



## CHAIRMAN'S STATEMENT



**Kong Dong** Chairman

As demand for airline and related services staged a sharp rebound from the level of the Severe Acute Respiratory Syndrome ("SARS") affected 2003, the Company and its subsidiaries (collectively the "Group") and its associated companies benefited from a strong improvement in earnings performance across all core businesses in 2004. However, contribution from these positive factors was partly overshadowed by the unprecedented rise in international fuel price in 2004 as well as heightened competition among regional airline operators. Still, with positive factors outweighing the negative ones, the Group managed to report a substantial recovery in 2004 profit.

For the year ended 31st December, 2004, the Group recorded a turnover of HK\$1,871.8 million (2003: HK\$1,227.0 million), a 52.5 per cent increase over the preceding year. Profit attributable to shareholders amounted to HK\$367.5 million compared to a loss of HK\$18.7 million last year. Basic earnings per share was HK11.09 cents, a sharp contrast to a basic loss per share of HK0.57 cent for 2003.

As a part of the corporate restructuring of China National Aviation Holding Company ("CNAH"), the Company has become a directly-owned subsidiary of Air China Limited ("Air China"), with the immediate 69 per cent controlling interest of the Company being transferred from China National Aviation Corporation (Group) Limited ("CNACG") to Air China in September 2004. Air China was then successfully listed on the Main Board of the Stock Exchange of Hong Kong Limited and the London Stock Exchange in December 2004.



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Leveraging on the closer relationship with Air China, the Group acquired 60 per cent equity interests in two China mainland airline-catering businesses from Air China, namely *Beijing Air Catering Co. Ltd.* ("BACL") and *Southwest Air Catering Company Limited* ("SWACL"), in 2004. The acquisition of BACL and SWACL well demonstrated Air China's strong support to the Group. Meanwhile, as the evidence of continuing support from CNACG, the Group successfully acquired an approximately 20.2 per cent equity interest of *LSG Lufthansa Service Hong Kong Limited* ("LLSHK") collectively from CNACG and another existing shareholder of LLSHK.

The synergies gained from this important corporate restructuring and the enhanced shareholding structure would be conducive to the long-term development of the Group.

### BUSINESS REVIEW

Among major contributors to Group earnings, *Air Macau Company Limited* ("Air Macau") managed to register strong recovery in 2004, despite keen competition caused by the introduction of low-cost carriers to the Macau SAR. Air Macau reported a 52.5 per cent increase in turnover of which passenger revenue increased by 37.7 per cent whereas cargo related revenue increased by 112.7 per cent.

The available seat kilometres increased by 29.4 per cent and passenger load factor increased by five percentage points. Passenger yield per revenue passenger kilometre remained the same as that of 2003, this was mainly due to the aggressive price promotions in its major markets – Taiwan, Shanghai and Macau. In March 2004, Air Macau inaugurated daily passenger services between Shenzhen and Taipei via Macau to capitalise on the niche for convenient and hassle free services between Taiwan region and the Pearl River Delta.

Air Macau demonstrated significant growth in cargo business in 2004. The freighter's cargo tonne kilometres and total cargo tonnes carried increased by 257.6 per cent and 124.7 per cent respectively. The Cargo Department was set up in May 2004 to cater for increased freighter business and to implement aggressive cargo development plans.

Air Macau leased out one A319 aircraft in return for one A321 aircraft being leased-in. This was intended to expand the fleet size and enhance service quality by phasing out the A319 aircraft. Air Macau's operating fleet as at the end of the year comprised of 15 aircraft including four A319s, one A320, six A321s and four freighter aircraft. As at 31st December, 2004, Air Macau operated passenger services up to thirteen regional destinations, of which eight were in the China mainland, and offered freighter services to Shanghai, Xiamen, Shenzhen and Taipei.

*Hong Kong Dragon Airlines Limited* ("Dragonair") experienced a sharp improvement in the results in 2004. It reported a 43.8 per cent increase in turnover of which passenger revenue increased by 51.1 per cent whereas cargo related revenue increased by 33.7 per cent. Total passengers carried and revenue passenger kilometres increased by 49.2 per cent and 54.7 per cent respectively. The available seat kilometres also increased by 41.5 per cent and the passenger load factor increased by 5.5 percentage points. Passenger yield per revenue passenger kilometre declined by 2.3 per cent due to the increase in longer-haul services to Bangkok and Tokyo this year with lower yield per kilometre basis.



### BUSINESS REVIEW (CONT'D)

Dragonair's profit before taxation surged significantly in 2004, up by 10 times that of 2003. This represented a strong recovery of passenger traffic from the SARS-inflicted 2003.

Cargo revenue and uplift tonnage increased by 33.7 per cent and 26.8 per cent respectively from those of the preceding year due to the higher tonnage carried by the company's new passenger route to Tokyo, wet lease freighter service to Osaka, Shanghai and Nanjing and new freighter service to Frankfurt and London Stansted. The cargo yield of passenger aircraft decreased by 1.9 per cent due to more longer-haul services with lower yield per kilometre basis. Despite this, the cargo yield of freighter increased by 8.5 per cent during the year due to favourable currency movements and improving yield of regional freighter services offered in Asia.

During the year under review, Dragonair took delivery of one A330 under operating lease in March 2004, one A300B4 freighter under wet lease in June 2004, two A320s under finance lease and one purchased B747-200 freighter in July 2004 respectively. At year-end, the Dragonair fleet comprised ten A320s, six A321s, ten A330s and five freighter aircraft.

The recovery of passenger transportation in 2004 also contributed to an increased demand for airline-catering services. BACL recorded a 31.2 per cent increase in turnover in 2004, with the number of flights catered for and number of meals served increasing by 16 per cent and 44.7 per cent respectively. With higher flight frequencies and passenger loads of flights catered for, SWACL also registered an improvement. The number of flights catered for and number of meals served by SWACL in 2004 increased by 12.3 per cent and 14.8 per cent respectively as compared with those for 2003, and the turnover increased by 15.2 per cent.

In comparison with 2003, the number of flights catered for and the number of meals served by LLSHK increased by 40.6 per cent and 48.3 per cent respectively mainly because of the post- SARS recuperation in air traffic.

*Jardine Airport Services Limited* ("JASL") reported a 28.3 per cent increase in its consolidated turnover when compared to that of the preceding year. The growth was largely attributable to the increase in flight frequencies handled.

JASL handled 60,346 aircraft movements for the year, representing a 35.5 per cent increase from that of 2003. It maintained an approximate 40 per cent share of the third party ground handling market at the Hong Kong International Airport. *Jardine Air Terminal Services Limited* ("JATS") handled 79,800 aircraft movements for the year, accounting for an approximate 60 per cent share of the third party ramp handling market at the Hong Kong International Airport.

In March 2004, JASL acquired a 50 per cent interest in *Ground Support Engineering Limited* ("GSEL"), a provider of ground support equipment maintenance services.

*Menzies Macau Airport Services Limited* ("Menzies Macau") provided ground services for a total of 19,291 aircraft turns and 171,450 tonnes of cargo in 2004. In comparison with 2003, turnover and operating profit for 2004 have increased by 21 per cent and 26 per cent respectively.



### BUSINESS REVIEW (CONT'D)

The utilisation of Logistics Centre and revenue per pallet of *Tradeport Hong Kong Limited* ("Tradeport Hong Kong") showed continued growth throughout the year due to increased services and improved space utilisation through material handling equipment. The business activity of Tradeport Hong Kong grew significantly during the year.

### OUTLOOK

The impetus of a thriving tourism industry in Greater China is anticipated to persist with the opening of Hong Kong Disneyland, expected in the fall of 2005, and a prospering gambling and entertainment sector in Macau. These favorable factors are likely to drive further momentum for the passenger airline operations of the Group and its associated companies. In addition, the management continues to eye other Asian regions that have great potential for expansion in both passenger and freight services.

Although the surging fuel price impacted the operating environment of the aviation industry in 2004, the Group and its associated companies managed to maintain a profitable business thanks to effective cost control. The Group continues to follow stringent cost control measures, and identify strategic investments and joint-venture opportunities in the aviation related business in order to broaden its income base.

Having completed a series of significant acquisition projects in 2004, the Group, banking on a diversified business portfolio and a positive macro-environment, is anticipated to achieve healthy growth in 2005.

### APPRECIATION

On behalf of the Board, I would like to thank you for the support of our business partners and shareholders and for the hard work of our management team and fellow staff who had gone through this remarkable year 2004.

**Kong Dong**

*Chairman*

Hong Kong, 23rd March, 2005