation-related business and therefore led to a lower turnover in 2003; and

LETTER FROM THE BOARD

- (b) the Proposed Caps have been set for the coming 3 years after the date of completion of the Beijing Contract and the Chengdu Contract and the management of the Company is predicting a healthy growth in the business of BACL and SWACL in the forthcoming 3 years.

If during the period ending three years after the date of completion of the Beijing Contract and the Chengdu Contract, the aggregate annual value of the transactions contemplated under the BACL Contract and the SWACL Contracts exceed the Proposed Caps or there is a material change to any of the BACL Contract or the SWACL Contracts, the Company will take necessary steps to ensure compliance with the Listing Rules. The Company shall seek independent Shareholders' approval on the BACL Contract and the SWACL Contracts in respect of a further three years' period commencing three years after the date of completion of the Beijing Contract and the Chengdu Contract in accordance with the Listing Rules. In any event, the BACL Contract and the SWACL Contracts will not exceed 3 years as BACL or SWACL, as the case may be, will have the right to terminate the relevant contract by way of giving 30 days prior written notice.

The transactions contemplated under the BACL Contract and the SWACL Contracts will also be subject to the annual review requirement under Rules 14A.37 to 14A.41 and the reporting requirement under Rules 14A.45 and 14A.46 of the Listing Rules.

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 logistics 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.

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.

EGM

There is set out on pages 43 to 45 a notice convening the EGM to be held at Salon 6 (Level 3), JW Marriott Hong Kong, Pacific Place, 88 Queensway, Hong Kong at 4:00 p.m. on Monday, 20 September 2004, at which resolutions will be proposed to the independent Shareholders to approve the Acquisitions, the Ongoing Connected Transactions and the Proposed Caps. The vote of the independent Shareholders at the EGM shall be taken by poll. In accordance with the Listing Rules, CNACG, which holds approximately 69.5% 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, and its associates will abstain from voting on the resolutions to approve the Acquisitions, the Ongoing Connected Transactions and the Proposed Caps 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, the Ongoing Connected Transactions and the Proposed Caps. Kingsway Capital considers that the terms of the Acquisitions, the Ongoing Connected Transactions and the Proposed Caps on the whole are fair and reasonable so far as the independent Shareholders are concerned and the Acquisitions, the Ongoing Connected Transactions and the Proposed Caps 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, the Ongoing Connected Transactions and the Proposed Caps and the principal factors and reasons considered by Kingsway Capital in arriving at its recommendation is set out on pages 22 to 36 of this circular.

The Independent Board Committee, having taken into account the advice of Kingsway Capital, considers that the terms of the Acquisitions, the Ongoing Connected Transactions and the Proposed Caps on the whole are fair and reasonable so far as the independent Shareholders are concerned and the Acquisitions, the Ongoing Connected Transactions and the Proposed Caps 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 Ongoing Connected Transactions and the Proposed Caps. The text of the letter from the Independent Board Committee is set out on page 21 of this circular.

The Directors believe that the terms of the Acquisitions, the Ongoing Connected Transactions and the Proposed Caps on the whole are fair and reasonable and the Acquisitions, the Ongoing Connected Transactions and the Proposed Caps 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, the Ongoing Connected Transactions and the Proposed Caps.

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)

2 September 2004

Dear independent Shareholders,

**ACQUISITION OF LLSHK,
THE ONGOING CONNECTED TRANSACTIONS
AND THE PROPOSED CAPS**

We refer to the circular issued by the Company on 2 September 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, the Ongoing Connected Transactions and the Proposed Caps and to advise you as to whether the terms of the Acquisitions, the Ongoing Connected Transactions and the Proposed Caps are fair and reasonable and whether the Acquisitions, the Ongoing Connected Transactions and the Proposed Caps 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, the Ongoing Connected Transactions and the Proposed Caps. 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, the Ongoing Connected Transactions and the Proposed Caps on the whole are fair and reasonable so far as the independent Shareholders are concerned and the Acquisitions, the Ongoing Connected Transactions and the Proposed Caps 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, the Ongoing Connected Transactions and the Proposed Caps. You are therefore strongly urged to complete your proxy form and vote in favour of the Acquisitions, the Ongoing Connected Transactions and the Proposed Caps.

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 2 September 2004 prepared for incorporation in this circular.



Kingsway Capital Limited

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

2 September 2004

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

Dear Sirs,

CONNECTED TRANSACTIONS:

PROPOSED ACQUISITION OF APPROXIMATELY 20.2% EQUITY INTEREST IN LLSHK, ONGOING CONNECTED TRANSACTIONS AND PROPOSED CAPS (COLLECTIVELY, THE "PROPOSED TRANSACTIONS")

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 Transactions are fair and reasonable so far as the independent Shareholders are concerned, and whether or not the Proposed Transactions are in the interests of the Company and the Shareholders as a whole. Details of the Proposed Transactions are set out in the circular of the Company dated 2 September 2004, 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 CNACG and Air China are regarded as the connected persons of the Company within the meanings of the Listing Rules as described in the "Letter from the Board" in this circular, the Proposed Transactions constitute connected transactions for the Company under the Listing Rules, which will be subject to, inter alia, the independent Shareholders' approval at the EGM.

LETTER FROM KINGSWAY CAPITAL

The Independent Board Committee, comprising 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 the independent Shareholders as regards the Proposed Transactions. 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 Proposed Transactions, 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 this 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 this 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 this 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 this 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 LLSHK, BACL, SWACL or any of their respective subsidiaries and associated companies.

PRINCIPAL FACTORS AND REASONS CONSIDERED

(I) The Acquisitions

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 analyses taken as a whole.

(1) *Overview*

As stated in the announcement dated 19 August 2004, Fly Top, a wholly-owned subsidiary of the Company, entered into the Acquisition Agreements pursuant to which Fly Top has conditionally agreed to acquire (1) an approximately 16.0% equity interest in LLSHK from CNACG at a consideration of HK\$89 million; and (2) an approximately 4.2% equity interest in LLSHK from HKIAC at a consideration of

LETTER FROM KINGSWAY CAPITAL

HK\$24.5 million. Completion of the Acquisition Agreements 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 CNACG Acquisition" and "The HKIAC Acquisition" in the "Letter from the Board" of this circular.

(2) *Assets to be acquired under the Acquisition Agreements*

Pursuant to the Acquisition Agreements, the Group, through Fly Top, has conditionally agreed to acquire approximately 16% and 4.2% equity interests in LLSHK from CNACG and HKIAC respectively. As advised by the Company, there is no outstanding shareholders' loan owing from LLSHK to each of CNACG and HKIAC as at the Latest Practicable Date.

LLSHK was incorporated with limited liability in Hong Kong on 2 December 1977 and is owned as to approximately 38.1% by LSG Catering Hong Kong Ltd., an Independent Third Party, approximately 31.9% by Dragonair, approximately 16.0% by CNACG and approximately 14.0% by HKIAC. Upon completion of the Acquisition Agreements, the Company, through Fly Top, will be interested in approximately 20.2% shareholding in LLSHK.

LLSHK is principally engaged in the provision of inflight catering services, laundry services and the operation of airport lounges and an airport restaurant in Hong Kong International Airport ("HKIA"). Based on the statistics issued by HKIA and production figures of LLSHK provided by the Company, LLSHK is capable of handling 30,000 inflight meals per day and it is the second largest aircraft caterer in HKIA in term of the number of inflight meals handled.

The table below sets out the number of inflight meals handled by LLSHK, the audited results of LLSHK for the two years ended 31 December 2003 and the audited net asset value of LLSHK as at 31 December, 2002 and 2003 which are based on the audited accounts of LLSHK for the years ended 31 December, 2002 and 2003 prepared in accordance with HKSSAP:

	Year ended	
	31 December	
	2003	2002
Total number of inflight meals handled by LLSHK	4,375,999	5,569,855
	<i>HK\$'000</i>	<i>HK\$'000</i>
Audited profit before taxation	5,470	60,033
Audited profit after taxation	1,233	52,985

LETTER FROM KINGSWAY CAPITAL

	As at 31 December,	
	2003	2002
	<i>HK\$'000</i>	<i>HK\$'000</i>
Audited net asset value	286,288	305,055

As illustrated above, the number of inflight meals handled by LLSHK decreased by approximately 1.19 million or 21.4% from approximately 5.57 million in 2002 to approximately 4.38 million in 2003, while the net profit of LLSHK decreased by approximately HK\$51.8 million or 97.7% from approximately HK\$53.0 million in 2002 to approximately 1.2 million in 2003. As advised by the Company, the significant decrease of the number of inflight meals handled by LLSHK and the net profit of LLSHK in 2003 was mainly attributable to the negative impact of the outbreak of SARS which adversely affected the passenger traffic of HKIA, which in turn reduced the demand for airline catering services. According to production figures of LLSHK provided by the Company, we note that the number of inflight meals handled by LLSHK had recovered from the negative impact of SARS in the fourth quarter of 2003 and has benefited from the growth in the region's aviation market. According to production figures of LLSHK provided by the Company, we note that the number of inflight meals handled by LLSHK for the six months ended 30 June 2004 amounted to approximately 3 million, compared with approximately 4.4 million inflight meals handled by LLSHK for the full year of 2003.

According to the statistics issued by Airports Council International, an international association of the world's airports, HKIA was the second and the third busiest airport in Asia in terms of passenger traffic in 2002 and 2003 respectively. The table below sets out the number of passengers handled by HKIA for the two years ended 31 December 2003 and the seven months ended 31 July, 2003 and 2004.

	Arrival	Departure	Total
2002	16,772,252	16,679,320	33,451,572
2003	13,419,252	13,333,042	26,752,294
2003 (Jan – Jul)	6,368,091	6,445,446	12,813,537
2004 (Jan – Jul)	10,181,397	10,065,950	20,247,347

Source: HKIA

As illustrated above, the number of passengers handled by HKIA decreased by approximately 6.7 million or 20.0% from approximately 33.5 million in 2002 to approximately 26.8 million in 2003 due to the outbreak of SARS in the first half of 2003. However, passenger traffic numbers at HKIA have recovered after the World Health Organization removed Hong Kong from the list of areas affected by SARS on 23 June 2003. According to HKIA, the number of passengers handled by HKIA increased by approximately 7.5 million or 58.6% from approximately 12.8 million in the seven months ended 31 July 2003 to approximately 20.3 million during the same period in 2004. In addition, on 15 August 2004, the HKIA announced that passenger traffic numbers at HKIA rose to 3,448,000 in July, breaking any monthly record ever made in Hong Kong, reflecting that the region's aviation market is expanding rapidly.

LETTER FROM KINGSWAY CAPITAL

(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 region. As stated in the announcement dated 26 April 2004, Fly Top entered into the Beijing Contract and the Chengdu Contract on 21 April 2004 which were supplemented on 26 April 2004 pursuant to which Fly Top has conditionally agreed to acquire from Air China 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.

As set out in the section headed "Reasons for the Acquisitions" in the "Letter from the Board" in this circular, the Directors consider that the Acquisitions are in line with the Group's long-term expansion strategy. As LLSHK, BACL and SWACL are major providers of inflight catering services in Greater China, following the completion of the Acquisition Agreements, the Beijing Contract and the Chengdu Contract, the Group will be interested in one of the biggest aviation-catering groups in Greater China in term of number of inflight meals handled and will further enhance the Group's position as a major conglomerate in Greater China for aviation and related businesses.

On the basis of the above, in particular (1) the growing economic ties and increasing number of tourists between Hong Kong and the mainland China as well as the opening of a major theme park in Hong Kong in the near future; (2) the ranking of HKIA among the top busiest airports in Asia; (3) the increasing passenger traffic numbers at HKIA in the first half of 2004 as shown above; and (4) the market share of the LLSHK (in term of the number of inflight meals handled) and the profitable track record of LLSHK shown in 2002 and 2003, although the financial performance of LLSHK was affected by the outbreak of SARS in 2003, we concur with the Directors' view 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 Greater China for aviation and related businesses, and ultimately create value for Shareholders

(4) *Consideration and valuation*

According to the terms of the Acquisition Agreements, the aggregate cash consideration for the CNACG Acquisition and the HKIAC Acquisition amounted to approximately HK\$113.5 million ("Consideration") which will be funded by the Group's internal resources.

As stated in the "Letter from the Board" in this circular, the Board is of the view that the Consideration has been arrived at after arm's length negotiations between the parties taking into consideration the value and financial position of LLSHK. Furthermore, the Directors consider that it is not appropriate to determine the Consideration based on the profit figures of LLSHK for the year 2003 because of the impact of the outbreak of SARS on the financial performance of LLSHK.

LETTER FROM KINGSWAY CAPITAL

In assessing the reasonableness of the Consideration, we have made reference to the price-earning multiples (“P/E Multiples”) of (1) comparables in the Asia Pacific region whose principal business is similar to that of LLSHK; and (2) BACL and SWACL which will be acquired by the Group in accordance with the Beijing Contract and Chengdu Contract (“Comparable Transactions”). Regarding the comparables in the Asia Pacific region, we have identified one Singapore-listed company, namely Singapore Airport Terminal Services Limited (“Comparable Company”) as similar comparable for our P/E Multiples analysis. However, we are not aware of any direct or close comparables companies listed in Hong Kong which have similar businesses as those of LLSHK.

Set out below are the P/E Multiples of the LLSHK, the Comparable Transactions and the Comparable Company. The P/E Multiples of the Comparable Company is based on its market price as at the Latest Practicable Date and its audited financial information for the financial year ended 31 March 2003. Shareholders should note that, according to the 2003/2004 annual report of the Comparable Company, its profit after tax decreased by Singapore dollar (“SGD”) 25.2 million or 11.7% from SGD214.8 million in financial year ended 31 March 2003 to SGD189.6 million in financial year ended 31 March 2004 mainly because of flight cancellations and drop in passenger loads as a result of the outbreak of SARS during the period March to June 2003. Under this circumstance, we consider that it is more appropriate to use the audited finance information of the Comparable Company during the financial year ended 31 March 2003, instead of the financial year ended 31 March 2004, for the below P/E Multiples analysis.

The financial information applied in calculating the P/E Multiples of the LLSHK and the Comparable Transactions, were derived from (1) the consideration for the Acquisitions and the Comparable Transactions; and (2) the audited accounts of LLSHK for the year ended 31 December 2002 prepared in accordance with HKSSAP, and the unaudited accounts of BACL and SWACL for the year ended 31 December 2002 prepared in accordance with PRC Accounting Regulations, after making adjustments to comply with HKSSAP.

Company	Country	Market capitalization as at the Latest Practicable Date (HK\$ million)	P/E Multiples (X)
<i>Comparable Company:</i>			
Singapore Airport Terminal Services Limited	Singapore	9,578	9.8 (Note 1)
<i>Comparable Transactions:</i>			
BACL	PRC	N/A	10.6 (Note 2)
SWACL	PRC	N/A	8.4 (Note 3)
LLSHK	Hong Kong	N/A	10.6 (Note 4)

Sources: Bloomberg

LETTER FROM KINGSWAY CAPITAL

Notes:

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

In assessing the reasonableness of the Consideration, we have compared the P/E Multiples of the LLSHK based on its net profit for the year ended 31 December 2002 ("2002 Multiples") with (1) the P/E Multiples of the Comparable Company based on its net profit for the year ended 31 March 2003; and (2) the P/E Multiples of the Comparable Transactions based on their respective net profit for the year ended 31 December 2002.

As illustrated above, although the 2002 Multiples implied under the Consideration is slightly higher than the P/E Multiples of SWACL and the Comparable Company, the 2002 Multiples is comparable to the P/E Multiples of BACL.

Having regard to the above P/E Multiples analysis on the LLSHK, Comparable Company and Comparable Transactions, and taking into account the benefits of the Acquisitions as set out in the section headed "Reasons for the Acquisitions" in the "Letter from the Board" in this circular, we consider that the Consideration to be fair and reasonable so far as the Company and the independent Shareholders are concerned.

(5) *Estimated financial effects of the Acquisitions on the Group*

(i) *Earnings*

Upon completion of the Acquisitions, the Company will indirectly be interested in approximately 20.2% of the issued share capital of LLSHK. The financial results and positions of LLSHK will be equity accounted for 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 HK\$57.2 million based on the audited net asset value of LLSHK 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 LLSHK from the Airport Authority.

LETTER FROM KINGSWAY CAPITAL

According to the franchise agreement dated 4 March 1996 between the Airport Authority and LLSHK, the commencement date of the 15-year venture period granted to LLSHK was 6 July 1998, being the opening date of HKIA, and will expire on 5 July 2013. Based on the aforesaid accounting treatment, the amount of goodwill arising from the Acquisitions will be amortised over a period of 9 years. Approximately HK\$6.4 million will be charged to the profit and loss account of the Group on an annual basis after the completion of the Acquisitions.

Hypothetically, based on the net profit of LLSHK of approximately HK\$53.0 million in 2002 and taking into consideration aforesaid amortisation of Goodwill of approximately HK\$6.4 million, the Group would derive net income of approximately HK\$4.3 million from its investment in LLSHK, representing a return of approximately 3.8% per annum, should the Group be interested in 20.2% of the share capital of LLSHK throughout a whole year and therefore share 20.2% of the net profit of LLSHK. Such hypothetical return on investment is higher than the average interest rate which would otherwise be earned by the Group from its time deposits at licensed banks in Hong Kong.

Based on the above, in particular, the expected financial contribution from LLSHK to the Group, profitable track record and growth potential of LLSHK, 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 net tangible asset value of the Group will decrease by approximately 2.5% to approximately HK\$2,278.9 million. The reduction of HK\$57.2 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 upon completion of the Acquisitions, we consider that the earnings potential of LLSHK is a core factor in considering the fairness and reasonableness of the Consideration given the business nature of LLSHK. On the basis of the above and the benefits arising from the Acquisitions as set out in the section headed "Reasons for the Acquisition" in the "Letter from the Board" in this circular, we consider that such reduction in net tangible asset value of the Group is acceptable.

LETTER FROM KINGSWAY CAPITAL

(iii) Working capital

As set out in the "Letter from the Board" in this circular, the cash consideration of approximately HK\$113.5 million for the Acquisitions will be funded by the Group's internal resources.

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. However, Shareholders should note that the Company is required to settle the consideration of approximately RMB361 million (equivalent to approximately HK\$340.6 million) for the Beijing Acquisition and Chengdu Acquisition in cash upon the completion of the Beijing Contract and Chengdu Contract.

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 2004, compared with a net cash outflow from operating activities in 2003 due to the outbreak of SARS.

Given that (1) the Consideration only represents approximately 10.7% of the Group's cash and bank balances as at 31 December 2003; and (2) the Group is expected to generate positive net cash inflow from its operating activities in 2004, we concur with the Directors' view that the Acquisitions will not have significant negative impact on the working capital of the Group.

(II) Ongoing Connected Transactions

In arriving at our opinion on the terms of the Continuing Connected Transactions, we have taken into consideration the following factors and reasons:

(1) *Background and reasons for the BACL Contract and the SWACL Contracts*

(i) BACL

BACL was established as a sino-foreign joint venture in May 1988. According to the production figures of BACL and confirmation from the Company, BACL is the largest aircraft caterer in Beijing Capital International Airport in term of number of inflight meals handled, 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.

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(ii) SWACL

SWACL was established as a sino-foreign joint venture in July 1993. According to the production figures of SWACL and confirmation from the Company, SWACL is the largest aircraft caterer in Chengdu Shuangliu International Airport in term of number of inflight meals handled, 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.

(iii) Air China, Air China Southwest and Air China Zhejiang

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

Taking into account of the principal business of BACL and SWACL, we are of the view that the transactions contemplated or to be contemplated under the BACL Contract and the SWACL Contracts are conducted in the ordinary and usual course of business of the BACL and SWACL respectively.

As informed by the Company, BACL has been engaged in the provision of Inflight Catering Services to Air China in respect of all Beijing CA Flights since its incorporation in 1988. Air China has been the largest customer of BACL since the date of incorporation of BACL. As stated in the "Letter from the Board" in this circular, the sums received by BACL for the provision of Inflight Catering Services to Air China in respect of all Beijing CA Flights for the three years ended 31 December 2003 in accordance with PRC Accounting Regulations amounted to RMB100 million, RMB139 million and RMB119 million respectively, which accounted for approximately 37%, 43% and 45% of the BACL's audited turnover for the respective period.

Similar to BACL, SWACL also commenced to provide (1) Inflight Catering Services to Air China in respect of all Chengdu CA Flights operated by Air China, Air China Zhejiang and Air China Southwest respectively; and (2) inflight ancillary services to Air China Southwest in respect of all Chengdu CA Flights operated by Air China Southwest since SWACL was established in 1993. As stated in the "Letter from the Board" in this circular, the sums received by SWACL for the provision of Inflight Catering Services and other ancillary services to Air China, Air China Zhejiang and Air China Southwest in respect of all Chengdu CA Flights operated by Air China, Air China Zhejiang and Air China Southwest for the three years ended 31 December 2003 in accordance with PRC Accounting Regulations amounted to RMB43 million, RMB56 million and RMB45 million respectively, which accounted for approximately 70%, 83% and 70% of the SWACL's audited turnover for the respective period.

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According to the news release from Civil Aviation Administration of China, PRC aviation industry is expected to grow at the rate of 10% annually until year 2010. As Air China is the flag carrier in the PRC, we expect Air China will be benefit from the sustained growth of PRC aviation industry. The Directors consider that through the BACL Contract and the SWACL Contracts, BACL and SWACL can secure its sales of inflight meals to Air China, Air China Southwest and Air China Zhejiang, and are able to be benefited from the continuous growth of Air China.

In view of the above, in particular, (1) the transactions contemplated or to be contemplated under the BACL Contract and the SWACL Contracts are in the ordinary and usual course of business of BACL and SWACL; (2) BACL and SWACL have established stable and long term business relationship with Air China; (3) a significant portion of turnover of BACL and SWACL have derived from Air China, Air China Southwest and Air China Zhejiang under the BACL Contract and the SWACL Contracts during the past, we concur with the views of the Directors that it is in the interest of the Group to continue and maintain the existing business relationship with Air China, Air China Southwest and Air China Zhejiang through the BACL Contract and the SWACL Contracts.

(2) *Terms of the BACL Contract and the SWACL Contracts*

I. BACL Contract

Date: 5 August 2004

Parties: BACL and Air China

Pursuant to the BACL Contract, BACL agrees to provide Inflight Catering Services to Air China in respect of all Beijing CA Flights for a term of three years commencing on 5 August 2004. Unless the terms of the BACL Contract are amended or the BACL Contract is terminated by either party by way of 30 days prior written notice after the expiry of its term, the BACL Contract shall continue for another three years until it is terminated by either party by way of 30 days prior written notice. If the BACL Contract will continue or be renewed after the initial 3 years term, the Company will comply with the relevant requirements under the Listing Rules upon its renewal.

II. SWACL Catering Contracts

(a) SWACL Air China Catering Contract

Date: 7 March 2003

Parties: SWACL and Air China

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(b) SWACL Air China Zhejiang Catering Contract

Date: 15 December 2003

Parties: SWACL and Air China Zhejiang

(c) SWACL Air China Southwest Catering Contract

Date: 25 June 2002

Parties: SWACL and Air China Southwest

Pursuant to the SWACL Catering Contracts, SWACL agrees to provide Inflight Catering Services to Air China, Air China Zhejiang and Air China Southwest in respect of all Chengdu CA Flights operated by Air China, Air China Zhejiang and Air China Southwest. Apart from the SWACL Air China Zhejiang Catering Contract which has a term of one year that had commenced on 15 December 2003 and shall continue for another year until it is being terminated by either party by way of 30 days prior written notice, the term for each of the other SWACL Catering Contracts has already been renewed and shall continue for another year until it is terminated by either party by way of 30 days prior written notice. The Company undertakes that upon completion of the Chengdu Contract, the Company shall procure SWACL to revise the term of each of the SWACL Catering Contracts to a fixed term of not more than 3 years in compliance with the relevant requirements under the Listing Rules and the Company will issue a further announcement in compliance with the Listing Rules upon the revision of the terms of any of the SWACL Catering Contract. If any of the SWACL Catering Contract will continue or be renewed after such 3 years term, the Company will comply with the relevant requirements under the Listing Rules upon its renewal.

III. SWACL Supply Contract

Date: 25 June 2002

Parties: SWACL and Air China Southwest

Pursuant to the SWACL Supply Contract, SWACL agrees to supply inflight accessories and other consumable items, magazines and newspapers and souvenirs and provide any ancillary and recycling services to Air China Southwest in respect of all Chengdu CA Flights operated by Air China Southwest. The term for the SWACL Supply Contract has already been renewed and shall continue for another year until it is terminated by either party by way of 30 days prior written notice. The Company undertakes that upon completion of the Chengdu Contract, the Company shall procure SWACL to revise the term of the SWACL Supply Contract to a fixed term of not more

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than 3 years in compliance with the relevant requirements under the Listing Rules and the Company will issue a further announcement in compliance with the Listing Rules upon the revision of the terms of the SWACL Supply Contract. If the SWACL Supply Contract will continue or be renewed after such 3 years term, the Company will comply with the relevant requirements under the Listing Rules upon its renewal.

As stated in the “Letter from the Board” in this circular, the Board considered that the terms of each of the BACL Contract and the SWACL Contracts have been determined after arm’s length negotiations between the parties thereto and will be no less favourable to BACL or SWACL than terms available to and from Independent Third Parties provided that the volume and scope of services to be provided by BACL and/or SWACL to such Independent Third Party are similar to those provided to Air China, Air China Zhejiang and Air China Southwest, as the case may be.

In accordance with the terms of the BACL Contract and the SWACL Catering Contracts, BACL and/or the SWACL will charge a service fee for the Inflight Catering Services. As advised by the Company, such fees will be determined from time to time by reference to the number and type of inflight meals being provided and the type of aircraft to which service is being provided by BACL and SWACL under the BACL Contract and the SWACL Catering Contracts respectively. We further understand that bulk purchase discount will be offered to customers of BACL and/or the SWACL with sizable purchase volume. As advised by the Company, the same pricing policy with respect to the bulk discount is and will be applied to all customers of BACL and/or the SWACL. After discussion with management of the Company, we note that offering bulk discount to customers with sizeable purchase volume is common practice in the inflight catering industry.

In accordance with the terms of the SWACL Supply Contract, SWACL will charge a fee for the provision of inflight accessories and other consumable items, magazines and newspapers and souvenirs to Air China Southwest in respect of all Chengdu CA Flights operated by Air China Southwest. As advised by the Company, such fee will be determined by reference to the type of aircraft to which service is being provided by SWACL and such service fee charged to Air China Southwest will be similar to those offer to Independent Third Party, provided that the scope of services to be provided by SWACL to such Independent Third Party are similar to those provided to Air China Southwest.

Having considered the above as a whole, we are of the view that the terms of the BACL Contract and the SWACL Contracts are fair and reasonable so far as the independent Shareholders are concerned.

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(III) Proposed Caps

(1) Basis of determination

As mentioned in the “Letter from the Board” in this circular, the Proposed Caps are determined with reference to (a) the growth in passenger uplift as projected by the management of the Company; (b) historic percentage of Inflight Catering Services provided to Air China in respect of all Beijing CA Flights over BACL’s annual audited turnover; and (c) historic percentage of Inflight Catering Services and other ancillary services provided to Air China, Air China Zhejiang and Air China Southwest in respect of all Chengdu CA Flights operated by Air China, Air China Zhejiang and Air China Southwest over SWACL’s annual audited turnover. The table below set out the Proposed Caps for the transactions under the BACL Contract and the SWACL Contracts:

Agreement	Proposed Cap
BACL Contract	RMB200 million (net/excluding tax) (equivalent to approximately HK\$189 million)
SWACL Contracts	RMB70 million (net/excluding tax) (equivalent to approximately HK\$66 million)

As stated in the “Letter from the Board” in this circular, the Proposed Caps have been set for the coming 3 years upon the date of completion of the Beijing Contract and the Chengdu Contract. In any event, the BACL Contract and the SWACL Contracts will not exceed 3 years as BACL or SWACL, as the case may be, will have the right to terminate the relevant contract by way of giving 30 days prior written notice.

We note that there is a substantial increment between Proposed Caps and the historical figures of the BACL Contract and the SWACL Contracts. We have (i) reviewed the summary, the key components and the breakdown analysis which resulted in the amounts of the historical connected transactions under the BACL Contract and the SWACL Contracts; and (ii) discussed with the management of the Company on various relevant assumptions and basis that have been taken into account the determination of the Proposed Caps, in particular, (1) the outbreak of SARS in 2003 has had a material adverse impact on the financial performance of companies in the aviation-related business and (2) the business opportunities of BACL and SWACL arising from the sustainable growth of PRC aviation industry in the next few years as predicted by Civil Aviation Administration of China. We consider that the basis of the assumptions adopted by the Directors in arriving at the Proposed Caps to be fair and reasonable and have been prepared with due care and objectivity.

Having taken into account the above, we consider the basis of determining the Proposed Caps for the BACL Contract and the SWACL Contracts to be fair and reasonable so far as the Company and the Independent Shareholders are concerned.

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(2) *Conditions of the Proposed Caps*

The transactions contemplated and to be contemplated under the BACL Contract and the SWACL Contracts will be subject to the annual review requirement under Rules 14A.37 to 14A.41 and the reporting requirement under Rules 14A.45 and 14A.46 of the Listing Rules.

Pursuant to Rules 14A.37 to 14A.41 of the Listing Rules, the transactions contemplated and to be contemplated under the BACL Contract and the SWACL Contracts will be subject to the annual review by the independent non-executive Directors of the terms of the BACL Contract and the SWACL Contracts and the Proposed Caps not being exceeded, certain agreed-upon procedure to be performed by the auditors of the Company and details of which must be included in the Company's subsequent published annual reports and accounts. In addition, pursuant to Rule 14A.40 of the Listing Rules, the Company shall publish an announcement if it knows or has reason to believe that (1) the independent non-executive Directors and/or its auditors will not be able to confirm the terms of the BACL Contract, the SWACL Contracts; and (2) the transactions contemplated under the BACL Contract and the SWACL Contracts exceed the Proposed Caps. We are of the view that there are appropriate measures in place to govern the conduct of the BACL Contract and the SWACL Contracts, and safeguard the interests of the Shareholders.

OVERALL RECOMMENDATION

Having considered the principal factors and reasons discussed above, we are of the opinion that the terms of the Proposed Transactions as mentioned in the "Letter from the Board" in this circular, on the whole, are fair and reasonable so far as the independent Shareholders are concerned and the Proposed Transactions 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, Ongoing Connected Transactions and the Proposed Caps, 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\$	Percentage of issued share capital %
Chuang Shih Ping	33,126,000	26 October, 2003 to 25 October, 2009	1.14	1.00
Zhang Xianlin	33,126,000	26 October, 2003 to 25 October, 2009	1.14	1.00
Tsang Hing Kwong, Thomas	33,126,000	26 October, 2003 to 25 October, 2009	1.14	1.00
Gu Tiefei	5,000,000	26 October, 2003 to 25 October, 2009	1.14	0.15

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. CNAH is a state-owned enterprise 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	2,303,098,000 (<i>note 1</i>)	69.5%
CNACG	Beneficial owner	2,303,098,000 (<i>note 1</i>)	69.5%
Other Persons			
Best Strikes Limited	Beneficial owner	187,656,000	5.6%
On Ling Investments Limited	Attributable interest	322,856,000 (<i>note 2</i>)	9.7%
Novel Investments Holdings Limited	Attributable interest	322,856,000 (<i>note 2</i>)	9.7%
Novel Enterprises (BVI) Limited	Attributable interest	322,856,000 (<i>note 2</i>)	9.7%
Novel Credit Limited	Attributable interest	322,856,000 (<i>note 2</i>)	9.7%
Novel Holdings (BVI) Limited	Attributable interest	322,856,000 (<i>note 2</i>)	9.7%
Westleigh Limited	Attributable interest	322,856,000 (<i>note 2</i>)	9.7%
J.P. Morgan Chase & Co.	Investment manager	122,612,000	3.70%
	Custodian corporation/ approved lending agent	89,010,000	2.69%
J.P. Morgan Chase Bank	Attributable interest	89,010,000 (<i>note 3</i>)	2.69%
JF Asset Management Limited	Attributable interest	122,612,000 (<i>note 4</i>)	3.70%
J.P. Management Fleming Asset Management (Asia) Inc.	Attributable interest	122,612,000 (<i>note 4</i>)	3.70%
J.P. Morgan Fleming Asset Management Holdings Inc.	Attributable interest	122,612,000 (<i>note 4</i>)	3.70%

Note 1: The entire issued share capital of CNACG is beneficially owned by CNAH, a state-owned enterprise established in the PRC. Accordingly, the interests of CNACG 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.

Note 3: The interest held by it in the Company duplicates with J.P. Morgan Chase & Co.'s interest in the Company held by it as custodian corporation/approved lending agent.

Note 4: The interest held by these companies in the Company duplicates with J.P. Morgan Chase & Co.'s interest in the Company held by it as investment manager. 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.

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 licensed corporation holding a licence under the Securities and Futures Commission of Hong Kong to conduct type 6 (advising on corporate finance) of the regulated activity 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, 46th 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, 20 September 2004:

- (i) the Acquisition Agreements;
- (ii) the BA CL Contract;
- (iii) the SWACL Contracts; and
- (iv) the letter of advice from Kingsway Capital to the Independent Board Committee and the independent Shareholders set out on pages 22 to 36 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 (the “Meeting”) of China National Aviation Company Limited (the “Company”) will be held at Salon 6 (Level 3), JW Marriott Hong Kong, Pacific Place, 88 Queensway, Hong Kong at 4:00 p.m. on Monday, 20 September 2004 for the purpose of considering and, if thought fit, passing the following resolutions which will be proposed as ordinary resolutions:-

ORDINARY RESOLUTIONS

1. **“THAT** the agreement dated 19 August 2004 (the “CNACG Agreement”) entered into between Fly Top Limited (“Fly Top”), a wholly-owned subsidiary of the Company, and China National Aviation Corporation (Group) Limited (“CNACG”), pursuant to which Fly Top has conditionally agreed to acquire from CNACG 80 shares of HK\$1.00 each in the share capital of LSG Luftanasa Service Hong Kong Limited (the “CNACG Acquisition”) for a cash consideration of HK\$89 million (a copy of the CNACG Agreement has been produced to this meeting marked “A” and initialled by the chairman of this meeting for the purpose of identification), the CNACG Acquisition and the transactions contemplated under the CNACG Agreement, each be and is hereby approved and ratified, and that the directors of the Company be and are hereby authorized 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 CNACG Agreement.”
2. **“THAT** the agreement dated 19 August 2004 (the “HKIAC Agreement”) entered into between Fly Top and Hong Kong International Air Catering Limited (“HKIAC”), pursuant to which Fly Top has conditionally agreed to acquire from HKIAC 21 shares of HK\$1.00 each in the share capital of LSG Luftanasa Service Hong Kong Limited (the “HKIAC Acquisition”) for a cash consideration of HK\$24.5 million (a copy of the HKIAC Agreement has been produced to this meeting marked “B” and initialled by the chairman of this meeting for the purpose of identification), the HKIAC Acquisition and the transactions contemplated under the HKIAC Agreement, each be and is hereby approved and ratified, and that the directors of the Company be and are hereby authorized 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 HKIAC Agreement.”

NOTICE OF EXTRAORDINARY GENERAL MEETING

3. “THAT

- (a) the contract dated 5 August 2004 (the “BACL Contract”) entered into between Beijing Air Catering Co., Ltd. (“BACL”), a subsidiary of the Company upon completion of the acquisition of 60% equity interest in BACL by the Company, and Air China International Corporation (“Air China”), pursuant to which BACL has agreed to provide inflight catering services to Air China in respect of all inbound and outbound flights to and from Beijing Capital International Airport operated by Air China with flight numbers carrying the prefix of CA (a copy of the BACL Contract has been produced to this meeting marked “C” and initialled by the chairman of this meeting for the purpose of identification) and the transactions contemplated under the BACL Contract, each be and is hereby approved and ratified on the condition that the annual amount for the transactions contemplated under the BACL Contract shall not exceed RMB200 million; and
- (b) the directors of the Company be and hereby authorized 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 BACL Contract.”

4. “THAT

- (a) (i) the contract dated 7 March 2003 (the “SWACL Air China Contract”) entered into between Southwest Air Catering Company Limited (“SWACL”), a subsidiary of the Company upon completion of the acquisition of 60% equity interest in SWACL by the Company, and Air China (a copy of the SWACL Air China Contract has been produced to this meeting marked “D” and initialled by the chairman of this meeting for the purpose of identification); (ii) the contract dated 15 December 2003 (the “SWACL Air China Zhejiang Contract”) entered into between SWACL and the Zhejiang branch of Air China (“Air China Zhejiang”) (a copy of the SWACL Air China Zhejiang Contract has been produced to this meeting marked “E” and initialled by the chairman of this meeting for the purpose of identification); (iii) the contract dated 25 June 2002 (the “SWACL Air China Southwest Contract”) entered into between SWACL and the Southwest branch of Air China (“Air China Southwest”, formerly known as Southwest Airlines Corporation) (a copy of the SWACL Air China Southwest Contract has been produced to this meeting marked “F” and initialled by the chairman of this meeting for the purpose of identification); and (iv) the contract dated 15 December 2003 (the “SWACL Supply Contract”) entered into between SWACL and Air China Southwest (a copy of the SWACL Supply Contract has been produced to this meeting marked “G” and initialled by the chairman of this meeting for the purpose of identification), pursuant to which SWACL has agreed

NOTICE OF EXTRAORDINARY GENERAL MEETING

to provide inflight catering services and supply inflight accessories and other consumable items to Air China, Air China Zhejiang and Air China Southwest in respect of all inbound and outbound flights to and from Chengdu Shuangliu International Airport operated by Air China, Air China Zhejiang and Air China Southwest with flight numbers carrying the prefix of CA and the transactions contemplated under each of the SWACL Air China Contract, the SWACL Air China Zhejiang Contract, SWACL Air China Southwest Contract and the SWACL Supply Contract each be and is hereby approved and ratified on the condition that the annual aggregate amount for the transactions contemplated under the SWACL Air China Contract, the SWACL Air China Zhejiang Contract, SWACL Air China Southwest Contract and the SWACL Supply Contract shall not exceed RMB70 million; and

- (b) the directors of the Company be and hereby authorized 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 each of the SWACL Air China Contract, the SWACL Air China Zhejiang Contract, SWACL Air China Southwest Contract and the SWACL Supply Contract.”

By order of the board
Li Man Kit
Company Secretary

2 September 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 in the circular to be dispatched by the Company. 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 46th 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.