



中航興業有限公司

CHINA NATIONAL AVIATION COMPANY LIMITED

(incorporated in Hong Kong with limited liability)

(Stock Code: 1110)

CNAC 2004 INTERIM RESULTS ANNOUNCEMENT

The Board of Directors (the “Directors”) of China National Aviation Company Limited (the “Company”) is pleased to present the unaudited consolidated interim results of the Company and its subsidiaries (collectively the “Group”) for the six months ended 30th June, 2004 as set out below:

UNAUDITED CONSOLIDATED PROFIT AND LOSS ACCOUNT

For the six months ended 30th June 2004

	Note	Six months ended 30th June,	
		2004 HK\$'000	2003 HK\$'000
Turnover		788,129	513,526
Other revenues		2,226	8,209
Total revenues		<u>790,355</u>	<u>521,735</u>
Staff costs		107,421	117,017
Passenger catering and service costs		43,064	31,392
Fuel costs		144,635	82,261
Route operating costs		195,076	131,862
Aircraft maintenance costs		52,929	76,049
Aircraft leases and equipment costs		161,840	170,844
Depreciation and amortisation costs		40,900	45,772
Sales and promotion costs		26,029	24,906
Other operating costs		34,305	32,192
Total operating expenses		<u>806,199</u>	<u>712,295</u>
Operating loss	2	(15,844)	(190,560)
Share of profits less losses of associated companies		166,568	(98,606)
Profit/(loss) before taxation		150,724	(289,166)
Taxation (charge)/credit	3	(22,798)	39,083
Profit/(loss) after taxation		127,926	(250,083)
Minority interests		(7,282)	68,796
Profit/(loss) attributable to shareholders		<u>120,644</u>	<u>(181,287)</u>
Proposed interim dividends	4	<u>19,876</u>	<u>9,938</u>
		<i>HK cents</i>	<i>HK cents</i>
Earnings/(loss) per share			
Basic	5	<u>3.64</u>	<u>(5.47)</u>
Diluted	5	<u>3.61</u>	<u>N/A</u>

Notes:

1. Segment information

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

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

	Six months ended 30th June, 2004			Group HK\$'000
	Airline operation HK\$'000	Airport ground handling HK\$'000	Logistics and other businesses HK\$'000	
Segment revenues	<u>789,434</u>	<u>–</u>	<u>–</u>	<u>789,434</u>
Segment results	<u>4,131</u>	<u>–</u>	<u>–</u>	<u>4,131</u>
Interest income				921
Unallocated costs				<u>(20,896)</u>
Operating loss				<u>(15,844)</u>
Share of profits less losses of associated companies	102,065	69,244	(4,741)	<u>166,568</u>
Profit before taxation				150,724
Taxation charge				<u>(22,798)</u>
Profit after taxation				127,926
Minority interests				<u>(7,282)</u>
Profit attributable to shareholders				<u>120,644</u>

	Six months ended 30th June, 2003			Group HK\$'000
	Airline operation HK\$'000	Airport ground handling HK\$'000	Logistics and other businesses HK\$'000	
Segment revenues	<u>516,044</u>	<u>–</u>	<u>–</u>	<u>516,044</u>
Segment results	<u>(176,428)</u>	<u>–</u>	<u>–</u>	<u>(176,428)</u>
Interest income				5,691
Unallocated costs				<u>(19,823)</u>
Operating loss				<u>(190,560)</u>
Share of losses less profits of associated companies	(128,961)	34,909	(4,554)	<u>(98,606)</u>
Loss before taxation				(289,166)
Taxation credit				<u>39,083</u>
Loss after taxation				(250,083)
Minority interests				<u>68,796</u>
Loss attributable to shareholders				<u>(181,287)</u>

2. Operating loss

Operating loss is stated after charging the following:

	Six months ended 30th June,	
	2004 HK\$'000	2003 HK\$'000
Amortisation of intangible assets		
– Goodwill	9,419	9,419
– Deferred expenditure	30	76
Cost of inventories consumed	20,499	20,867
Depreciation of fixed assets	<u>31,449</u>	<u>36,277</u>

3. Taxation (charge)/credit

	Six months ended 30th June,	
	2004	2003
	HK\$'000	HK\$'000
Company and subsidiaries:		
Current		
– Macau Complementary Tax	100	–
– Taxation outside Hong Kong and Macau	(542)	(386)
Deferred	(613)	27,702
	(1,055)	27,316
Associated companies	(21,743)	11,767
	(22,798)	39,083

Hong Kong profits tax has been provided at the rate of 17.5% (six months ended 30th June, 2003: 17.5%) on the estimated assessable profit for the period. Macau Complementary Tax has been provided at the rate of 15.75% (six months ended 30th June, 2003: 15.75%) on the estimated assessable profit for the period. Taxation outside Hong Kong and Macau has been calculated on the estimated assessable profit for the period at the rates of taxation prevailing in the countries in which the Group operates.

4. Interim dividends

	Six months ended 30th June,	
	2004	2003
	HK\$'000	HK\$'000
Interim of HK0.6 cent (six months ended 30th June, 2003: HK0.3 cent) per share	19,876	9,938

At a meeting held on 17th September, 2004, the Directors declared an interim dividend of HK0.6 cent per share for the year ending 31st December, 2004. This dividend is not reflected as a dividend payable in these accounts, but will be reflected as an appropriation of retained earnings for the year ending 31st December, 2004.

5. Earnings/(loss) per share

The calculations of basic and diluted earnings/(loss) per share are based on the Group's profit attributable to shareholders of HK\$120,644,000 (six months ended 30th June, 2003: loss of HK\$181,287,000).

The basic earnings/(loss) per share is based on the weighted average of 3,312,680,000 shares (six months ended 30th June, 2003: 3,316,939,359 shares) in issue during the period. The diluted earnings per share for the six months ended 30th June, 2004 is based on 3,342,630,924 shares representing the weighted average of shares in issue during the period plus the weighted average 29,950,924 shares which would be issued at no consideration on the exercise of all dilutive options. No diluted loss per share for the six months ended 30th June, 2003 was presented as the exercise of options was anti-dilutive.

MANAGEMENT DISCUSSION AND ANALYSIS

Review of Operations and Prospects

Since the latter part of 2003 the continuous growth in the regional economy overwhelmed the effect of the scattered cases of Severe Acute Respiratory Syndrome ("SARS") and the outbreak of Bird Flu in certain parts of Asia during the first half of 2004. Recovery of the worldwide travel market in the second quarter marked record growth in the passenger transportation in the Greater China market. With the sustained rise in international fuel price, the fuel surcharge for passenger traffic and fuel hedging programme could not compensate for the increased operating costs caused by such rise, the air transportation operation of the Group still managed to obtain positive performance.

For the six months ended 30th June, 2004, the Group recorded a net profit attributable to shareholders of HK\$120.6 million whereas there was a loss attributable to shareholders of HK\$181.3 million for the first half of 2003. Turnover of the Group increased by 53.5 per cent to HK\$788.1 million and loss in the operating results of the Group decreased by 91.7 per cent to HK\$15.8 million during the period as compared to the corresponding period of 2003.

In April 2004, the Group entered into certain acquisition agreements with Air China International Corporation ("Air China") to acquire 60 per cent of the equity interest in Beijing Air Catering

Co., Ltd. (“BACL”) and 60 per cent of the equity interest in Southwest Air Catering Company Limited (“SWACL”) for a total consideration of HK\$340.6 million. The principal business of BACL is the provision of in-flight catering services and other related in-flight food and beverage services, as well as the production of Chinese and western snack food and beverages for the Beijing Capital International Airport (“Capital Airport”). The principal business of SWACL is the production of food, beverages and other in-flight services products, the provision of other related services and the sale of its own products in Chengdu Shuangliu International Airport (“Shuangliu Airport”). These acquisitions are expected to be completed in the second half of 2004.

Air Macau Company Limited (“Air Macau”)

In the first half of 2004, the operations of Air Macau was adversely affected by the alarm over SARS in January, the outbreak of Bird Flu in Thailand and other parts of Asia and a minor outbreak of SARS in May 2004 in Beijing which resulted in the cancellation of bookings and group seats.

Total operating revenue in the first half of 2004 increased by 53.5 per cent over the same period in 2003. During the period, Air Macau operated a total of 9,549 flights and carried a total of 790,355 passenger-sectors, representing 56.8 per cent and 69.4 per cent increase, respectively, compared to the corresponding period in 2003. Air Macau inaugurated daily passenger services to Shenzhen in March to capitalise the niche for convenient and hassle free services between Taiwan region and Pearl River Delta. At the same time, Air Macau restructured its network to meet increasing demand in Shanghai and improved its overall aircraft utilisation. As a result of these manoeuvres, revenue passenger kilometres and available seat kilometres increased by 60.2 per cent and 41.9 per cent respectively. Passenger load factor improved by 7.6 percentage points but the average passenger yield decreased by 8.0 per cent as compared to the first six months of 2003.

Air Macau acquired two A300B4 freighters in the first half of 2004. The first unit was delivered in April and it was deployed immediately to operate between Shanghai, Macau and Taipei. The second unit was delivered in May 2004 and now operates between Nanjing, Macau and Taipei. During the period, cargo uplift as measured by cargo tonne kilometres and available tonne kilometres increased by 69.2 per cent and 98.9 per cent respectively over the corresponding period of 2003. With the increased capacity, cargo load factor achieved 65.2 per cent in the first half of 2004. The cargo revenue from freighter operation increased by 104.3 per cent but the average cargo yield per cargo tonne kilometre was merely decreased by 0.6 per cent.

The carrier’s operating fleet at the end of June 2004 was fourteen aircraft, comprising eleven passenger aircraft (five A319s, one A320 and five A321s) and three freighters (one B727F and two A300B4s).

As at 30th June, 2004, Air Macau operated passenger services to thirteen regional destinations, of which nine are in the China mainland and it also offered freighter services to Shanghai, Nanjing, Shenzhen and Taipei.

Aside from adopting measures to further improve cost control management and efficiency, Air Macau plans to introduce different products and services to meet challenges from its competitors.

Hong Kong Dragon Airlines Limited (“Dragonair”)

During the first half of 2004, Dragonair reverted from a loss to profit position and its profit returned to the 2002 level, a sharp improvement from the loss position which resulted during the same period last year when it was adversely affected by the impact of SARS.

Passenger revenue increased significantly by 81.9 per cent to HK\$2,301.1 million over the same period in 2003. Passenger numbers reached 2.2 million, representing a 92.1 per cent increase, while passenger load factor also increased by 10.9 percentage points to 61.3 per cent. However, due to severe market competition, the longer-haul services launched during the first half of 2004 caused a lower yield on a per kilometre basis and therefore passenger yield decrease of 8.0 per cent.

The effect of SARS on cargo services is relatively less. Cargo revenue increased by 21.8 per cent as compared with the same period in 2003. Cargo demand remains strong with 148,000 tonnes of cargo carried in the first half of 2004, an increase of 22.3 per cent. Cargo load factor decreased by

8.6 percentage points to 74.1 per cent. During the period cargo yield increased by 12.8 per cent mainly due to favourable currency movements and more regional freighter services generating higher yield being provided in Asia.

Dragonair entered into a code sharing agreement with Air China in February 2004 in respect of the Chengdu, Chongqing, Dalian and Tianjin routes. In addition, Dragonair commenced passenger service to Tokyo in April 2004 and freighter service to Nanjing in June 2004. As at 30th June, 2004, Dragonair operated passenger services to twenty nine destinations in Asia of which twenty are in the China mainland and provided freighter services to eight destinations in Asia, the Middle East and Europe including the United Kingdom.

During the period, one A330 passenger aircraft under operating lease and one A300B4 freighter under wet lease were delivered in March and June 2004 respectively. At the end of June 2004, Dragonair's fleet in service comprised of eight A320, six A321 and ten A330 passenger aircraft and one A300B4 and three B747-300 freighters. Dragonair also purchased a B747-200 freighter, which commenced service to Frankfurt and London in July, 2004. Dragonair also purchased two A320 passenger aircraft which were deployed for routes in the China mainland.

A total of 19 aircraft of which all of the narrow-body aircraft and one-half of the wide-body aircraft had been reconfigured with new cabin design that included new passenger seats, colour combinations, fabrics and serviceware. The wide-body aircraft fleet was also equipped with in-flight entertainment system.

With the introduction of new passenger services to Bangkok and Tokyo, Dragonair will continue to expand its operations for non-China routes in the near future to reduce its reliance on China destinations. In 2005, Dragonair will take delivery of three additional A330 aircraft under operating lease and also purchase one more A320 aircraft so as to meet its expansion plan for passenger services. In 2006, Dragonair will acquire three more A330 aircraft under operating leases. In addition, Dragonair plans to acquire five more B747-400 freighters so as to further expand its cargo business.

For the third consecutive year, Dragonair had been voted 'The Best Airline-China' in the Skytrax passenger survey. Dragonair was also ranked as one of the top world's 20 airlines for best services, moving from the 21st in the previous year to the 18th position in the 'Skytrax Airline of the Year' survey.

In the first half of 2004, fuel cost accounted for 16.6 per cent of its total operating expenditure, up from 13.0 per cent for the same period last year. Hong Kong Civil Aviation Department approved Dragonair's application to levy a fuel surcharge on passenger traffic from Hong Kong with effect from 7th June, 2004 and fuel surcharge for cargo had also been revised upward. Due to these surcharges and the on-going fuel hedging programme in place, the impact of the effect of high fuel prices had been partially alleviated.

Despite the challenges ahead, Dragonair's management remains confident on the future of the airline due to the rapid economic growth of the China mainland. It is considering plans to take advantage of the business opportunities provided by Stage Two of the Closer Economic Partnership Arrangement and the recently concluded agreement in air services arrangements between the governments of China and the Hong Kong Special Administrative Region.

Jardine Airport Services Limited ("JASL")

During the period, the consolidated turnover of JASL increased by 39.2 per cent which was mainly due to favourable market conditions that have bounced back to the pre-SARS level. JASL handled 28,230 aircraft movements, an increase of 47 per cent over that of 2003, and maintained an approximately 40 percent of the third-party market at the Hong Kong International Airport (the "HK Airport"). Jardine Air Terminal Services Limited ("JATS") handled 38,810 aircraft movements, an increase of 40.2 per cent compared to the same period in 2003, representing an approximately 60 per cent share of the third-party market at the HK Airport.

In March 2004, JASL acquired a 50 per cent shareholding in Ground Support Engineering Limited, its principal activity is the provision of ground support equipment maintenance services.

Given the strong support and business connections of its shareholders, JASL continues to explore new business opportunities in the China mainland and is confident of successfully securing these opportunities.

Menzies Macau Airport Services Limited (“Menzies Macau”)

For the first quarter of 2004, Menzies Macau handled 4,030 aircraft movements, representing a reduction of 8 per cent, but the cargo volume had increased by 47 per cent, reaching 10,150 tonnes as compared with the same period in 2003. With the expansion of Air Macau’s freighter operations and the commencement of Shanghai Airline freighter services in the second quarter of 2004, Menzies Macau will need to handle more aircraft movements and air cargoes.

In the first half of 2004, Menzies Macau provided ground services for 8,794 aircraft movements and 74,700 tonnes of cargo. With the adverse impact of SARS affecting the performance for the first half of 2003, it cannot be used as an indicator for comparison with the same period for 2004. However, Menzies Macau’s turnover and cargo volume had increased as compared with the first six months of 2003.

Since the start of this year, the business activity of Menzies Macau has not been abated and it is expected that there will be better performance during the remaining period of this year.

Tradeport Hong Kong Limited (“Tradeport Hong Kong”)

During the first half of 2004, Tradeport Hong Kong’s business activities had grown significantly and became fully operational with several major logistics contracts being implemented. As at the end of June 2004, its utilisation had reached approximately 48 per cent of its capacity.

Outlook

While the price of crude oil has come down from its historical peak, conditions remain volatile and fuel prices will possibly maintain at high level and thus resulting an increase in the operating costs of the Group’s air transportation business. The combination of the fuel surcharge levy and the fuel hedging programme will only partially offset the increased fuel costs and the adverse impact on the performance of the airline operations this year will still exist.

The Group has taken steps to diversify its business portfolio, expanding into the catering business in the Capital Airport and Shuangliu Airport. This is the first time for the Group entering into aviation-related businesses in the China mainland.

The introduction of low-cost carriers to Macau has intensified competition in the air transport market for that region. However the gradual opening of new casinos by casino licence holders would also bring along an increase in the number of tourists to Macau. Air Macau, aside from continuing with costs reduction, is presently actively looking to improve its operations through the provision of diversified products and exploration of new destinations.

Although the prospect for the region economy looks upbeat and we expect strong demands for the transportation business during the next half of this year, we remain optimistic and hope to achieve better results for the Group.

Financial Review

Liquidity and Financial Resources

As at 30th June, 2004, the Group’s shareholders’ funds amounted to HK\$2,743 million, compared to HK\$2,642 million as at 31st December, 2003.

The Group generally financed its operations with cash flows generated internally. As at 30th June, 2004, the Group had cash and bank balances of a total amount of approximately HK\$1,088 million and net current assets of approximately HK\$907 million, as compared to HK\$1,063 million and HK\$850 million respectively as at 31st December, 2003. The current liabilities of the Group increased from HK\$417 million (as at 31st December, 2003) to approximately HK\$430 million as at 30th June, 2004. The Group had no outstanding borrowings and consistently maintained a strong working capital base that provides a good foundation for the Group’s future business development.

Share Capital

Neither the Company nor any of its subsidiaries has purchased, sold or redeemed any of the Company’s shares during the six months ended 30th June, 2004.

Apart from 32,351,800 options which expired in March 2004, there were no options granted or exercised during the period, and 104,378,000 options remained outstanding as at 30th June, 2004.

As at 30th June, 2004, 3,312,680,000 shares were in issue (31st December, 2003: 3,312,680,000 shares).

Contingent Liabilities and Commitments

As at 30th June, 2004, the Group had given a guarantee of HK\$15 million to a bank for the banking facilities provided to an associated company, and in February 2001, the Group together with the Tradeport Logistics Centre consortium partners jointly gave a guarantee to the Hong Kong Airport Authority in respect of their obligations to provide sufficient funding for the development of the Tradeport Logistics Centre. On 17th March, 2004, Hong Kong Airport Authority agreed to reduce the maximum liability limit from approximately HK\$780 million to approximately HK\$312 million. The Directors are of the opinion that, had the Group been required to perform its obligation under the guarantee in the event of default of all of the consortium partners, the maximum amount of the contingent liabilities assumed, including the Group's estimated share of capital commitments of approximately HK\$78 million, would have been approximately HK\$312 million.

Charge on Assets

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

Foreign Exchange and Currency Risks

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

Human Resources

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

Air Macau, a 51 per cent held subsidiary, employs about 740 staff (six months ended 30th June, 2003: 800 staff), of which about 162 (six months ended 30th June, 2003: 144) are based outside Macau. Employees' remuneration packages are designed and structured based on the foregoing market conditions, relevant laws and regulations, industry practices and standards, work performance, education or professional training background and past working experience.

CORPORATE GOVERNANCE

The Company has complied throughout the six months ended 30th June, 2004 with the Code of Best Practice as set out in the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the "Listing Rules"), save and except that the independent non-executive directors are not appointed for any specific term are subject to retirement by rotation and re-election at the annual general meeting of the Company in accordance with the Articles of Association of the Company.

AUDIT COMMITTEE

The audit committee consists of three independent non-executive directors, namely Mr. Lok Kung Nam, Dr. Hu Hung Lick, Henry and Mr. Li Kwok Heem, John. The audit committee has reviewed with the management the accounting principles and practices adopted by the Group, and discussed auditing, internal control and financial matters including the review of the unaudited interim results for the six months ended 30th June, 2004.

INTERIM DIVIDEND

The Directors have declared an interim dividend of HK0.6 cent per share for the six months ended 30th June, 2004 (six months ended 30th June, 2003: HK0.3 cent per share) payable to the shareholders ("Eligible Shareholders") whose names appear on the Register of Members of the Company on Friday, 8th October, 2004. Dividend warrants will be despatched to the Eligible Shareholders on or about Wednesday, 27th October, 2004.

CLOSURE OF REGISTER OF MEMBERS

The Register of Members will be closed from Monday, 4th October, 2004 to Friday, 8th October, 2004 both days inclusive, during which period no transfers of shares will be registered. In order to qualify for the interim dividend, all transfer documents together with the relevant share certificates must be lodged with the Company's Share Registrars, Computershare Hong Kong Investor Services Limited, 17th Floor, Hopewell Centre, 183 Queen's Road East, Hong Kong not later than 4:00 p.m. on Thursday, 30th September, 2004.

SUBSEQUENT EVENT

On 19th August, 2004, the Group entered into certain acquisition agreements with CNACG and Hong Kong International Air Catering Limited to acquire approximately 16 per cent and 4.2 per cent, respectively, of the equity interest in LSG Lufthansa Service Hong Kong Limited ("LLSHK") for a total consideration of approximately HK\$113.5 million. The principal business of LLSHK is the provision of in-flight catering and laundry services and the operation of airport lounges, including a restaurant at the HK Airport. These acquisitions are expected to be completed in the second half of 2004.

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

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

BOARD OF DIRECTORS

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

On behalf of the Board
KONG DONG
Chairman

Hong Kong, 17th September, 2004

"Please also refer to the published version of this announcement in The Standard."