



### 1. PRINCIPAL ACCOUNTING POLICIES

The principal accounting policies adopted in the preparation of these accounts are set out below:

#### (a) Basis of preparation

The accounts have been prepared in accordance with accounting principles generally accepted in Hong Kong and comply with accounting standards issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA"). They have been prepared under the historical cost convention.

The HKICPA has issued a number of new and revised Hong Kong Financial Reporting Standards and Hong Kong Accounting Standards ("HKAS") (collectively the "new HKFRSs") which are effective for accounting periods beginning on or after 1st January, 2005. The Group has not early adopted these new HKFRSs in the accounts for the year ended 31st December, 2004. The Group is in the process of making an assessment of the impact of these new HKFRSs and has so far concluded that the adoption of HKAS 31 "Investments in Joint Ventures" would have the following significant effects:

Under HKAS 31, interests in jointly controlled entities are accounted for by proportionate consolidation. Share of jointly controlled entities' individual income and expenses, assets and liabilities are combined in the Group's accounts on a line by line basis. The adoption of HKAS 31 would result in an increase of non-current assets, current assets and current liabilities by approximately HK\$43,509,000, HK\$90,876,000 and HK\$134,385,000 respectively and there would be no impact on the profit for the year ended 31st December, 2004 and the retained earnings as at 31st December, 2004.

The Group will be continuing with the assessment of the impact of the other new HKFRS and other significant changes may be identified as a result.

#### (b) Consolidation

The consolidated accounts include the accounts of the Company and its subsidiaries made up to 31st December. Subsidiaries are those entities in which the Group controls the composition of the board of directors, controls more than half the voting power or holds more than half of the equity share capital. In the circumstances where subsidiaries over which the Company does not have unilateral control but joint control, the subsidiaries are accounted for as jointly controlled entities in accordance with the accounting policy set out in note (d)(i) below.

The results of subsidiaries acquired or disposed of during the year are included in the consolidated profit and loss account from the effective date of acquisition or up to the effective date of disposal, as appropriate.

All significant intercompany transactions and balances within the Group are eliminated on consolidation.



## NOTES TO THE ACCOUNTS

### 1. PRINCIPAL ACCOUNTING POLICIES (CONT'D)

#### (b) Consolidation (cont'd)

The gain or loss on the disposal of a subsidiary represents the difference between the proceeds of the sale and the Group's share of its net assets together with any unamortised goodwill which was not previously charged or recognised in the consolidated profit and loss account.

Minority interests represent the interests of outside shareholders in the operating results and net assets of subsidiaries.

In the Company's balance sheet the investments in subsidiaries are stated at cost less provision for impairment losses. The results of subsidiaries are accounted for by the Company on the basis of dividend income.

#### (c) Associated companies

An associated company is a company, not being a subsidiary, in which an equity interest is held for the long-term and significant influence is exercised in its management.

The consolidated profit and loss account includes the Group's share of the results of associated companies for the year, and the consolidated balance sheet includes the Group's share of the net assets of the associated companies and goodwill (net of accumulated amortisation) on acquisition.

In the Company's balance sheet the investments in associated companies are stated at cost less provision for impairment losses. The results of associated companies are accounted for by the Company on the basis of dividend income.

#### (d) Joint ventures

A joint venture is a contractual arrangement whereby the Group and other parties undertake an economic activity which is subject to joint control and none of the participating parties has unilateral control over the economic activity.

##### (i) *Jointly controlled entities*

The consolidated profit and loss account includes the Group's share of the results of jointly controlled entities for the year, and the consolidated balance sheet includes the Group's share of the net assets of the jointly controlled entities and goodwill (net of accumulated amortisation) on acquisition.

##### (ii) *Jointly controlled operations*

The assets that the Group controls and liabilities that it incurs in relation to jointly controlled operations joint ventures are recognised in the balance sheet on an accrual basis and classified according to the nature of the item. The expenses that the Group incurs and its share of income that it earns from services rendered by these jointly controlled operations are included in the profit and loss account.



### 1. PRINCIPAL ACCOUNTING POLICIES (CONT'D)

#### (e) Intangible assets

##### (i) *Goodwill*

Goodwill represents the excess of the cost of an acquisition over the fair value of the Group's share of the net assets of the acquired subsidiaries, associated companies and jointly controlled entities at the date of acquisition.

Goodwill on acquisitions of subsidiaries occurring on or after 1st January, 2001 is included in intangible assets. Goodwill on acquisitions of associated companies and jointly controlled entities occurring on or after 1st January, 2001 is included in investments in associated companies and investments in jointly controlled entities respectively. Goodwill is amortised using the straight-line method over its estimated useful lives of not more than 20 years.

##### (ii) *Trademark*

Expenditure on trademark is carried at cost less accumulated amortisation and impairment losses. Amortisation is calculated on a straight-line basis at an annual rate of 16.66%.

##### (iii) *Deferred expenditure*

Transaction fees and transportation charges in relation to placing the leased aircraft into operation are deferred and amortised over the terms of the related leases.

##### (iv) *Impairment of intangible assets*

The carrying amount of any intangible assets, including goodwill previously taken directly to reserves, is reviewed annually and provision is only made to write down to its recoverable amount where, in the opinion of the Directors, there is a long-term impairment in value.

#### (f) Fixed assets

Fixed assets, comprising leasehold improvements, aircraft and engines, flight equipment and rotatable spares and machinery, other equipment, furniture and motor vehicles, are stated at cost less accumulated depreciation and impairment losses.



## NOTES TO THE ACCOUNTS

### 1. PRINCIPAL ACCOUNTING POLICIES (CONT'D)

#### (f) Fixed assets (cont'd)

Fixed assets are depreciated at rates sufficient to write off their cost less accumulated impairment losses over their estimated useful lives on a straight-line basis, after taking into account their estimated residual values. The estimated useful lives are as follows:

Leasehold improvements	6 years
Aircraft and engines	10 to 20 years
Flight equipment and rotatable spares	7 to 20 years
Machinery, other equipment, furniture and motor vehicles	3 to 10 years

Expenditure incurred to replace a component of an item of fixed assets that is accounted for separately, including major inspection and overhaul expenditure, is capitalised (note 1(q)). Other subsequent expenditure is capitalised only when it increases the future economic benefits embodied in the item of fixed assets. All other expenditure is expensed as incurred.

At each balance sheet date, both internal and external sources of information are considered to assess whether there is any indication that the fixed assets are impaired. If any such indication exists, the recoverable amount of the asset is estimated and where relevant, an impairment loss is recognised to reduce the assets to its recoverable amount. Such impairment losses are recognised in the profit and loss account.

The gain or loss on disposal of a fixed asset is the difference between the net sales proceeds and the carrying amount of the relevant asset, and is recognised in the profit and loss account.

#### (g) Inventories

Inventories comprise expendable spare parts and supplies, are stated at the lower of cost and net realisable value, and are expensed when used in operations. Cost is calculated on the average cost basis except for aircraft spare parts, cost of which is calculated on the first-in-first-out basis. Net realisable value is determined on the basis of anticipated sales proceeds less estimated selling expenses.

#### (h) Deferred taxation

Deferred taxation is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the accounts. The principal temporary differences arise from depreciation on fixed assets and tax losses carried forward; and, in relation to acquisitions, on the difference between the fair values of the net assets acquired and their tax base. Tax rates enacted or substantively enacted by the balance sheet date are used to determine deferred taxation.

Deferred tax assets are recognised to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised.



## NOTES TO THE ACCOUNTS

### 1. PRINCIPAL ACCOUNTING POLICIES (CONT'D)

#### (h) Deferred taxation (cont'd)

Deferred taxation is provided on temporary differences arising on investments in subsidiaries, associated companies and jointly controlled entities, except where the timing of the reversal of the temporary difference can be controlled and it is probable that the temporary difference will not reverse in the foreseeable future.

#### (i) Translation of foreign currencies

Transactions in foreign currencies are translated at exchange rates ruling at the transaction dates. Monetary assets and liabilities expressed in foreign currencies at the balance sheet date are translated at rates of exchange ruling at the balance sheet date. Exchange differences arising in these cases are dealt with in the profit and loss account.

The balance sheets of subsidiaries, associated companies and jointly controlled entities expressed in foreign currencies are translated at the rates of exchange ruling at the balance sheet date whilst the profit and loss accounts of subsidiaries, associated companies and jointly controlled entities are translated at the weighted average rate during the year. Exchange differences are dealt with as a movement in reserves.

#### (j) Accounts receivable

Provision is made against accounts receivable to the extent they are considered to be doubtful. Accounts receivable in the balance sheet are stated net of such provision.

#### (k) Manufacturers' credits

Manufacturers' credits received in connection with leasing of aircraft, which the company can apply those credits to reduce future costs of acquiring aircraft spares or rental payments, are either deferred and amortised as income or as a reduction of rental expenses for aircraft over relevant leases.

#### (l) Cash and cash equivalents

Cash and cash equivalents comprise cash on hand, deposits held at call with banks, cash investments with a maturity of three months or less from date of investment and bank overdrafts.

#### (m) Provisions

Provisions are recognised when there is has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources will be required to settle the obligation, and a reliable estimate of the amount can be made. Where it is expected a provision to be reimbursed, the reimbursement is recognised as a separate asset but only when the reimbursement is virtually certain.



### 1. PRINCIPAL ACCOUNTING POLICIES (CONT'D)

#### (n) Employee benefits

##### (i) *Employee leave entitlements*

Employee entitlements to annual leave are recognised when they accrue to employees of the company. A provision is made for the estimated liability for annual leave as a result of services rendered by employees up to the balance sheet date.

Employee entitlements to sick leave and maternity or paternity leave are not recognised until the time of leave.

##### (ii) *Retirement benefit costs*

Contributions to the defined contribution schemes are charged to the profit and loss account in the year in which the contributions relate.

##### (iii) *Equity compensation benefits*

Share options are granted to Directors and continuous contract employees. No compensation cost is recognised in the profit and loss account in connection with share options granted. When the share options are exercised, the proceeds received net of any transaction costs are credited to share capital (nominal value) and share premium.

#### (o) Contingent liabilities and contingent assets

A contingent liability is a possible obligation that arises from past events and whose existence will only be confirmed by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the Group. It can also be a present obligation arising from past events that is not recognised because it is not probable that outflow of economic resources will be required or the amount of obligation cannot be measured reliably.

A contingent liability is not recognised but is disclosed in the notes to the accounts. When a change in the probability of an outflow occurs so that outflow is probable, they will then be recognised as a provision.

A contingent asset is a possible asset that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain events not wholly within the control of the company.

Contingent assets are not recognised but are disclosed in the notes to the accounts when an inflow of economic benefits is probable. When inflow is virtually certain, an asset is recognised.



## NOTES TO THE ACCOUNTS

### I. PRINCIPAL ACCOUNTING POLICIES (CONT'D)

#### (p) Revenue recognition

##### (i) Traffic revenue

Passenger, cargo and mail revenues are recognised when the transportation is provided. Ticket sales for transportation not yet provided are included in current liabilities as sales in advance of carriage.

##### (ii) Inflight sales commission

Inflight sales commission is recognised when services are rendered.

##### (iii) Rental income

Rental income is recognised on a straight-line basis over the terms of the leases.

##### (iv) Interest income

Interest income is recognised on a time proportion basis, taking into account the principal amounts outstanding and the interest rates applicable.

##### (v) Dividend income

Dividend income is recognised when the right to receive payment is established.

#### (q) Maintenance and overhaul costs

Costs of major checks and overhauls performed on owned aircraft to replace a component of an item of fixed assets are capitalised and amortised over a period of 3 years. Other maintenance and major overhaul costs incurred for owned aircraft are expensed as and when incurred.

In respect of aircraft under operating leases, a provision is made for the estimated costs of major checks and overhauls required to be conducted to fulfill the requirements under the relevant leases based on the maintenance cycle of each aircraft.

#### (r) Operating leases

Leases where substantially all the risks and rewards of ownership of assets remain with the lessor are accounted for as operating leases. Payments made under operating leases net of any incentives received from the lessor are charged to the profit and loss account on a straight-line basis over the lease periods.

#### (s) Segment reporting

In accordance with the Group's internal financial reporting, the Group has determined that the primary segment reporting is by business segments and the secondary segment reporting is by geographical segments.



## NOTES TO THE ACCOUNTS

### 1. PRINCIPAL ACCOUNTING POLICIES (CONT'D)

#### (s) Segment reporting (cont'd)

Unallocated costs represent corporate expenses and amortisation of unallocated goodwill. Segment assets consist primarily of intangible assets, fixed assets, lease and equipment deposits, inventories, trade and other receivables and operating cash and mainly exclude unallocated goodwill, associated companies, jointly controlled entities, tax recoverable and non-operating bank balances and cash. Segment liabilities comprise operating liabilities and mainly exclude taxation payable. Capital expenditure comprises additions to intangible assets and fixed assets, including additions resulting from acquisitions through purchases of subsidiaries.

In respect of geographical segment reporting, traffic revenue from inbound and outbound services between Macau and overseas markets is attributed to the geographical area in which the relevant overseas origin or destination lies.

Total assets and capital expenditure are where the assets are located.

### 2. TURNOVER, REVENUES AND SEGMENT INFORMATION

The Group is principally engaged in provision of aviation related services. Revenues recognised during the year are as follows:

	<b>2004</b>	2003
	<b>HK\$'000</b>	HK\$'000
Turnover		
Traffic revenues		
– Passenger services	<b>1,355,391</b>	984,211
– Cargo and mail services	<b>516,372</b>	242,820
	<b>1,871,763</b>	1,227,031
Other revenues		
Inflight sales commission	<b>3,136</b>	1,861
Interest income	<b>4,813</b>	9,172
Rental income from sub-leases of aircraft	<b>9,855</b>	14,460
	<b>17,804</b>	25,493
Total revenues	<b>1,889,567</b>	1,252,524

The Group is organised into four main business segments including airline operation, airport ground handling, catering services, logistics and other businesses.

There are no sales or other transactions between the business segments.





## NOTES TO THE ACCOUNTS

### 2. TURNOVER, REVENUES AND SEGMENT INFORMATION (CONT'D)

#### Business segments

	Year ended and as at 31st December, 2004				Group HK\$'000
	Airline operation HK\$'000	Airport ground handling HK\$'000	Airline catering services HK\$'000	Logistics and other businesses HK\$'000	
Segment revenues	<u>1,884,754</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>1,884,754</u>
Segment results	<u>52,791</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>52,791</u>
Interest income					4,813
Unallocated costs					<u>(41,752)</u>
Operating profit					15,852
Share of profits less losses of					
– Associated companies	341,821	146,312	167	(8,056)	480,244
– Jointly controlled entities	-	-	506	-	<u>506</u>
Profit before taxation					496,602
Taxation charge					<u>(95,637)</u>
Profit after taxation					400,965
Minority interests					<u>(33,495)</u>
Profit attributable to shareholders					<u>367,470</u>
Segment assets	1,093,645	-	-	-	1,093,645
Associated companies	1,404,727	141,282	115,114	24,566	1,685,689
Jointly controlled entities	-	-	345,532	-	345,532
Unallocated assets					<u>689,435</u>
Total assets					<u>3,814,301</u>
Segment liabilities	559,319	-	-	-	559,319
Unallocated liabilities					<u>5,054</u>
Total liabilities					<u>564,373</u>
Capital expenditure	38,251	-	-	-	38,251
Depreciation	64,740	-	-	-	64,740
Amortisation	45	-	-	-	45
Other non-cash expenses	<u>1,175</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>1,175</u>

Amortisation charge by business segments did not include goodwill arising from acquisitions of China National Aviation Corporation (Macau) Company Limited (“CNAC Macau”) of HK\$18,840,000 (2003: HK\$18,840,000) as the Directors consider that there is no meaningful basis for allocation of such amortisation of goodwill between airline operation and airport ground handling businesses.



## NOTES TO THE ACCOUNTS

### 2. TURNOVER, REVENUES AND SEGMENT INFORMATION (CONT'D)

#### Business segments (cont'd)

	Year ended and as at 31st December, 2003				Group HK\$'000
	Airline operation HK\$'000	Airport ground handling HK\$'000	Airline catering services HK\$'000	Logistics and other businesses HK\$'000	
Segment revenues	1,243,352	–	–	–	1,243,352
Segment results	(193,390)	–	–	–	(193,390)
Interest income					9,172
Unallocated costs					(39,365)
Operating loss					(223,583)
Share of profits less losses of associated companies	29,796	101,280	–	(9,594)	121,482
Loss before taxation					(102,101)
Taxation credit					13,944
Loss after taxation					(88,157)
Minority interests					69,410
Loss attributable to shareholders					(18,747)
Segment assets	931,323	–	–	–	931,323
Associated companies	1,125,143	132,271	–	29,628	1,287,042
Unallocated assets					1,155,070
Total assets					3,373,435
Segment liabilities	477,442	–	–	–	477,442
Unallocated liabilities					4,865
Total liabilities					482,307
Capital expenditure	27,467	–	–	–	27,467
Depreciation	68,519	–	–	–	68,519
Amortisation	138	–	–	–	138



## NOTES TO THE ACCOUNTS

### 2. TURNOVER, REVENUES AND SEGMENT INFORMATION (CONT'D)

#### Geographical segments

The Group operates in four main geographical areas including China mainland, Taiwan and other regions (mainly Macau, Thailand and Philippines) which are all attributed to the Group's airline operation business. There are no sales between the geographical segments.

	Segment revenues		Segment results	
	2004 HK\$'000	2003 HK\$'000	2004 HK\$'000	2003 HK\$'000
China mainland	<b>753,909</b>	489,377	<b>(26,947)</b>	(106,745)
Taiwan	<b>1,025,639</b>	651,251	<b>134,486</b>	(9,838)
Other regions	<b>105,206</b>	102,724	<b>(54,748)</b>	(76,807)
Total	<b><u>1,884,754</u></b>	<u>1,243,352</u>	<b><u>52,791</u></b>	<u>(193,390)</u>
Interest income			<b>4,813</b>	9,172
Unallocated costs			<b>(41,752)</b>	(39,365)
Operating profit/(loss)			<b><u>15,852</u></b>	<u>(223,583)</u>

The major revenue-earning assets of the Group are its aircraft fleet, all of which are registered in Macau. Since the Group's aircraft fleet is deployed flexibly across its route network, the Directors consider that there is no meaningful basis to allocating such assets to geographical segments.

The Group's assets, other than its aircraft fleet as mentioned in the above, and capital expenditure are mainly located in Macau.

### 3. STAFF COSTS

	2004 HK\$'000	2003 HK\$'000
Wages and salaries (including directors' emoluments)	<b>242,948</b>	211,345
Retirement benefit costs	<b>1,190</b>	4,065
	<b><u>244,138</u></b>	<u>215,410</u>



## NOTES TO THE ACCOUNTS

### 3. STAFF COSTS (CONT'D)

The Company contributes to the mandatory provident fund scheme ("MPF Scheme") established under the Hong Kong Mandatory Provident Fund Scheme Ordinance which is available to eligible employees in Hong Kong.

The subsidiary in Macau operates defined contribution pension plans which are available to eligible employees. The assets of the plans are held separately from the subsidiary in independently administrated funds. Monthly contributions made by the subsidiary are calculated based on certain percentages of the applicable payroll costs or fixed sums as stipulated under the relevant requirements, as appropriate.

The retirement benefit costs represent gross contributions paid and payable to the MPF Scheme in Hong Kong and the defined contribution pension plans in Macau (collectively the "Retirement Schemes"). Contributions totalling HK\$1,934,000 (2003: HK\$3,394,000) payable to the Retirement Schemes as at 31st December, 2004 are included in trade and other payables. Forfeited contributions totalling HK\$1,490,000 (2003: HK\$927,000) were utilised during the year leaving no balance available at the year end to reduce future contributions (2003: HK\$51,000).

### 4. OPERATING PROFIT/(LOSS)

Operating profit/(loss) is stated after crediting and charging the following:

	2004 HK\$'000	2003 HK\$'000
<b>Crediting</b>		
Amortisation of manufacturers' credits	1,393	7,600
Net exchange gains	<u>6,486</u>	<u>349</u>
<b>Charging</b>		
Amortisation of intangible assets		
– Goodwill	18,840	18,840
– Deferred expenditure	45	138
Auditors' remuneration	1,275	1,312
Cost of inventories expensed	38,681	43,560
Depreciation of fixed assets	64,740	68,519
Loss on disposal of fixed assets	334	458
Operating lease rentals		
– Aircraft and related equipments	374,580	332,340
– Land and buildings	20,298	20,226
Provision for overhaul and major checks costs (note 21)	<u>84,772</u>	<u>95,658</u>



## NOTES TO THE ACCOUNTS

### 5. SHARE OF PROFITS LESS LOSSES OF ASSOCIATED COMPANIES AND JOINTLY CONTROLLED ENTITIES

The Group's share of profits less losses of associated companies and jointly controlled entities includes the amortisation of goodwill in respect of associated companies and jointly controlled entities amounting to HK\$255,000 (2003: Nil) and HK\$1,261,000 (2003: Nil) respectively.

### 6. TAXATION (CHARGE)/CREDIT

	2004 HK\$'000	2003 HK\$'000
Company and subsidiaries:		
Taxation outside Hong Kong and Macau	(1,063)	(613)
Over provisions in prior years	5	468
Deferred taxation (note 22)		
– Deferred taxation relating to the origination and reversal of temporary difference	(11,039)	30,333
	<u>(12,097)</u>	<u>30,188</u>
Associated companies:		
Hong Kong profits tax	(16,861)	(10,165)
Macau complementary tax	(13,376)	(10,463)
Taxation outside Hong Kong and Macau	(14,936)	(7,251)
Under provisions in prior years	(11,914)	1,819
Deferred taxation	(26,206)	9,816
	<u>(83,293)</u>	<u>(16,244)</u>
Jointly controlled entities		
Taxation outside Hong Kong and Macau	(247)	–
	<u>(95,637)</u>	<u>13,944</u>

Hong Kong profits tax has been provided at the rate of 17.5% (2003: 17.5%) on the estimated assessable profit for the year. Macau complementary tax has been provided at the rate of 15.75% (2003: 15.75%) on the estimated assessable profit for the year. Taxation outside Hong Kong and Macau has been calculated on the estimated assessable profit for the year at the rates of taxation prevailing in the regions of operations.



## NOTES TO THE ACCOUNTS

### 6. TAXATION (CHARGE)/CREDIT (CONT'D)

The taxation on the Group's profit/(loss) before taxation differs from the theoretical amount that would arise using the tax rate prevailing in Macau, where the Group's principal subsidiary operates, as follows:

	2004 HK\$'000	2003 HK\$'000
Profit/(loss) before taxation	<b>496,602</b>	(102,101)
Calculated at the tax rate of 15.75% (2003: 15.75%)	<b>78,215</b>	(16,081)
Effect of different taxation rates in other territories	<b>14,944</b>	5,161
Income not subject to taxation	<b>(7,853)</b>	(9,530)
Expenses not deductible for taxation purposes	<b>3,859</b>	4,887
Utilisation of previously unrecognised tax losses	<b>(743)</b>	(177)
Increase in taxation resulting from an increase in tax rate	–	4,540
Tax losses not recognised	<b>5,260</b>	5,770
Under/(over) provision for taxation in prior years	<b>11,909</b>	(2,287)
Others	<b>(9,954)</b>	(6,227)
Taxation charge/(credit)	<b>95,637</b>	(13,944)

### 7. PROFIT/(LOSS) ATTRIBUTABLE TO SHAREHOLDERS

The profit/(loss) attributable to shareholders includes a profit of the Company to the extent of HK\$64,735,000 (2003: HK\$36,173,000).

### 8. DIVIDENDS

	2004 HK\$'000	2003 HK\$'000
Interim dividend, paid, of HK0.6 cent (2003: HK0.3 cent) per share	<b>19,876</b>	9,938
Final dividend, proposed, of HK1.0 cent (2003: HK0.6 cent) per share	<b>33,127</b>	19,876
Adjustment on 2002 final dividend due to the repurchase of shares	–	(53)
	<b>53,003</b>	29,761

The Directors proposed a final dividend of HK1.0 cent per share. This proposed 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, 2005.



## NOTES TO THE ACCOUNTS

### 9. 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\$367,470,000 (2003: loss of HK\$18,747,000).

The basic earnings/(loss) per share is based on the weighted average of 3,312,680,000 (2003: 3,314,824,000) shares in issue during the year. The diluted earnings per share for the year ended 31st December, 2004 is based on 3,340,747,828 shares representing the weighted average of 3,312,680,000 shares in issue during the year plus the weighted average of 28,067,828 shares which would be issued at no consideration on the exercise of all dilutive options. No diluted loss per share for the year ended 31st December, 2003 was presented as the exercise of options was anti-dilutive.

### 10. DIRECTORS' AND SENIOR MANAGEMENT'S EMOLUMENTS

#### (a) Directors' emoluments

The aggregate amounts of emoluments payable to Directors during the year are as follows:

	<b>2004</b> <b>HK\$'000</b>	2003 HK\$'000
Fees	<b>710</b>	202
Salaries and allowances	<b>6,600</b>	5,973
	<b>7,310</b>	6,175

Directors' emoluments above include fees of HK\$174,000 (2003: HK\$80,000) to independent non-executive Directors.

During the year ended 31st December, 2003, options to subscribe for 104,378,000 shares were granted to the Directors under the share option scheme approved by the shareholders at the Annual General Meeting held on 29th May, 2002. The market value of the share at the date of grant was HK\$1.12. No share options were granted to the Directors during the year ended 31st December, 2004. Details of share options lapsed and exercised during the year are set out in note 19(a) below.



## NOTES TO THE ACCOUNTS

### 10. DIRECTORS' AND SENIOR MANAGEMENT'S EMOLUMENTS (CONT'D)

#### (a) Directors' emoluments (cont'd)

The emoluments of the Directors fell within the following bands:

Emolument bands	Number of Directors	
	2004	2003
HK\$ nil – HK\$1,000,000	8	6
HK\$1,000,001 – HK\$1,500,000	–	1
HK\$1,500,001 – HK\$2,000,000	2	1
HK\$2,000,001 – HK\$2,500,000	1	1
	11	9
	11	9

#### (b) Five highest paid individuals

The five individuals whose emoluments were the highest in the Group for the year include three Directors (2003: three) whose emoluments are set out above. The emoluments payable to the remaining two (2003: two) individuals during the year are as follows:

	2004 HK\$'000	2003 HK\$'000
Wages, salaries and allowances	3,059	2,318
Retirement benefit costs	155	128
	3,214	2,446
	3,214	2,446

The emoluments of the employees fell within the following bands:

Emolument bands	Number of individuals	
	2004	2003
HK\$1,000,001 – HK\$1,500,000	1	2
HK\$1,500,001 – HK\$2,000,000	1	–
	2	2
	2	2





## NOTES TO THE ACCOUNTS

### 11. FIXED ASSETS

	Group				
	Leasehold improvements	Aircraft and engines	Flight equipment and rotatable spares	Machinery, other equipment, furniture, and motor vehicles	Total
	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Cost					
At 1st January, 2004	28,941	418,040	243,797	56,326	747,104
Additions	1,229	12,160	3,868	20,994	38,251
Disposals	(13,114)	–	(1,166)	(7,681)	(21,961)
<b>At 31st December, 2004</b>	<b>17,056</b>	<b>430,200</b>	<b>246,499</b>	<b>69,639</b>	<b>763,394</b>
Accumulated depreciation					
At 1st January, 2004	22,257	137,126	153,371	34,972	347,726
Charge for the year	1,465	31,809	23,246	8,220	64,740
Disposals	(12,517)	–	(1,008)	(7,380)	(20,905)
<b>At 31st December, 2004</b>	<b>11,205</b>	<b>168,935</b>	<b>175,609</b>	<b>35,812</b>	<b>391,561</b>
Net book value					
<b>At 31st December, 2004</b>	<b>5,851</b>	<b>261,265</b>	<b>70,890</b>	<b>33,827</b>	<b>371,833</b>
At 31st December, 2003	6,684	280,914	90,426	21,354	399,378



## NOTES TO THE ACCOUNTS

### 12. INTANGIBLE ASSETS

	Group			Total HK\$'000
	Goodwill HK\$'000	Trademarks HK\$'000	Deferred expenditure HK\$'000	
Cost				
At 1st January, 2004 and at 31st December, 2004	339,111	928	2,733	342,772
Accumulated amortisation				
At 1st January, 2004	32,970	928	2,679	36,577
Charge for the year	18,840	–	45	18,885
<b>At 31st December, 2004</b>	<b>51,810</b>	<b>928</b>	<b>2,724</b>	<b>55,462</b>
Net book amount				
<b>At 31st December, 2004</b>	<b>287,301</b>	<b>–</b>	<b>9</b>	<b>287,310</b>
At 31st December, 2003	306,141	–	54	306,195

### 13. SUBSIDIARIES

	Company	
	2004 HK\$'000	2003 HK\$'000
Unlisted shares, at cost	<b>803,666</b>	803,666
Amounts due from subsidiaries (note a)	<b>1,178,194</b>	714,674
Amounts due to subsidiaries (note a)	–	(216)
	<b>1,981,860</b>	1,518,124

- (a) The amounts due from/to subsidiaries are unsecured, interest free and have no fixed terms of repayment.



## NOTES TO THE ACCOUNTS

### 13. SUBSIDIARIES (CONT'D)

(b) The subsidiaries at 31st December, 2004 are set out below:

Name	Place of incorporation	Place of operation	Principal activities	Particulars of issued share/capital	Group equity interest	
					2004	2003
<sup>1,2</sup> Air Macau Company Limited	Macau	Macau	Airline operator	4,000,000 ordinary shares of MOP100 each	51%	51%
<sup>2</sup> China National Aviation Corporation (Macau) Company Limited	Macau	Macau	Investment holding	Quota capital of MOP10,000,000	100%	100%
Skylink Global Limited	British Virgin Islands	Hong Kong	Investment holding	10 ordinary shares of US\$1 each	100%	100%
Fly Top Limited	British Virgin Islands	Hong Kong	Investment holding	10 ordinary shares of US\$1 each	100%	–
Kingston International Limited	British Virgin Islands	Hong Kong	Investment holding	2 ordinary shares of US\$1 each	100%	100%
Queenston International Limited	British Virgin Islands	Hong Kong	Investment holding	2 ordinary shares of US\$1 each	100%	100%
Serfil Limited	British Virgin Islands	Hong Kong	Investment holding	1 ordinary share of US\$1	100%	100%
Skyrise Limited	British Virgin Islands	Hong Kong	Investment holding	1 ordinary share of US\$1	100%	100%
Wington Limited	British Virgin Islands	Hong Kong	Investment holding	1 ordinary share of US\$1	100%	100%
China National Aviation Logistics Company Limited	Hong Kong	Hong Kong	Investment holding	2 ordinary shares of HK\$10 each	100%	100%



## NOTES TO THE ACCOUNTS

### 13. SUBSIDIARIES (CONT'D)

(b) The subsidiaries at 31st December, 2004 are set out below (cont'd):

Name	Place of incorporation	Place of operation	Principal activities	Particulars of issued share/capital	Group equity interest	
					2004	2003
China National Aviation Technology Company Limited	Hong Kong	Hong Kong	Investment holding	2 ordinary shares of HK\$10 each	100%	100%
<sup>2</sup> China National Aviation CyberWorks Limited	Bermuda	Hong Kong	Dormant	1,000,000 ordinary shares of HK\$0.1 each	100%	100%

All subsidiaries are limited liability companies.

<sup>1</sup> Subsidiary not audited by PricewaterhouseCoopers. The aggregate net assets, turnover and profit/(loss) before taxation of the subsidiary not audited by PricewaterhouseCoopers amounted to approximately 30% (2003: 18%), 100% (2003: 100%) and 16% (2003: Not meaningful) respectively.

<sup>2</sup> Subsidiary held indirectly by the Company.

### 14. ASSOCIATED COMPANIES

	2004 HK\$'000	Group 2003 HK\$'000
Unlisted shares, at cost	<b>359,171</b>	244,102
Share of net assets	<b>1,550,878</b>	1,204,939
Goodwill, net of amortisation	<b>52,708</b>	–
Loans to associated companies	<b>82,103</b>	82,103
	<b>1,685,689</b>	1,287,042



## NOTES TO THE ACCOUNTS

### 14. ASSOCIATED COMPANIES (CONT'D)

	Company	
	2004 HK\$'000	2003 HK\$'000
Unlisted shares, at cost	51,789	51,789
Loans to associated companies	34,560	37,560
	<b>86,349</b>	<b>89,349</b>

The loans to associated companies are unsecured interest free and have no fixed terms of repayment except for a loan to an associated company of HK\$446,000 (2003: HK\$446,000) which bears interest at the prime rate plus 2% (2003: prime rate plus 2%).

The shares of Tradeport Hong Kong Limited, an associated company, held by the Group were pledged as securities for a banking facility granted to the associated company (note 26).

The following is a list of associated companies at 31st December, 2004:

Name	Place of incorporation and operation	Principal activities	Particulars of issued shares/capital	Group equity Interest	
				2004	2003
<sup>1</sup> Hong Kong Dragon Airlines Limited ("Dragonair")	Hong Kong	Airline operator	500,000,000 ordinary shares of HK\$1 each	43.29%	43.29%
<sup>2</sup> LSG Lufthansa Service Hong Kong Limited ("LLSHK")	Hong Kong	Airline catering	501 ordinary shares of HK\$1 each	20.20%	-
Jardine Airport Services Limited	Hong Kong	Airport ground handling services	1,000 ordinary shares of HK\$10 each	50.00%	50.00%
<sup>2</sup> Tradeport Hong Kong Limited	Hong Kong	Development and operation of a logistics centre	400 ordinary shares of HK\$1 each	25.00%	25.00%
<sup>2,3</sup> Menzies Macau Airport Services Limited ("Menzies Macau")	Macau	Airport ground handling services	Quota capital of MOP10,000,000	33.65%	33.65%
<sup>2,3</sup> Macau Aircraft Repair and Conversion Company Limited	Macau	Aircraft repair and conversion	Quota capital of MOP100,000	25.05%	25.05%

<sup>1</sup> 1.47% of the Group's equity interest in Dragonair is held directly by the Company, while the remaining 41.82% is held indirectly through subsidiaries.

<sup>2</sup> Associated companies held indirectly by the Company.

<sup>3</sup> Associated companies not audited by PricewaterhouseCoopers.



## NOTES TO THE ACCOUNTS

### 14. ASSOCIATED COMPANIES (CONT'D)

A summary of the audited financial information of Dragonair, a significant associated company of the Group is set out as follows:

	2004 HK\$'000	2003 HK\$'000
<b>Results</b>		
Turnover	<b>8,435,710</b>	5,867,790
Operating profit after finance costs	<b>751,903</b>	52,617
Share of profits less losses of associated companies	<b>37,704</b>	16,212
Profit before taxation	<b>789,607</b>	68,829
Taxation (charge)/credit	<b>(138,076)</b>	1,972
Profit after taxation	<b>651,531</b>	70,801
<b>Net assets</b>		
Fixed assets	<b>7,376,526</b>	6,831,966
Associated companies	<b>150,415</b>	154,896
Investments in securities	<b>14,543</b>	20,234
Deferred tax assets	<b>3,213</b>	2,473
Other non-current assets	<b>823,148</b>	1,009,113
Current assets	<b>3,172,360</b>	2,699,288
Current liabilities	<b>(2,664,926)</b>	(2,285,513)
Deferred income	<b>(434,211)</b>	(475,047)
Deferred liabilities	<b>(136,497)</b>	(78,711)
Provision for overhaul and major checks	<b>(127,722)</b>	(155,966)
Long-term liabilities	<b>(4,931,935)</b>	(5,123,659)
	<b>3,244,914</b>	2,599,074

### 15. JOINTLY CONTROLLED ENTITIES

	2004 HK\$'000	Group 2003 HK\$'000
Unlisted shares, at cost	<b>345,273</b>	—
Share of net assets	<b>103,595</b>	—
Goodwill, net of amortisation	<b>241,937</b>	—
	<b>345,532</b>	—



## NOTES TO THE ACCOUNTS

### 15. JOINTLY CONTROLLED ENTITIES (CONT'D)

The following is a list of jointly controlled entities at 31st December, 2004:

Name	Place of incorporation	Place of operation	Principal activities	Particulars of Interest in ownership/voting power/profit sharing	
				2004	2003
<sup>1,2</sup> Beijing Air Catering Co., Ltd. ("BACL")	The People's Republic of China (the "PRC")	PRC	Airline catering	60%/56%/60%	–
<sup>1,2</sup> Southwest Air Catering Company Limited ("SWACL")	PRC	PRC	Airline catering	60%/60%/60%	–

<sup>1</sup> Jointly controlled entity held indirectly by the Company.

<sup>2</sup> Jointly controlled entity not audited by PricewaterhouseCoopers.

BACL and SWACL were acquired by the Group during the year. BACL and SWACL are subsidiaries, as defined by section 2(4) of the Hong Kong Companies Ordinance but the Group does not have unilateral control but joint control over these entities. Accordingly, they are accounted for as jointly controlled entities in accordance with Statement of Standard Accounting Practice 21 "Accounting for interest in joint ventures".

### 16. TRADE AND OTHER RECEIVABLES

	Group		Company	
	2004 HK\$'000	2003 HK\$'000	2004 HK\$'000	2003 HK\$'000
Trade receivables (notes a and c)	161,481	111,440	–	–
Prepayments, deposits and other receivables	33,900	42,514	687	4,664
Due from (notes b and c):				
Immediate holding company	4,607	–	–	–
An associated company	–	30	–	–
Fellow subsidiaries	–	28	–	–
Related companies	2,610	44	–	–
	<b>202,598</b>	154,056	<b>687</b>	4,664



## NOTES TO THE ACCOUNTS

### 16. TRADE AND OTHER RECEIVABLES (CONT'D)

- (a) The credit terms granted to sales agents and other trade customers are generally half month.
- (b) The amounts due from immediate holding company, an associated company, fellow subsidiaries and related companies are unsecured, interest free and have credit periods ranging from 15 days to 45 days.
- (c) The age analysis of the trade receivable with third parties, immediate holding company, an associated company, fellow subsidiaries and related companies is as follows:

	Group		Company	
	2004 HK\$'000	2003 HK\$'000	2004 HK\$'000	2003 HK\$'000
Within 31 days	<b>158,998</b>	103,643	–	–
31 – 60 days	<b>4,896</b>	7,198	–	–
61 – 90 days	<b>1,474</b>	112	–	–
Over 90 days	<b>3,330</b>	589	–	–
	<b>168,698</b>	111,542	–	–

### 17. BANK BALANCES AND CASH

Bank balances and cash of the Group include a deposit of HK\$61,220,000 (2003: HK\$25,637,000), which has been pledged to banks for banking facilities and guarantees granted to and obtained by the Group.

### 18. TRADE AND OTHER PAYABLES

	Group		Company	
	2004 HK\$'000	2003 HK\$'000	2004 HK\$'000	2003 HK\$'000
Trade payables (note a)	<b>105,541</b>	117,016	–	–
Other payables and accruals	<b>217,716</b>	166,489	<b>4,343</b>	4,160
Due to (notes a and b):				
Associated companies	<b>14,698</b>	13,869	–	–
Fellow subsidiaries	<b>15,720</b>	11,895	–	–
Immediate holding company	–	50	–	50
Related companies	<b>62</b>	63	–	–
	<b>353,737</b>	309,382	<b>4,343</b>	4,210





## NOTES TO THE ACCOUNTS

### 18. TRADE AND OTHER PAYABLES (CONT'D)

- (a) The age analysis of trade payable with third parties, associated companies, fellow subsidiaries and related companies is as follows:

	Group		Company	
	2004 HK\$'000	2003 HK\$'000	2004 HK\$'000	2003 HK\$'000
Within 31 days	95,791	68,208	-	-
31 – 60 days	30,552	36,030	-	-
61 – 90 days	3,339	11,392	-	-
Over 90 days	6,339	27,213	-	-
	<b>136,021</b>	<b>142,843</b>	<b>-</b>	<b>-</b>

- (b) The amounts due to associated companies, fellow subsidiaries, immediate holding company and related companies are unsecured and interest free. Except for the amount due to immediate holding company which had no fixed terms of repayment, other balances have the credit terms generally ranging from 40 to 45 days.

### 19. SHARE CAPITAL

	Ordinary shares of HK\$0.10 each	
	Number of shares	HK\$'000
Authorised:		
At 1st January, 2003, 2004 and 31st December, 2004	<b>4,000,000,000</b>	<b>400,000</b>
Issued and fully paid:		
At 1st January, 2003	3,319,308,000	331,931
Repurchase of own shares (note b)	(6,628,000)	(663)
At 1st January, 2004 and 31st December, 2004	<b>3,312,680,000</b>	<b>331,268</b>



## NOTES TO THE ACCOUNTS

### 19. SHARE CAPITAL (CONT'D)

#### (a) Share options

At an Annual General Meeting of the Company held on 29th May, 2002, a share option scheme ("Share Option Scheme") was approved by the shareholders of the Company. Under the terms of the Share Options Scheme, the Directors may, at their discretion, grant to any Director, employee, supplier, customer or other relevant business partners of the Group, share options to subscribe for the Company's shares at the subscription price of the highest of (i) the closing price of the Company's shares as stated in The Stock Exchange of Hong Kong Limited's (the "Stock Exchange") daily quotations sheets on the date of grant; (ii) the average closing price of the Company's shares 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. A nominal consideration at HK\$1 was paid by the grantees for the acceptance of the grant of share options.

The maximum number of shares may be issued upon exercise of all outstanding options granted and yet to be exercised under the Share Option Scheme and any other share option scheme of the Group must not exceed 30% of the number of issued shares of the Company from time to time.

The total number of shares to be granted under the Share Option Scheme and any other share option scheme of the Group shall not exceed 331,931,000, representing 10% of the number of issued shares at the date of adoption of the Share Option Scheme.

An option may be exercised in accordance with the terms of the Share Option Scheme at any time during a period, in relation to the relevant option, to be notified by the Directors to the grantee, such period not exceeding six years commencing on the date falling three months after the date of grant and expiring on the last day of the said period.

The Share Option Scheme will remain in force for a period of ten years commencing on the date on which it was adopted.

Movements in the number of share options outstanding during the year are as follow:

	Number of options	
	2004	2003
At 1st January	136,729,800	147,059,800
Granted (note i)	–	104,378,000
Lapsed	(32,351,800)	(114,708,000)
At 31st December (note iii)	104,378,000	136,729,800



## NOTES TO THE ACCOUNTS

### 19. SHARE CAPITAL (CONT'D)

#### (a) Share options (cont'd)

- (i) Share options were granted on 25th July, 2003 at the exercise price of HK\$1.14 per share and will expire on 25th October, 2009. Consideration received was HK\$4 in respect of the share options granted during the year ended 31st December, 2003.
- (ii) No share options were exercised during the year ended 31st December, 2004 (2003: Nil).
- (iii) Share options outstanding at the end of the year have the following terms:

Expiry Date	Exercise price	Number of options		Vested percentages	
		2004	2003	2004	2003
<b>Directors</b>					
24th March, 2004	0.82	–	32,351,800	–	100%
25th October, 2009	1.14	<b>104,378,000</b>	104,378,000	<b>100%</b>	100%
		<b><u>104,378,000</u></b>	<b><u>136,729,800</u></b>		

#### (b) Repurchase of own shares

In April 2003, the Company repurchased a total of 6,628,000 ordinary shares of the Company of HK\$0.1 each at an aggregated consideration of HK\$5,325,000. The highest and lowest prices per share paid for the repurchase were HK\$0.83 and HK\$0.77 respectively. The above shares repurchased were then cancelled.



## NOTES TO THE ACCOUNTS

### 20. RESERVES

#### Group

	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, 2004	1,434,558	663	3,666	2,464	869,712	2,311,063
Share of exchange differences of associated companies	–	–	–	–	51	51
Share of deficit on revaluation of investments in securities of an associated company	–	–	–	(2,464)	–	(2,464)
Transfer	–	–	43	–	(43)	–
Profit for the year	–	–	–	–	367,470	367,470
Dividends	–	–	–	–	(39,752)	(39,752)
<b>At 31st December, 2004</b>	<b><u>1,434,558</u></b>	<b><u>663</u></b>	<b><u>3,709</u></b>	<b><u>–</u></b>	<b><u>1,197,438</u></b>	<b><u>2,636,368</u></b>
Representing:						
Reserves	1,434,558	663	3,709	–	1,144,435	2,583,365
2004 final dividend proposed	–	–	–	–	53,003	53,003
<b>At 31st December, 2004</b>	<b><u>1,434,558</u></b>	<b><u>663</u></b>	<b><u>3,709</u></b>	<b><u>–</u></b>	<b><u>1,197,438</u></b>	<b><u>2,636,368</u></b>
Retained by:						
Company and subsidiaries	1,434,558	663	3,666	–	171,415	1,610,302
Associated companies	–	–	–	–	1,025,807	1,025,807
Jointly controlled entities	–	–	43	–	216	259
<b>At 31st December, 2004</b>	<b><u>1,434,558</u></b>	<b><u>663</u></b>	<b><u>3,709</u></b>	<b><u>–</u></b>	<b><u>1,197,438</u></b>	<b><u>2,636,368</u></b>



## NOTES TO THE ACCOUNTS

### 20. RESERVES (CONT'D)

#### Group

	<b>Share premium</b>	<b>Capital redemption reserve</b>	<b>Legal reserve</b>	<b>Investments revaluation reserve</b>	<b>Retained earnings</b>	<b>Total</b>
	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000
At 1st January, 2003	1,434,558	–	3,666	4,180	930,164	2,372,568
Share of exchange differences of associated companies	–	–	–	–	59	59
Share of reserve realised upon disposal of investments in securities of an associated company	–	–	–	(1,716)	–	(1,716)
Repurchase of own shares (note 19(b))	–	663	–	–	(5,325)	(4,662)
Loss for the year	–	–	–	–	(18,747)	(18,747)
Dividends	–	–	–	–	(36,439)	(36,439)
At 31st December, 2003	<u>1,434,558</u>	<u>663</u>	<u>3,666</u>	<u>2,464</u>	<u>869,712</u>	<u>2,311,063</u>
Representing:						
Reserves	1,434,558	663	3,666	2,464	849,836	2,291,187
2003 final dividend proposed	–	–	–	–	19,876	19,876
At 31st December, 2003	<u>1,434,558</u>	<u>663</u>	<u>3,666</u>	<u>2,464</u>	<u>869,712</u>	<u>2,311,063</u>
Retained by:						
Company and subsidiaries	1,434,558	663	3,666	–	129,945	1,568,832
Associated companies	–	–	–	2,464	739,767	742,231
At 31st December, 2003	<u>1,434,558</u>	<u>663</u>	<u>3,666</u>	<u>2,464</u>	<u>869,712</u>	<u>2,311,063</u>

A subsidiary in Macau and jointly controlled entities in China Mainland have transferred 10% of their profits to non-distributable legal reserve in accordance with local rules and regulations respectively.



## NOTES TO THE ACCOUNTS

### 20. RESERVES (CONT'D)

#### Company

	Share premium HK\$'000	Capital redemption reserve HK\$'000	Retained earnings HK\$'000	Total HK\$'000
At 1st January, 2004	1,434,558	663	655,050	2,090,271
Profit for the year	–	–	64,735	64,735
Dividends	–	–	(39,752)	(39,752)
<b>At 31st December, 2004</b>	<b><u>1,434,558</u></b>	<b><u>663</u></b>	<b><u>680,033</u></b>	<b><u>2,115,254</u></b>
Representing:				
Reserves	1,434,558	663	627,030	2,062,251
2004 final dividend proposed	–	–	53,003	53,003
<b>At 31st December, 2004</b>	<b><u>1,434,558</u></b>	<b><u>663</u></b>	<b><u>680,033</u></b>	<b><u>2,115,254</u></b>
At 1st January, 2003	1,434,558	–	660,641	2,095,199
Profit for the year	–	–	36,173	36,173
Repurchase of own shares	–	663	(5,325)	(4,662)
Dividends	–	–	(36,439)	(36,439)
At 31st December, 2003	<u>1,434,558</u>	<u>663</u>	<u>655,050</u>	<u>2,090,271</u>
Representing:				
Reserves	1,434,558	663	635,174	2,070,395
2003 final dividend proposed	–	–	19,876	19,876
At 31st December, 2003	<u>1,434,558</u>	<u>663</u>	<u>655,050</u>	<u>2,090,271</u>



## NOTES TO THE ACCOUNTS

### 21. PROVISION FOR OVERHAUL AND MAJOR CHECKS

	<b>Group</b>	
	<b>2004</b>	2003
	<b>HK\$'000</b>	HK\$'000
At beginning of year	<b>64,869</b>	53,695
Charged during the year (note 4)	<b>84,772</b>	95,658
Utilised during the year	<b>(57,702)</b>	(84,484)
	<hr/>	<hr/>
At end of year	<b>91,939</b>	64,869
	<hr/> <hr/>	<hr/> <hr/>

### 22. DEFERRED TAXATION ASSETS

	<b>Group</b>	
	<b>Tax losses</b>	
	<b>2004</b>	2003
	<b>HK\$'000</b>	HK\$'000
At beginning of year	<b>30,333</b>	–
(Charged)/credited to profit and loss account (note 6)	<b>(11,039)</b>	30,333
	<hr/>	<hr/>
At end of year	<b>19,294</b>	30,333
	<hr/> <hr/>	<hr/> <hr/>
Deferred tax assets to be recovered after more than 12 months	<b>11,267</b>	19,494
	<hr/> <hr/>	<hr/> <hr/>

Deferred taxation is calculated in full on temporary differences under the liability method using the statutory profits tax rate prevailing in which the Group's principal operating subsidiary operates of 15.75% (2003: 15.75%).

Deferred income tax assets are recognised for tax loss carry forwards to the extent that realisation of the related tax benefit through the future taxable profits is probable. The Group and the Company have unrecognised tax losses of HK\$78,703,000 (2003: HK\$54,155,000) and HK\$70,923,000 (2003: HK\$54,155,000) respectively to carry forward against future taxable income; except for tax losses of a subsidiary of HK\$7,780,000 which will be expired from 2005 to 2007, the remaining tax losses have no expiry date.



## NOTES TO THE ACCOUNTS

### 23. NOTES TO THE CONSOLIDATED CASH FLOW STATEMENT

#### (a) Reconciliation of operating profit/(loss) to cash generated from operations

	2004 HK\$'000	2003 HK\$'000
Operating profit/(loss)	15,852	(223,583)
Depreciation	64,740	68,519
Amortisation of goodwill	18,840	18,840
Amortisation of development costs, patents and trademarks	45	138
Loss on disposal of fixed assets	334	458
Interest income	(4,813)	(9,172)
Operating profit/(loss) before working capital changes	94,998	(144,800)
Decrease in inventories	4,353	340
Decrease in lease and equipment deposits	14,279	5,214
(Increase)/decrease in trade and other receivables	(40,892)	30,621
Change in balances with fellow subsidiaries	3,853	(3,722)
Change in balances with related companies	(2,567)	(823)
Increase in amount due to immediate holding company	(4,657)	(131)
Change in balances with associated companies	859	(4,416)
Increase in trade and other payables	39,750	4,688
Increase in sales in advance of carriage	10,592	1,226
Increase in provision for overhaul and major checks	27,070	11,174
Cash generated from/(used in) operations	<u>147,638</u>	<u>(100,629)</u>

#### (b) Analysis of changes in financing during the year

	Share capital		Minority interests		Dividend payable	
	including premium					
	2004	2003	2004	2003	2004	2003
	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000
At beginning of year	1,765,826	1,766,489	248,797	318,207	21	3,252
Repurchase of own shares	-	4,662	-	-	-	-
Minority interests' share of profits/(loss)	-	-	33,495	(69,410)	-	-
Dividends	-	-	-	-	39,752	36,439
Cash outflows	-	(5,325)	-	-	(39,750)	(39,670)
At end of year	<u>1,765,826</u>	<u>1,765,826</u>	<u>282,292</u>	<u>248,797</u>	<u>23</u>	<u>21</u>





## 24. 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 Tradeport Logistics Centre at the South Commercial District of the Hong Kong International Airport (the “Project”). The Group has 25% interest in the Project. On 17th March, 2004, the Airport Authority Hong Kong 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 (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 Airport Authority Hong Kong 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 (2003: HK\$649,350,000).

(b) **Commitments under operating leases**

The Group had future aggregate minimum lease payments under non-cancellable operating leases in respect of aircraft and related equipment as follows:

	<b>2004</b>	<b>Group</b>
	<b>HK\$'000</b>	2003
		HK\$'000
Not later than one year	<b>357,491</b>	290,071
Later than one year and not later than five years	<b>1,011,211</b>	831,081
More than five years	<b>407,760</b>	609,249
	<b><u>1,776,462</u></b>	<u>1,730,401</u>

The above operating lease commitments included commitment for fixed rent only. Rentals payable in some cases include an additional rent, calculated according to exact flying hours, in excess of a fixed rent.



## NOTES TO THE ACCOUNTS

### 24. COMMITMENTS (CONT'D)

#### (c) Future minimum rental payments receivables

The Group had future minimum lease receipts under non-cancellable operating lease in respect of aircraft as follows:

	<b>Group</b>	
	<b>2004</b>	2003
	<b>HK\$'000</b>	HK\$'000
Not later than one year	<b>10,241</b>	–

(d) At 31st December, 2004, the Company did not have any significant commitments (2003: Nil).

### 25. FINANCIAL INSTRUMENTS

#### (a) Foreign currency swap contracts

The Group employed foreign exchange contracts to manage its foreign currency exposure in Taiwan. The Group has no foreign exchange contracts outstanding at 31st December, 2004 (2003: Nil). These instruments are used solely to reduce or eliminate the foreign exchange risk associated with the operation activities and not for trading and speculation purposes.

#### (b) Fuel price forward contact

As at 31st December, 2004, the Group had two derivative contracts outstanding to lock in future fuel price at a certain range. The Group receives from the counter-party the applicable difference between the fuel price and the strike price for the notional quantity if the fuel prices rises above the strike price. In return, the Group pays the counter-party the difference between the fuel price and the strike price if the fuel price falls below the strike price. The two contracts will expire on 31st March, 2005 and 31st December, 2005, respectively.

	<b>Group</b>	
	<b>Number of barrels</b>	
	<b>2004</b>	2003
Fuel price forward and option contracts	<b>15,000</b>	15,000



## NOTES TO THE ACCOUNTS

### 26. CONTINGENT LIABILITIES

	<b>Group and Company</b>	
	<b>2004</b>	2003
	<b>HK\$'000</b>	HK\$'000
Guarantee for banking facilities granted by bank to an associated company	<b>15,000</b>	15,000

### 27. 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:

	<b>2004</b>	2003
	<b>HK\$'000</b>	HK\$'000
Revenues:		
Value of tickets sold to (note i):		
– Immediate holding company	<b>1,545</b>	–
– Fellow subsidiaries	<b>3,395</b>	4,201
– Related companies	<b>7,755</b>	15,468
– An associated company	<b>2,032</b>	550
Lease of an aircraft to immediate holding company (note ii)	<b>9,856</b>	–
Operating expenses:		
Management fee paid to:		
– Immediate holding company (note iii)	–	6,000
– Fellow subsidiaries (notes iii and note iv)	<b>9,600</b>	3,600
Landing, loading, parking and other airport charges paid to a fellow subsidiary (note v)	<b>69,337</b>	51,927
Ground handling costs paid to an associated company (note vi)	<b>119,866</b>	93,858
Technical and ground handling costs paid to an associated company (note vii)	<b>4,475</b>	3,201
Inflight meal services expenses paid to a related company (note viii)	<b>41,199</b>	40,637
Lease rentals paid to fellow subsidiaries (note ix)	<b>688</b>	–
Others:		
Purchase of jointly controlled entities from a fellow subsidiary (note x)	<b>340,566</b>	–
Purchase of an associated company from a fellow subsidiary (note xi)	<b>89,000</b>	–



## NOTES TO THE ACCOUNTS

### 27. RELATED PARTY TRANSACTIONS (CONT'D)

- (i) Air tickets were sold to the related ticket sales agents in accordance with the pricing policy of the Group.
- (ii) The Group entered into a lease agreement with Air China Limited, immediate holding company, pursuant to which the Group leases aircraft to Air China Limited at a monthly fee of US\$358,500 (equivalent to approximately HK\$2,796,000) with monthly maintenance hour charge of US\$470 (equivalent to approximately HK\$4,000) per block hour.
- (iii) On 27th August, 2003, the Company and China National Aviation Corporation (Group) Limited ("CNACG"), a former immediate holding company and now a fellow subsidiary, 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.
- (iv) The Group entered into a management services agreement with CNAC (Macau) Aviation Limited, a fellow subsidiary, pursuant to which CNAC (Macau) Aviation Limited provides general management services including but not limited to secretarial, personnel, accounting and general office administrative services to CNAC Macau at a monthly fee of HK\$300,000.
- (v) The airport related charges paid to ADA-Administrative Airport Limited ("ADA"), a fellow subsidiary, 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.
- (vi) The ground handling services rendered were charged at terms pursuant to agreements entered into by the Group with Menzies Macau.
- (vii) The technical and ground handling services rendered were charged at terms pursuant to agreements entered into by the Group with Dragonair.
- (viii) 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.
- (ix) The Group entered into a lease agreement with Easy Advance Limited and Wise Advice Limited, fellow subsidiaries, pursuant to which Easy Advance Limited and Wise Advice Limited lease office premises and certain car parks to the Group at a total monthly rental of MOP141,800 (equivalent to approximately HK\$138,000).
- (x) In April 2004, the Group entered into share transfer contracts with Air China International Corporation ("Air China International") pursuant to which the Group agreed to acquire 60% of equity interests in BACL and SWACL from Air China International at considerations of RMB294 million and RMB 67 million respectively. The transactions were completed in November 2004.



### 27. RELATED PARTY TRANSACTIONS (CONT'D)

- (xi) In August 2004, the Group entered into sale and purchase agreements with CNACG pursuant to which the Group agreed to acquire 16% of equity interests in LLSHK from CNACG at a consideration of HK\$89 million. The transaction was completed in December 2004.
- (xii) On 18th October, 1997, the Company entered into a license agreement with China National Aviation Corporation ("CNAC") pursuant to which CNAC has 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 ("Old License Agreement").

On 25th August, 2004, CNACG entered into two license agreements with the Company pursuant to which CNACG has agreed to grant licenses to the Company, free of royalty, for the rights to use those trademarks in Hong Kong and Macau, respectively, so long as the Company is a direct or indirect subsidiary of China National Aviation Holding Company ("New License Agreements"). These license agreements supersede the Old License Agreement.

No royalty charge was levied under the Old License Agreement and the New License Agreements in respect of the use of these trademarks during the year (2003: Nil).

### 28. HOLDING COMPANIES

Pursuant to a restructuring agreement entered into on 20th November, 2004 among China National Aviation Holding Company, Air China Limited and CNACG, CNACG transferred its 69% equity interest in the Company to Air China Limited by way of capital contribution (the "Restructuring"). The effective date of the Restructuring was 30th September, 2004. Upon completion of the Restructuring, Air China Limited became the immediate holding company of the Company. Air China Limited was listed on the Main Board of the Stock Exchange of Hong Kong Limited in December 2004.

The Directors regard China National Aviation Holding Company, a state-owned enterprise established in the People's Republic of China, as being the ultimate holding company.

### 29. APPROVAL OF ACCOUNTS

The accounts were approved by the Board of Directors on 23rd March, 2005.