



中航興業有限公司

CHINA NATIONAL AVIATION COMPANY LIMITED

(於香港註冊成立之有限公司)

(incorporated in Hong Kong with limited liability)

2004

中期報告

INTERIM REPORT



CORPORATE INFORMATION

Directors

Kong Dong (*Chairman*)

Chuang Shih Ping

Zhang Xianlin

Tsang Hing Kwong, Thomas

Gu Tiefei

Zhao Xiaohang (*Appointed on 31st May, 2004*)

Lok Kung Nam*

Hu Hung Lick, Henry*

Ho Tsu Kwok, Charles*

Li Kwok Heem, John*

Chan Ching Har, Eliza* (*Appointed on 26th August, 2004*)

* *Independent Non-Executive Directors*

Company Secretary

Li Man Kit

Registered Office

5th Floor, CNAC House

12 Tung Fai Road

Hong Kong International Airport

Lantau

Hong Kong

Principal Bankers

Bank of China (Hong Kong) Limited

Nanyang Commercial Bank, Ltd.

Bank of Communications, Hong Kong Branch

Solicitors

Baker & McKenzie

Auditors

PricewaterhouseCoopers

Public Relations

Ketchum Newscan Public Relations Limited

Share Registrars

Computershare Hong Kong Investor Services Limited

17th Floor, Hopewell Centre

183 Queen's Road East

Wanchai

Hong Kong

Financial Calendar

Six months ended 30th June 2004

Book Close from 4th October, 2004

to 8th October, 2004

2004 interim dividend payable 27th October, 2004



The Board of Directors (the “Directors”) of China National Aviation Company Limited (the “Company”) is pleased to present the Interim Report and accounts of the Company and its subsidiaries (collectively the “Group”) for the six months ended 30th June, 2004. The consolidated results, consolidated cash flow statement and consolidated statement of changes in equity for the Group for the six months ended 30th June, 2004, and the consolidated balance sheet as at 30th June, 2004 of the Group, all of which are unaudited and condensed, along with selected explanatory notes, are set out on pages 11 to 22 of this report.

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 prices, 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 cargo 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 its loss position to a profitable level comparable to the year of 2002, a sharp improvement from a loss in the same period last year when the company 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”)

During the first half of 2004, Tradeport'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 held by the Group were pledged as securities for a banking facility granted to Tradeport.

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.

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.

DIRECTOR'S AND CHIEF EXECUTIVE'S INTERESTS AND SHORT POSITIONS IN SHARES, UNDERLYING SHARES AND DEBENTURES

Apart from the interests of the Directors in the share options of the Company are separately disclosed in the "Share Options" below, as at 30th June, 2004, none of the directors and the chief executive of the Company and/or any of their respective associates had any interest or deemed interest in the long and short position in the shares, underlying shares and debentures of the Company or any of its associated corporation (within the meaning of Part XV of the Securities and Future Ordinance ("SFO")) as recorded in the register required to be kept by the Company under Section 352 of the SFO; or as otherwise notified to the Company and The Stock Exchange of Hong Kong Limited (the "Stock Exchange") pursuant to Part XV of the SFO or the Model Code for Securities Transaction by Directors of Listed Companies of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the "Listing Rules").

SHARE OPTIONS

To comply with the requirements for share option schemes under the Listing Rules, the share option scheme previously adopted by the Company on 22nd October, 1997 (the "Old Share Option Scheme") was terminated and replaced by a new share option scheme ("New Share Option Scheme") which was adopted by the Company on 29th May, 2002. Upon termination of the Old Share Option Scheme, no further options could be granted thereunder but in all other respects, the provisions of the Old Share Option Scheme shall remain in force and all options granted prior to termination shall continue to be valid and exercisable in accordance therewith.

As at 30th June, 2004, there were no share options outstanding under the Old Share Option Scheme and 104,378,000 share options outstanding under the New Share Option Scheme.



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

1. The purpose of the New Share Option Scheme is to provide incentives to participants to contribute to the prosperity, business development or growth of the Group and/or to enable the Group to recruit and/or retain high-calibre employees and attract resources that are valuable to the Group.
2. The participants of the New Share Option Scheme are any Director, employee, supplier, customer or other relevant business partners of the Group as invited by the Board.
3. The subscription price determined by the Board will be the higher of (i) the closing price of the Company's share as stated in the Stock Exchange daily quotations sheet on the date of grant; (ii) the average closing price of the Company's share as stated in the Stock Exchange's daily quotations sheets for the five business days immediately preceding the date of grant; and (iii) the nominal value of the Company's shares.
4. The acceptance of grant of share options must be made within 28 days from the date of grant with a non-refundable payment of HK\$1.00 from the grantee.
5. The maximum number of shares over which options may be granted under the New Share Option Scheme shall not exceed 30% of the issued share capital of the Company from time to time.

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

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

No options were granted or exercised under the scheme during six months ended 30th June, 2004.



Details of the share options outstanding as at 30th June, 2004 under both share option scheme are as follows:

Name of grantee	Options held at 1 January, 2004	Options granted during the period	Options exercised during the period	Options lapsed during the period	Options held at 30 June, 2004	Exercise price HK\$	Grant date	Exercise period
Kong Dong	32,351,800 ¹	-	-	32,351,800 ¹	-	0.82	24/09/2001	25/03/2002 to 24/03/2004
Chuang Shih Ping	33,126,000 ²	-	-	-	33,126,000 ²	1.14	25/07/2003	26/10/2003 to 25/10/2009
Zhang Xianlin	33,126,000 ²	-	-	-	33,126,000 ²	1.14	25/07/2003	26/10/2003 to 25/10/2009
Tsang Hing Kwong, Thomas	33,126,000 ²	-	-	-	33,126,000 ²	1.14	25/07/2003	26/10/2003 to 25/10/2009
Gu Tiefei	5,000,000 ²	-	-	-	5,000,000 ²	1.14	25/07/2003	26/10/2003 to 25/10/2009
Total:	136,729,800	-	-	32,351,800	104,378,000			

Note:

1. Share options that have been granted under the Old Share Option Scheme.
2. Share options that have been granted under the New Share Option Scheme.



SUBSTANTIAL SHAREHOLDERS

As at 30th June, 2004, the register of substantial shareholders and short positions maintained under Part XV of the SFO shows that the following shareholders' with interests representing 5% or more of the Company's issued share capital:

Name	Percentage of issued capital	Number of ordinary shares	Note
China National Aviation Holding Company	69.5	2,302,972,000	1
China National Aviation Corporation (Group) Limited	69.5	2,302,972,000	1
Best Strikes Limited	5.6	187,656,000	
On Ling Investments Limited	9.7	322,856,000	2
Novel Investments Holdings Limited	9.7	322,856,000	2
Novel Enterprises (BVI) Limited	9.7	322,856,000	2
Novel Credit Limited	9.7	322,856,000	2
Novel Holdings (BVI) Limited	9.7	322,856,000	2
Westleigh Limited	9.7	322,856,000	2

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

Save as disclosed above, as at 30th June, 2004, no other person had an interest in the long and short position in the shares or underlying shares of the Company as recorded in the register, which is required to be kept by the Company under section 336 of the SFO.

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 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.

**CONSOLIDATED PROFIT AND LOSS ACCOUNT**
FOR THE SIX MONTHS ENDED 30TH JUNE, 2004

		Unaudited Six months ended 30th June,	
	Note	2004 HK\$'000	2003 HK\$'000
Turnover		788,129	513,526
Other revenues		<u>2,226</u>	<u>8,209</u>
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		<u>34,305</u>	<u>32,192</u>
Total operating expenses		<u>806,199</u>	<u>712,295</u>
Operating loss	3	(15,844)	(190,560)
Share of profits less losses of associated companies		<u>166,568</u>	<u>(98,606)</u>
Profit/(loss) before taxation		150,724	(289,166)
Taxation (charge)/credit	4	<u>(22,798)</u>	<u>39,083</u>
Profit/(loss) after taxation		127,926	(250,083)
Minority interests		<u>(7,282)</u>	<u>68,796</u>
Profit/(loss) attributable to shareholders		<u>120,644</u>	<u>(181,287)</u>
Interim dividends	5	<u>19,876</u>	<u>9,938</u>
		HK cents	HK cents
Earnings/(loss) per share			
Basic	6	<u>3.64</u>	<u>(5.47)</u>
Diluted	6	<u>3.61</u>	<u>N/A</u>

**CONSOLIDATED BALANCE SHEET**

AS AT 30TH JUNE, 2004

	<i>Note</i>	Unaudited 30th June, 2004 HK\$'000	31st December, 2003 HK\$'000
Non-current assets			
Fixed assets	7	369,933	399,378
Intangible assets	8	296,746	306,195
Associated companies	9	1,399,845	1,287,042
Lease and equipment deposits		73,463	83,041
Deferred tax assets		29,720	30,333
Total non-current assets		2,169,707	2,105,989
Current assets			
Inventories, at cost		47,462	50,824
Trade and other receivables	10	201,377	154,056
Bank balances and cash	11		
– Pledged		35,712	25,637
– Unpledged		1,052,737	1,036,929
		1,337,288	1,267,446
Current liabilities			
Trade and other payables	12	318,634	309,382
Sales in advance of carriage		111,197	107,469
Taxation payable		354	587
		430,185	417,438
Net current assets		907,103	850,008
Total assets less current liabilities		3,076,810	2,955,997
Financed by:			
Share capital	13	331,268	331,268
Reserves		2,392,056	2,291,187
Dividend		19,876	19,876
Shareholders' funds		2,743,200	2,642,331
Minority interests		256,079	248,797
Non-current liabilities			
Provision for overhaul and major checks		77,531	64,869
		3,076,810	2,955,997

On behalf of the Board

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



CONSOLIDATED CASH FLOW STATEMENT
FOR THE SIX MONTHS ENDED 30TH JUNE, 2004

	Unaudited Six months ended 30th June,	
	2004 HK\$'000	2003 HK\$'000
Net cash from/(used in) operating activities	14,604	(204,929)
Net cash from investing activities	20,842	147
Net cash used in financing activities	<u>(19,638)</u>	<u>(32,192)</u>
Net increase/(decrease) in cash and cash equivalents	15,808	(236,974)
Cash and cash equivalents at beginning of period	<u>1,036,929</u>	<u>1,158,014</u>
Cash and cash equivalents at end of period	<u>1,052,737</u>	<u>921,040</u>
Analysis of balances of cash and cash equivalents:		
Bank balances and cash (unpledged)	<u>1,052,737</u>	<u>921,040</u>



CONSOLIDATED STATEMENT OF CHANGES IN EQUITY
FOR THE SIX MONTHS ENDED 30TH JUNE, 2004

	Share capital HK\$'000	Share premium HK\$'000	Capital redemption reserve HK\$'000	Unaudited Legal reserve HK\$'000	Investments revaluation reserve HK\$'000	Retained earnings HK\$'000	Total HK\$'000
At 1st January, 2004	331,268	1,434,558	663	3,666	2,464	869,712	2,642,331
Share of exchange differences of an associated company not recognised in the consolidated profit and loss account	-	-	-	-	-	101	101
Profit for the period	-	-	-	-	-	120,644	120,644
Dividends	-	-	-	-	-	(19,876)	(19,876)
At 30th June, 2004	331,268	1,434,558	663	3,666	2,464	970,581	2,743,200
	Share capital HK\$'000	Share premium HK\$'000	Capital redemption reserve HK\$'000	Legal reserve HK\$'000	Investments revaluation reserve HK\$'000	Retained earnings HK\$'000	Total HK\$'000
At 1st January, 2003	331,931	1,434,558	-	3,666	4,180	930,164	2,704,499
Share of exchange differences of an associated company	-	-	-	-	-	(3)	(3)
Share of deficit on revaluation of investments in securities of an associated company	-	-	-	-	(1,716)	-	(1,716)
Net gains or losses not recognised in the consolidated profit and loss account	-	-	-	-	(1,716)	(3)	(1,719)
Repurchase of own shares	(663)	-	663	-	-	(5,325)	(5,325)
Loss for the period	-	-	-	-	-	(181,287)	(181,287)
Dividends	-	-	-	-	-	(26,501)	(26,501)
At 30th June, 2003	331,268	1,434,558	663	3,666	2,464	717,048	2,489,667



NOTES TO ACCOUNTS

1. Basis of preparation and accounting policies

These unaudited consolidated accounts have been prepared in accordance with Hong Kong Statement of Standard Accounting Practice 25 “Interim Financial Reporting” issued by Hong Kong Institute of Certified Public Accountants.

The accounting policies and methods of computation used in the preparation of these accounts are consistent with those used in the 2003 annual accounts. These accounts should be read in conjunction with the 2003 annual accounts.

2. Segment information

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

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

	Unaudited Six months ended 30th June, 2004			
	Airline operation HK\$'000	Airport ground handling HK\$'000	Logistics and other businesses HK\$'000	Group 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>



	Unaudited			
	Six months ended 30th June, 2003			
	Airline operation HK\$'000	Airport ground handling HK\$'000	Logistics and other businesses HK\$'000	Group 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				(190,560)
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>

3. Operating loss

Operating loss is stated after charging the following:

	Unaudited	
	Six months ended	
	30th June,	
	2004	2003
	HK\$'000	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>



4. Taxation (charge)/credit

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

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.

5. Interim dividends

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

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.

6. 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.

**7. Fixed assets**

	Unaudited				
	Leasehold improvements <i>HK\$'000</i>	Aircraft and engines <i>HK\$'000</i>	Flight equipment and rotable spares <i>HK\$'000</i>	Machinery, other equipment, furniture, and motor vehicles <i>HK\$'000</i>	Total <i>HK\$'000</i>
Cost or valuation					
As at 1st January, 2004	28,941	418,040	243,797	56,326	747,104
Additions	77	–	1,836	1,125	3,038
Disposals	(674)	–	(624)	(916)	(2,214)
	<u>28,344</u>	<u>418,040</u>	<u>245,009</u>	<u>56,535</u>	<u>747,928</u>
As at 30th June, 2004	28,344	418,040	245,009	56,535	747,928
Accumulated depreciation					
As at 1st January, 2004	22,257	137,126	153,371	34,972	347,726
Charge for the period	705	15,672	11,691	3,381	31,449
Disposals	(438)	–	(537)	(205)	(1,180)
	<u>22,524</u>	<u>152,798</u>	<u>164,525</u>	<u>38,148</u>	<u>377,995</u>
As at 30th June, 2004	22,524	152,798	164,525	38,148	377,995
Net book value					
As at 30th June, 2004	<u>5,820</u>	<u>265,242</u>	<u>80,484</u>	<u>18,387</u>	<u>369,933</u>
As at 31st December, 2003	<u>6,684</u>	<u>280,914</u>	<u>90,426</u>	<u>21,354</u>	<u>399,378</u>

8. Intangible assets

	Unaudited			
	Goodwill <i>HK\$'000</i>	Trademarks <i>HK\$'000</i>	Deferred expenditures <i>HK\$'000</i>	Total <i>HK\$'000</i>
Cost				
As at 1st January, 2004 and 30th June, 2004	<u>339,111</u>	<u>928</u>	<u>2,733</u>	<u>342,772</u>
Accumulated amortisation				
As at 1st January, 2004	32,970	928	2,679	36,577
Charge for the period	9,419	–	30	9,449
	<u>42,389</u>	<u>928</u>	<u>2,709</u>	<u>46,026</u>
As at 30th June, 2004	42,389	928	2,709	46,026
Net book amount				
As at 30th June, 2004	<u>296,722</u>	<u>–</u>	<u>24</u>	<u>296,746</u>
As at 31st December, 2003	<u>306,141</u>	<u>–</u>	<u>54</u>	<u>306,195</u>

**9. Associated companies**

	Unaudited 30th June, 2004 HK\$'000	31st December, 2003 HK\$'000
Hong Kong Dragon Airlines Limited ("Dragonair")	1,216,721	1,125,142
Jardine Airport Services Limited ("JASL")	92,666	66,277
Menzies Macau Airport Services Limited ("Menzies Macau")	62,570	65,989
Tradeport Hong Kong Limited ("Tradeport")	27,732	29,435
Macau Aircraft Repair and Conversion Company Limited ("MARCCO")	156	199
	<u>1,399,845</u>	<u>1,287,042</u>

The investments in associated companies also include loans and advance to JASL, Tradeport and MARCCO of HK\$52,560,000 (31st December, 2003: HK\$37,560,000), HK\$47,096,000 (31st December, 2003: HK\$44,096,000) and HK\$446,000 (31st December, 2003: HK\$446,000), respectively.

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

10. Trade and other receivables

Trade and other receivables include amounts receivable from third parties, a fellow subsidiary, an associated company and a related company of HK\$141,716,000 (31st December, 2003: HK\$111,542,000), which are unsecured, interest free and have credit periods ranging from 15 days to 45 days. The credit terms granted to sales agents and other trade customers are generally half month.

The age analysis of the trade receivable from third parties, a fellow subsidiary, an associated company and a related company is as follows:

	Unaudited 30th June, 2004 HK\$'000	31st December, 2003 HK\$'000
Within 30 days	139,450	103,643
31 – 60 days	616	7,198
61 – 90 days	984	112
Over 90 days	666	589
	<u>141,716</u>	<u>111,542</u>

11. Bank balances and Cash

Bank balances and cash include HK\$96,716,000 (31st December, 2003: HK\$23,988,000) denominated in Renminbi which are held by the Group with bank accounts operating in China mainland where exchange controls apply.



12. Trade and other payables

Trade and other payables include amounts payable to third parties, an associated company, a fellow subsidiary and related companies of HK\$138,289,000 (31st December, 2003: HK\$142,843,000).

The age analysis of the trade payable to third parties, an associated company, a fellow subsidiary and related companies is as follows:

	Unaudited 30th June, 2004 HK\$'000	31st December, 2003 HK\$'000
Within 30 days	95,859	68,208
31 – 60 days	26,765	36,030
61 – 90 days	9,273	11,392
Over 90 days	6,392	27,213
	<u>138,289</u>	<u>142,843</u>

13. Share capital

	Unaudited Shares of HK\$0.10 each Number of shares	HK\$'000
Authorised:		
At 1st January, 2004 and 30th June, 2004	4,000,000,000	400,000
Issued and fully paid:		
At 1st January, 2003	3,319,308,000	331,931
Repurchase of shares	(6,628,000)	(663)
At 1st January, 2004 and 30th June, 2004	<u>3,312,680,000</u>	<u>331,268</u>

14. Commitments

- (a) The Group is a party to an agreement with third parties (the "Consortium Partners") in respect of the joint development and operation of the Tradeport Logistics Centre at the South Commercial District of the HK Airport (the "Project"). The Group has 25% interest in the Project. On 17th March, 2004, Hong Kong Airport Authority agreed to reduce the maximum liability limit from HK\$780,000,000 to HK\$312,000,000. The Group's attributable share of capital commitments in respect of the Project is approximately HK\$78,000,000 (31st December, 2003: HK\$130,650,000).

In the event of default of any of the Consortium Partners, the Group will be required to provide additional funds for the Project. The Group and the Consortium Partners have jointly given a guarantee to the Hong Kong Airport Authority in respect of their obligations to provide sufficient funding for the Project. Should the Group be required to perform its obligations under the guarantee in the event of default of all of the Consortium Partners, the maximum amount of the additional liabilities assumed, in addition to the Group's estimated share of capital commitments as disclosed above, would be approximately HK\$234,000,000 (31st December, 2003: HK\$649,350,000).



- (b) On 21st April, 2004, the Group entered into agreements (“Acquisition Agreements”) with Air China for the acquisition of 60% of the equity interest in BACL and SWACL, both established in the People’s Republic of China, for considerations of RMB294,000,000 (equivalent to approximately HK\$277,400,000) and RMB67,000,000 (equivalent to approximately HK\$63,200,000) respectively. The aggregate consideration of approximately RMB361,000,000 (equivalent to approximately HK\$340,600,000) under the Acquisition Agreements will be paid in cash which will be funded by Group’s internal resources. The completion of the acquisition of BACL and SWACL are subject to certain conditions, details of which were set out in the circular of the Company dated 15th May, 2004. The Group and Air China are currently procuring the completion of the conditions as set out in the Acquisition Agreements and the Directors of the Company anticipate that the acquisition of BACL and SWACL would be completed in 2004.

15. Contingent liabilities

	Unaudited 30th June, 2004 HK\$’000	31st December, 2003 HK\$’000
Guarantee for banking facilities granted by bank to an associated company	15,000	15,000

16. Related party transactions

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

	Unaudited Six months ended 30th June, 2004 HK\$’000	2003 HK\$’000
Management fee expense:		
– Immediate holding company (<i>note i</i>)	3,000	3,000
– A fellow subsidiary (<i>note ii</i>)	1,800	1,800
Landing, loading, parking and other airport charges to a fellow subsidiary (<i>note iii</i>)	31,829	23,052
Ground handling costs to an associated company (<i>note iv</i>)	55,609	39,305
Technical and ground handling costs to an associated company (<i>note v</i>)	2,107	1,071
Inflight meal services expenses to a related company (<i>note vi</i>)	20,298	15,944
Value of tickets sold (<i>note vii</i>):		
– Fellow subsidiaries	1,508	2,484
– Related companies	7,021	6,533
– An associated company	1,229	43

- (i) On 27th August, 2003, the Company and CNACG renewed the management services agreement with the same terms under the management services agreement dated 3rd August, 2001. Pursuant to the renewed management services agreement, CNACG has agreed to provide secretarial, personnel, accounting and general office administrative services to the Group for a period of two years from 1st July, 2003 to 30th June, 2005 at a monthly fee of HK\$500,000.



- (ii) The Group entered into a management services agreement with CNAC (Macau) Aviation Limited pursuant to which CNAC (Macau) Aviation Limited will provide general management services including but not limited to secretarial, personnel, accounting and general office administrative services to China National Aviation Corporation (Macau) Company Limited at a monthly fee of HK\$300,000.
- (iii) The airport related charges to ADA-Administrative Airport Limited (“ADA”) were either at terms pursuant to the tariff published by the Macau Airport or at terms pursuant to agreements entered into by the Group with ADA or the Macau Airport.
- (iv) The ground handling services rendered were charged at terms pursuant to agreements entered into by the Group with Menzies Macau.
- (v) The technical and ground handling services rendered were charged at terms pursuant to agreements entered into by the Group with Dragonair.
- (vi) The inflight meal services rendered were charged at terms pursuant to agreements entered into by the Group with Macau Catering Services Company Limited, a 34.5% owned associated company held by a minority shareholder of Air Macau Company Limited, a subsidiary of the Company.
- (vii) Air tickets were sold to the related ticket sales agents in accordance with the pricing policy of the Group.

In addition to the above, on 18th October, 1997, the Company entered into a license agreement with China National Aviation Corporation (“CNAC”) pursuant to which CNAC agreed to grant a license to the Company, free of royalty, for the use of certain trademarks in Hong Kong, the Taiwan region and Macau so long as the Company is a subsidiary of CNACG. No royalty charge was levied in respect of the use of these trademarks during the period (six months ended 30th June, 2003: Nil).

17. Subsequent event

On 19th August, 2004, the Group entered into agreements (“CNACG Agreement and HKIAC Agreement”) with CNACG and Hong Kong International Air Catering Limited respectively, for the acquisition of 16% and 4.2% of the equity interest in LLSHK, incorporated in Hong Kong, for considerations of HK\$89,000,000 and HK\$24,500,000 respectively. The aggregate consideration of approximately HK\$113,500,000 under the CNACG agreement and HKIAC Agreement will be paid in cash which will be funded by the Group’s internal resources. The completion of the acquisition of LLSHK is subject to certain conditions and required shareholders’ approval, details of which were set out in the circular of the Company dated 2nd September, 2004.

18. Approval of the accounts

The accounts were approved by the Directors on 17th September, 2004.

On behalf of the Board
KONG DONG
Chairman

Hong Kong, 17th September, 2004



中航興業有限公司

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