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

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**中航興業有限公司**

CHINA NATIONAL AVIATION COMPANY LIMITED

*(incorporated in Hong Kong with limited liability)*

**(Stock Code: 1110)**

**DISCLOSEABLE TRANSACTION:**

**ESTABLISHMENT OF MACAU ASIA EXPRESS**

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## DEFINITIONS

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

“Air China”	Air China Limited, a joint stock limited company incorporated under the laws of the PRC with limited liability, whose H shares are listed on the Stock Exchange and the London Stock Exchange, plc.
“Airpax”	Airpax Limited, a company incorporated in Macau with limited liability and an indirectly owned subsidiary of Shun Tak upon completion of the Shun Tak Subscription
“Board”	the board of directors of the Company
“Business Day”	a day (other than a Saturday or Sunday) on which banks are open for business in Hong Kong
“CNAC Macau”	China National Aviation Corporation (Macau) Limited, a company incorporated in Macau with limited liability and a wholly-owned subsidiary of the Company
“CNAH”	China National Aviation Holding Company (中國航空集團公司), a state-owned enterprise incorporated under the laws of the PRC and the ultimate controlling shareholder of the Company
“Company”	China National Aviation Company Limited, a company incorporated in Hong Kong with limited liability and the shares of which are listed on the Stock Exchange
“Completion Date”	the date on which the last of the Conditions Precedent is satisfied (or waived by agreement between NX and ST-CNAC)
“Concession”	the exclusive right of NX to operate air transport services to and from Macau, including air transport services in respect of passengers, freight, mail and postal parcels, pursuant to the Concession Contract
“Concession Contract”	the contract between NX and the Macau Government dated 8 March 1995 which grants the Concession to NX for a term of 25 years (as it may from time to time be amended or modified or supplemented)

## DEFINITIONS

“Conditions Precedent”	the conditions precedent set out in the paragraph headed “Conditions Precedent to the Effectiveness of the MAX JV Agreement” in this circular
“Conditions Subsequent”	the conditions subsequent set out in the paragraph headed “Conditions Subsequent to the Continuance of the Terms and Conditions of the MAX JV Agreement” in this circular
“Dragonair”	Hong Kong Dragon Airlines Limited, an airline operator incorporated in Hong Kong with limited liability, a 43.29% owned associated company of the Company and not a connected person of the Company as defined in the Listing Rules
“Group”	the Company and its subsidiaries
“Groupax”	Groupax Limited, a company incorporated in Hong Kong with limited liability and a subsidiary of Shun Tak upon completion of the Shun Tak Subscription
“Groupax JV Agreement”	the joint venture agreement entered into between CNAC Macau, Shun Tak and Groupax on 24 January 2006 in relation to the management and control of Groupax and the Shun Tak Subscription
“Hong Kong”	the Hong Kong Special Administrative Region of the PRC
“Independent Third Party”	party(ies) who is/are not connected with the directors, chief executive and substantial shareholders of the Company or any of its subsidiaries or any of their respective associates and not connected person(s) of the Company as defined in the Listing Rules
“Latest Practicable Date”	1 March 2006, being the latest practicable date prior to the printing of this circular for ascertaining certain information contain herein

## DEFINITIONS

“Low Cost Model”	the business model adopted by low-cost carriers including the model as operated by each of Virgin Blue Airlines, Easyjet Airline Company Ltd. and JetBlue Airways Corporation on or about the date of the MAX JV Agreement which includes but not limited to the following characteristics: single aisle, narrow bodied aircraft, commercial passenger flight range of up to six hours in duration; user pays’ services elements such as food and beverage service, in-flight entertainment and VIP lounges
“Listing Rules”	the Rules Governing the Listing of Securities on the Stock Exchange
“Macau”	the Macau Special Administrative Region of the PRC
“Macau Asia Express”	Macau Asia Express Limited, a company incorporated in Macau with limited liability and an indirectly owned subsidiary of the Company under the laws of Macau
“Macau Asia Express Group”	Macau Asia Express and its subsidiaries
“MAX JV Agreement”	the joint venture agreement entered into between NX, Starpax, Airpax, CNAC Macau and Macau Asia Express on 24 January 2006 in relation to the management and control of Macau Asia Express
“MOP”	Macau Patacas, the lawful currency of Macau
“NX”	Air Macau Company Limited, a company incorporated in Macau with limited liability and a 51% owned subsidiary of CNAC Macau. The other shareholders of NX are Servicos, Administracao e Participacoes, Limitada (SEAP), Sociedade de Turismo e Diversoes de Macau (STDM), Evergreen Airways Service (Macau) Ltd., Regiao Administrativa Especial de Macau (Macau Government) and various other investors, each of them is an Independent Third Party
“PRC”	the People’s Republic of China, excluding Hong Kong and Macau
“SFO”	Securities and Futures Ordinance (Chapter 571 of the Laws of Hong Kong)

## DEFINITIONS

“Shareholding Percentage”	in relation to a shareholder, a fraction the numerator of which is the total number of the shares held by the shareholder and the denominator of which is the total number of all the shares (including the shares held by that shareholder) in issue
“Shun Tak”	Shun Tak Air Transport Limited, a company incorporated in Macau with limited liability and a wholly-owned subsidiary of Shun Tak Holdings Limited, a company listed on the Stock Exchange
“Shun Tak Subscription”	the subscription of 640 shares of HK\$10.00 each in the share capital of Groupax under the Groupax JV Agreement
“ST-CNAC”	Starpax and Airpax collectively
“Starpax”	Starpax Limited, a company incorporated in Macau with limited liability and an indirectly owned subsidiary of Shun Tak upon completion of the Shun Tak Subscription
“Sub-Concession”	a sub-concession under the Concession of the exclusive right to operate Low Cost Model air transport services to and from Macau, obtained or to be obtained by Macau Asia Express from NX pursuant to the Sub-Concession Contract
“Sub-Concession Contract”	the contract to be entered into between NX and Macau Asia Express in relation to the Sub-Concession
“Shareholders”	shareholders of the Company
“Stock Exchange”	The Stock Exchange of Hong Kong Limited

*In this circular, except as otherwise indicated, MOP has been translated into HK\$ at the rate of HK\$1.00 = MOP1.03 and US\$ has been translated into HK\$ at the rate of US\$1.00 = HK\$7.80 for reference purpose only.*

LETTER FROM THE BOARD



中航興業有限公司

CHINA NATIONAL AVIATION COMPANY LIMITED

(incorporated in Hong Kong with limited liability)

(Stock Code: 1110)

*Directors:*

Kong Dong (*Chairman*)

Chuang Shih Ping

Zhang Xianlin

Tsang Hing Kwong, Thomas

Gu Tiefei

Zhao Xiaohang

Lok Kung Nam\*

Hu Hung Lick, Henry\*

Ho Tsu Kwok, Charles\*

Li Kwok Heem, John\*

Chan Ching Har, Eliza\*

*Registered office:*

5th Floor, CNAC House

12 Tung Fai Road

Hong Kong

International Airport

Lantau

Hong Kong

\* *independent non-executive directors*

6 March 2006

**DISCLOSEABLE TRANSACTION:**

**ESTABLISHMENT OF MACAU ASIA EXPRESS**

*To the Shareholders*

Dear Sir or Madam,

**INTRODUCTION**

Reference is made to the announcement issued by the Company dated 24 January 2006 relating to the establishment of Macau Asia Express.

It was announced that on 24 January 2006, (a) CNAC Macau entered into the Groupax JV Agreement with, inter alia, Shun Tak; and (b) NX and CNAC Macau entered into the MAX JV Agreement with, inter alia, Starpax and Airpax to establish Macau Asia Express to engage in the business activities of operating Low Cost Model air transport services based in Macau with the aim to provide affordable, value-added, air transport services mainly in Asia.

Pursuant to the MAX JV Agreement, NX and ST-CNAC agreed to invest an initial aggregate sum of US\$30,000,000 (equivalent to approximately HK\$234,000,000) in cash as initial funding for the registered and working capital of Macau Asia Express. Upon signing

## LETTER FROM THE BOARD

of the MAX JV Agreement, Macau Asia Express will be owned as to 51% by NX and 49% by ST-CNAC. ST-CNAC are wholly-owned subsidiaries of Groupax which in turn will be owned as to 64% by Shun Tak and 36% by CNAC Macau upon completion of the Shun Tak Subscription. Therefore, upon completion of the Shun Tak Subscription, Macau Asia Express will remain as a subsidiary of the Company.

The transactions contemplated under the MAX JV Agreement and the Groupax JV Agreement constitute a discloseable transaction for the Company under Chapter 14 of the Listing Rules.

The purpose of this circular is to provide you with information relating to the establishment of Macau Asia Express and the Shun Tak Subscription.

### MAX JV AGREEMENT

Date: 24 January 2006

Parties: NX;  
Starpax;  
Airpax;  
CNAC Macau; and  
Macau Asia Express

Prior to the completion of the Shun Tak Subscription, each of NX, Starpax, Airpax, CNAC Macau and Macau Asia Express is a subsidiary of the Company.

NX is a 51% owned subsidiary of the Company. The other shareholders of NX are Servicos, Administracao e Participacoes, Limitada (SEAP), Sociedade de Turismo e Diversoes de Macau ("STDM"), Evergreen Airways Service (Macau) Ltd., Regiao Administrativa Especial de Macau (Macau Government) and various other investors, each of them is an Independent Third Party.

Business: Macau Asia Express will engage in the business activities of operating Low Cost Model air transport services based in Macau with the aim to provide affordable, value-added, air transport services mainly in Asia.

Macau Asia Express is a newly established entity which has not yet commenced any operation. Being an airline to be based in Macau, Macau Asia Express will obtain an air operator's certificate from the Macau Civil Aviation Authority which will contain, among other things, the right to land on the Macau International Airport.



## LETTER FROM THE BOARD

**Capital Structure:** Prior to the Completion Date, the issued capital of Macau Asia Express is MOP25,000,000 (equivalent to approximately HK\$24,271,845) divided into 2,500 ordinary shares of MOP10,000 (equivalent to approximately HK\$9,709) each of which 1,275 ordinary shares are beneficially owned by CNAC Macau, 1,200 ordinary shares are beneficially owned by Starpax and 25 ordinary shares are beneficially owned by Airpax.

As one of the Condition Precedents, CNAC Macau will transfer 1,275 ordinary shares of Macau Asia Express to NX upon the signing of the MAX JV Agreement.

On Completion Date, each of NX, Starpax and Airpax will subscribe for additional 3,825, 3,600 and 75 ordinary shares of Macau Asia Express respectively at a subscription price of MOP10,000 each. The subscription price has been determined on a dollar for dollar basis. Upon completion of such subscription, the issued capital of Macau Asia Express will be MOP100,000,000 (equivalent to approximately HK\$97,087,379) divided into 10,000 ordinary shares of MOP10,000 (equivalent to approximately HK\$9,709) each, of which 5,100 ordinary shares are beneficially owned by NX, 4,800 ordinary shares are beneficially owned by Starpax and 100 ordinary shares are beneficially owned by Airpax.

**Funding:** The registered and working capital of Macau Asia Express shall be satisfied by:

- (a) utilization of the proceeds of subscription of the ordinary shares of Macau Asia Express by each of CNAC Macau, NX and ST-CNAC as described above; and
- (b) the contribution of up to US\$30,000,000 (equivalent to approximately HK\$234,000,000) (inclusive of the proceeds of subscription of ordinary shares of Macau Asia Express mentioned in paragraph (a) above) by NX and ST-CNAC, either by way of contributing to the share capital of Macau Asia Express or by way of advancing interest free shareholders' loan to Macau Asia Express, pro-rata to their Shareholding Percentage in Macau Asia Express, as and when additional funding may be required by the board of directors of Macau Asia Express.

## LETTER FROM THE BOARD

In the event additional funds are required for Macau Asia Express' working capital or to fund the acquisition of additional assets, such funding shall be obtained by:

- (a) arranging borrowings in the form of loans or overdraft facilities from banks or other financial institutions for Macau Asia Express; or
- (b) contributing such additional funds by way of interest free shareholders' loan pro-rata to their Shareholding Percentage in Macau Asia Express; or
- (c) contributing such additional funds by way of contribution to the share capital of Macau Asia Express on a pro-rata basis.

Pursuant to the MAX JV Agreement, NX is required to contribute US\$15,300,000 (equivalent to approximately HK\$119,340,000) to Macau Asia Express. NX will satisfy such capital contribution from its internal resources. Any additional contribution of fund and provision of financial assistance (as defined in the Listing Rules) by NX to Macau Asia Express in the future will be subject to applicable Listing Rules requirements.

Board of Directors:

The maximum number of directors for Macau Asia Express shall be 13 (including the chairman) of which NX shall have the right to appoint and remove up to 7 directors and ST-CNAC shall have the right to appoint and remove up to 6 directors.

The quorum for all board meetings and their adjournment shall be 6, of which 3 shall be directors nominated by NX and 3 shall be directors nominated by ST-CNAC.

Approval of the  
board of directors:

Apart from certain matters relating to, inter alia, the adopting of the business plan, budget and accounts, change in share capital, material acquisition and disposal of asset, creating charges over the asset and the winding up of Macau Asia Express, which require the approval of at least 75% of all directors of Macau Asia Express (other than the chairman) who are entitled to vote on the resolution, questions arising at any meeting of the board of directors shall be decided by a majority of votes of directors present at the meeting.

## LETTER FROM THE BOARD

**Management:**

The management committee is responsible for the management of the day-to-day operations of the business of Macau Asia Express and are responsible for the formulation of operational and safety policies of Macau Asia Express in accordance with the business plan and budget approved by the board of directors of Macau Asia Express.

The management committee shall be comprise of a maximum number of 5 managers (including the chief executive officer) of which 2 managers shall be nominated by ST-CNAC and 3 managers shall be nominated by NX.

**Restriction on  
transfer of shares:**

No transfer of any shares of Macau Asia Express shall be made by any shareholder of Macau Asia Express unless prior approval from the Macau Government, if required, is obtained and certain right of first refusal and tag-along right provisions in the MAX JV Agreement are complied with in respect of such transfer and no shareholder of Macau Asia Express shall otherwise sell, mortgage, charge, or otherwise dispose of or encumber the whole or any part of its shareholding or assign or otherwise purport to deal with the beneficial interest therein or any right in relation thereto separate from the legal interest unless with the prior written consent of the Macau Government, if required, and other shareholders of Macau Asia Express.

Each of NX, Starpax and Airpax undertakes to use its respective reasonable endeavours to procure its direct or indirect shareholder(s) not to sell, transfer or otherwise dispose of any of their respective direct or indirect interest or rights in NX, Starpax or Airpax or other party representing an effective interest in the share capital of Macau Asia Express in excess of 15% of the issued share capital of Macau Asia Express, from time to time, unless with the prior approval of the Macau Government, if required.

### **Conditions Precedent to the Effectiveness of the MAX JV Agreement**

Apart from certain provisions, the effectiveness of the MAX JV Agreement is conditional upon the following conditions being fulfilled (or waived by NX and ST-CNAC jointly on such terms that may be reasonably prescribed) on or before 24 March 2006:

1. the transfer of 1,275 ordinary shares in the capital of Macau Asia Express from CNAC Macau to NX; and

## LETTER FROM THE BOARD

2. all necessary approvals and consents to the execution of the Macau Asia Express JV Agreement and the performance of the transactions thereby contemplated being obtained.

In the event any of the Conditions Precedent are not fulfilled (or, as the case may be, waived by NX and ST-CNAC jointly) by 24 March 2006 (or any other date as agreed in writing by the parties to the MAX JV Agreement), save for the liability of either of the shareholders of Macau Asia Express to the other in respect of any breaches of the terms thereof, the MAX JV Agreement shall terminate and of no effect and the shareholders of Macau Asia Express shall immediately proceed to wind-up the affairs of Macau Asia Express and its subsidiaries.

### **Conditions Subsequent to the Continuance of Terms and Conditions of the MAX JV Agreement**

On the Completion Date, the other terms of the MAX JV Agreement shall become effective but, the continuance of the terms and conditions of the MAX JV Agreement is subject to the following conditions being satisfied (or waived by NX and ST-CNAC jointly on such terms that may be reasonable prescribed):

1. NX and ST-CNAC and the board of Macau Asia Express approving and adopting the initial budget of Macau Asia Express for the financial year ending 31 December 2006 and the business plan for the operations and activities of Macau Asia Express;
2. appointment of the managers of Macau Asia Express;
3. approval of the Sub-Concession Contract by the Macau Government;
4. the execution and delivery of the Sub-Concession Contract and the terms of, and entering into of the Sub-Concession Contract being approved by the respect boards of directors of the parties to the Sub-Concession Contract;
5. the grant of an air operator's certificate by the Macau Civil Aviation Authority to Macau Asia Express to operate an International Air Transportation Association (IATA) code separate from NX;
6. Macau Asia Express being designated a Macau airline for the purposes of the applicable air services agreements (or equivalent in the case of PRC) for air services on the routes intended to be operated in the first year of operations set out in the business plan of Macau Asia Express, and acceptance of such designation by the other contracting parties to those air services agreements;
7. Macau Asia Express being granted the appropriate licenses and sufficient capacity rights required to operate air services on the routes intended to be operated in the first year of operations set out in the business plan of Macau Asia Express; and

## LETTER FROM THE BOARD

8. Macau Asia Express and CAM-Sociedade do Aeroporto Internacional de Macau, SARL having entered into an agreement to allow Macau Asia Express to operate to and from the Macau International Airport.

In the event any of the Conditions Subsequent are not fulfilled (or, as the case may be, waived by NX and ST-CNAC jointly) by the first anniversary of the Completion Date (or any other date as agreed in writing by the parties to the MAX JV Agreement) (the “**Macau Asia Express Deadline Date**”), the following shall occur:

1. the parties to the MAX JV Agreement will immediately consult with one another to determine whether an alternate structure may be put in place which will deliver the parties the same or substantially the same economic and commercial objectives as that intended to be achieved by the MAX JV Agreement and which enables the Conditions Subsequence to be satisfied; or
2. failing agreement or the availability of an alternate structure within 10 Business Days from the Macau Asia Express Deadline Date, the MAX JV Agreement and the Sub-Concession Contract shall terminate and be of no effect, save for any claims arising out of any antecedent breach of the MAX JV Agreement and the shareholders of Macau Asia Express shall immediately proceed to wind-up the affairs of Macau Asia Express and its subsidiaries.

### GROUPAX JV AGREEMENT

Date: 24 January 2006

Parties: Shun Tak;  
CNAC Macau; and  
Groupax

Shun Tak and its beneficial owners are Independent Third Parties.

Business: Groupax will engage in the business of holding certain interest in the share capital of Macau Asia Express.

Capital Structure: The authorized and issued capital of Groupax is HK\$10,000 divided into 1,000 shares of HK\$10.00 each, of which 360 shares are beneficially owned by CNAC Macau.

Shun Tak Subscription: Groupax has agreed to issue and allot and Shun Tak has agreed to subscribe for 640 shares of HK\$10.00 each in the capital of Groupax at par value. Completion of the Shun Tak Subscription takes place upon the signing of the Groupax JV Agreement.

## LETTER FROM THE BOARD

Upon completion of the Shun Tak Subscription, Shun Tak is interested in 64% of the enlarged issued share capital of Groupax and Groupax becomes a subsidiary of Shun Tak.

### Funding:

The registered and working capital of Groupax shall be satisfied by:

- (a) utilization of the proceeds of subscription of the ordinary shares of Groupax by each of CNAC Macau and Shun Tak as described above and in the Shun Tak Subscription; and
- (b) the contribution of up to US\$14,700,000 (equivalent to approximately HK\$114,660,000) (inclusive of the proceeds of subscription of 1,000 shares of Groupax by CNAC Macau and Shun Tak) by Shun Tak and CNAC Macau, either by way of contributing to the share capital of Groupax or by way of advancing interest free shareholders' loan to Groupax, pro-rata to their Shareholding Percentage in Groupax, as and when may be required by the board of directors of Groupax.

In the event additional funds are required for Groupax's working capital or to fund the acquisition of additional assets, such funding shall be obtained by:

- (a) arranging borrowings in the form of loans or overdraft facilities from banks or other financial institutions for Groupax; or
- (b) contributing such additional funds by way of interest free shareholders' loan pro-rata to their Shareholding Percentage; or
- (c) contributing such additional funds by way of contribution to the share capital of Groupax on a pro-rata basis.

Pursuant to the Groupax JV Agreement, CNAC Macau is required to contribute US\$5,292,000 (equivalent to approximately HK\$41,277,600) to Groupax. CNAC Macau will satisfy such capital contribution from its internal resources. Any additional contribution of fund by CNAC Macau to Groupax in the future will be subject to applicable Listing Rules requirements.

## LETTER FROM THE BOARD

Board of Directors: The maximum number of directors for Groupax shall be 6 of which Shun Tak shall have the right to appoint and remove up to 4 directors and CNAC Macau shall have the right to appoint and remove up to 2 directors.

The quorum for all board meetings and their adjournment shall be 3, of which 2 shall be directors nominated by Shun Tak and 1 shall be directors nominated by CNAC Macau.

Approval of the board of directors: Apart from certain matters relating to, inter alia, change in share capital, material acquisition and disposal of asset, creating charges over the asset and the winding up of Groupax, which require the approval of at least 75% of all directors of Groupax (other than the chairman) who are entitled to vote on the resolution, questions arising at any meeting of the board of directors shall be decided by a majority of votes of directors present at the meeting.

### **Conditions Subsequent to the Continuance of Terms and Conditions of the Groupax JV Agreement**

The continuance of the terms and conditions of the Groupax JV Agreement is subject to the Conditions Subsequent being satisfied (or waived by NX and ST-CNAC jointly under the MAX JV Agreement on such terms that may be reasonable prescribed).

In the event any of the Conditions Subsequent are not fulfilled (or, as the case may be, waived by NX and ST-CNAC jointly under the MAX JV Agreement) by the first anniversary of the Completion Date (or any other date as agreed in writing by the parties to the Groupax JV Agreement) (the “**Groupax Deadline Date**”), the following shall occur:

1. the parties to the Groupax JV Agreement will immediately consult with one another to determine whether an alternate structure may be put in place which will deliver the parties the same or substantially the same economic and commercial objectives as that intended to be achieved by the Groupax JV Agreement and which enables the Conditions Subsequent to be satisfied; or
2. failing agreement or the availability of an alternate structure within 10 Business Days from the Groupax Deadline Date, the Groupax JV Agreement shall terminate and of no effect, save for claim arising out of any antecedent breach of the Groupax JV Agreement and the shareholders of Groupax shall immediately proceed to wind-up the affairs of Groupax and its subsidiaries.

### **INFORMATION ON MACAU ASIA EXPRESS**

Macau Asia Express was established to engage in the business activities of operating Low Cost Model air transport services based in Macau to provide affordable, value-added, air transport services mainly in Asia.

## LETTER FROM THE BOARD

Macau Asia Express is to be an airline based in Macau that will initially operate on routes into China mainland and other Asian destinations, with a focus on bringing visitors into Macau and the Pearl River Delta Region. Macau Asia Express is a joint venture between NX, CNAC Macau and Shun Tak. These partners bring the know-how of airline operations together with the alignment of other tourist resources, such as hotels, casinos and ferry services.

It is anticipated that Macau Asia Express will undertake its first commercial flight in the 4th quarter of 2006.

NX will directly hold a 51% direct stake in Macau Asia Express, thereby bestowing upon Macau Asia Express its operational rights as a Macau flag carrier that will allow Macau Asia Express to fly to various destinations within China mainland and Asia. NX will also make the formal application to the Macau authorities for formal approval of the grant of the Sub-Concession by NX to Macau Asia Express.

Macau Asia Express remains as a subsidiary of the Company under the laws of Macau upon the signing of the MAX JV Agreement and the Groupax JV Agreement. Since the Company does not have unilateral control over Macau Asia Express (as certain matters relating to, inter alia, the adopting of the business plan, budget and accounts of Macau Asia Express require the approval of at least 75% of all directors of Macau Asia Express under the MAX JV Agreement and the Company does not have control over 75% of all directors of Macau Asia Express), the accounts of Macau Asia Express will be accounted for by proportionate consolidation into the consolidated accounts of the Company in accordance with the Hong Kong Financial Reporting Standards.

The aggregate amount to be contributed by the Group under the MAX JV Agreement and the Groupax JV Agreement is US\$20,592,000 (equivalent to approximately HK\$160,617,600). Such funding will be satisfied from internal resources within the Group.

### **Sub-Concession Contract**

Subject to the formal approval by the Macau Government, Macau Asia Express proposes to enter into the Sub-Concession Contract with NX which shall, in principle, contain the following terms:

1. NX shall grant to Macau Asia Express the exclusive right to operate Low Cost Model air transport services to and from Macau in accordance to the terms and conditions in the Sub-Concession Contract.
2. The Sub-Concession Contract shall take effect from the date of formal approval by the Macau Government.
3. Except as otherwise may be agreed in writing between the parties, NX shall have the right to terminate and redeem the concession of any route which has already commenced regular commercial flight services by Macau Asia Express if there is at least 6 months unused capacity on such route since the date of commencement of regular commercial flight services.



## LETTER FROM THE BOARD

4. As remuneration of the Sub-Concession, Macau Asia Express will pay NX, an annual remuneration equivalent to 2% of the net earning made in the previous year commencing from 1 year after the commencement of commercial operations of Macau Asia Express.
5. The Sub-Concession shall remain in full force and effect until the earlier of (a) expiry of the period for which the Concession was originally granted under the Concession Contract; (b) mutual agreement between the parties; or (c) failure to satisfy any one of the Conditions Subsequent numbered 3 to 6 by the Macau Asia Express Deadline Date.

### **Management of Macau Asia Express**

NX and Shun Tak will be involved in the management of Macau Asia Express through their participation on the management committee. The airline will be managed by an independent professional team with proven ability both in the airline and travel industries with responsibility for the operational and commercial aspects of Macau Asia Express.

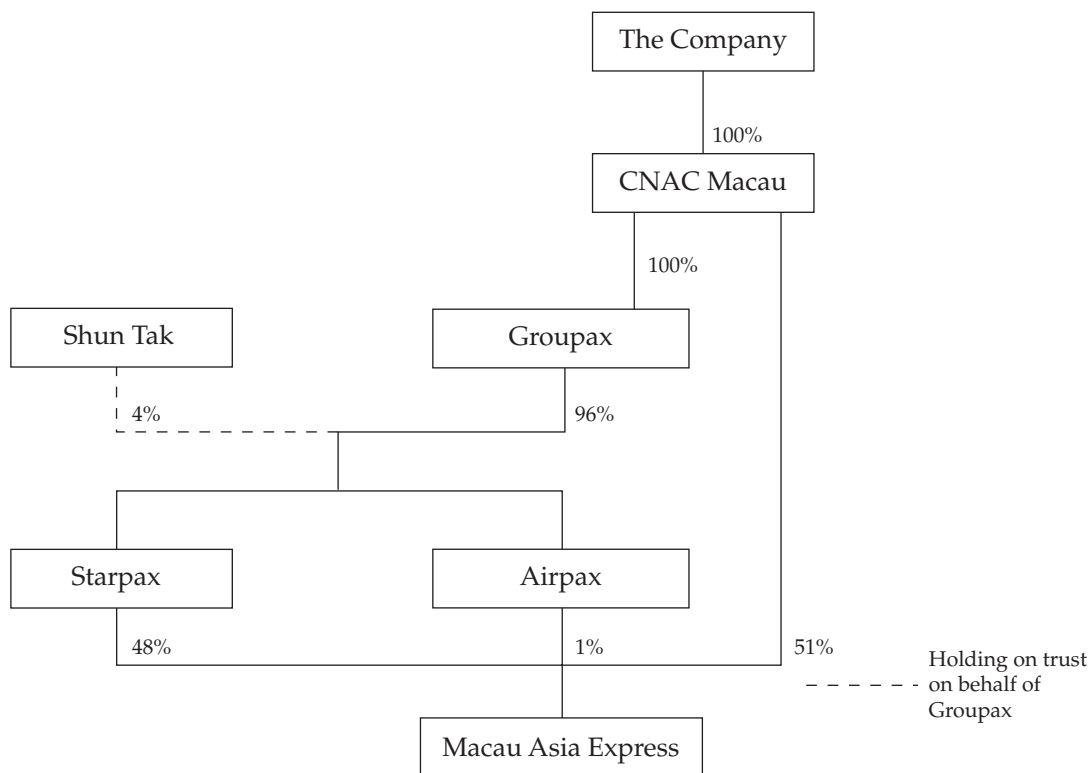
A management committee will be established to ensure that the strategic objectives within the business plan as well as the budget approved by the board of directors of Macau Asia Express are implemented and with overall responsibility for the operational business. Its powers include, inter alia, the formulation of the operational and safety policies of Macau Asia Express, the establishment of new routes and services, the appointment and removal of the chief executive officer, etc.

After the Completion Date and completion of the Shun Tak Subscription, Macau Asia Express remains as a non wholly-owned subsidiary of the Company under the laws of Macau with its share capital being owned as to 51% by NX and 49% by ST-CNAC, subsidiaries of Shun Tak. The initial funding that is intended to be contributed by NX and ST-CNAC to Macau Asia Express (inclusive of the proceeds of subscription of ordinary shares of Macau Asia Express by CNAC Macau, NX and ST-CNAC) under the MAX JV Agreement is US\$30,000,000 (equivalent to approximately HK\$234,000,000) which shall be contributed pro-rata to their Shareholding Percentage in Macau Asia Express.

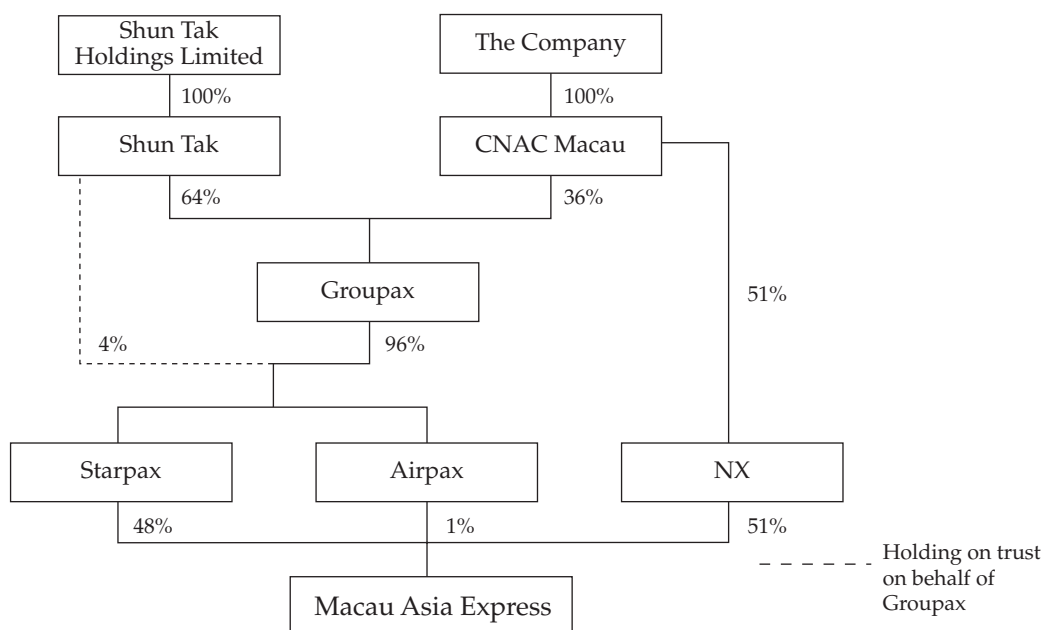
## LETTER FROM THE BOARD

### SHAREHOLDING STRUCTURE OF MACAU ASIA EXPRESS GROUP BEFORE AND AFTER COMPLETION DATE AND THE SHUN TAK SUBSCRIPTION

Prior to the Completion Date and completion of the Shun Tak Subscription, the shareholding structure of the Macau Asia Express Group is as follows:



After the Completion Date and completion of the Shun Tak Subscription, the shareholding structure of the Macau Asia Express Group is as follows:



## LETTER FROM THE BOARD

### REASONS FOR THE ESTABLISHMENT OF MACAU ASIA EXPRESS

Macau is undergoing massive growth in tourism infrastructure and visitor numbers, primarily as a result of the granting of more casino licences by the Macau Government and liberalisation on restrictions to travel from China mainland. Given Macau's emergence as the leisure and entertainment hub in the Pearl River Delta Region, it is anticipated that Macau Asia Express, with the combined synergies created between NX, CNAC Macau and Shun Tak, will be able to benefit from the dynamic economic growth in Macau.

Furthermore, it is intended that Macau Asia Express and NX will work together to enhance the overall volume of air traffic into Macau and to work towards the objective of the Macau Government in developing Macau as a major tourist destination in Asia.

Macau Asia Express is set up as a joint venture between Shun Tak, the Company and NX, with NX being the majority shareholder in Macau Asia Express and Shun Tak and the Company holding a minority interest. To implement the parties' intention that the Company shall hold a minority interest in Macau Asia Express through CNAC Macau while allowing Shun Tak to manage and control the 49% interest in Macau Asia Express, the Directors are of the view that a structure involving NX and Groupax (being a separate joint venture between the Company and Shun Tak) will be most appropriate to address the interests of all parties commercially.

The Directors believe that the terms of the MAX JV Agreement and the Groupax JV Agreement are fair and reasonable and in the interests of the Company and the Shareholders as a whole.

Groupax, being a company incorporated in Hong Kong, cannot directly invest in Macau Asia Express because Macau Asia Express, being an airline based in Macau must be owned by companies incorporated in Macau. Furthermore, it is a requirement under Macau laws that Macau Asia Express, being an anonymous company, must consist at least 3 shareholders. Under such circumstances, Groupax's interest in Macau Asia Express is held via Starpax and Airpax.

### FINANCIAL EFFECTS OF THE TRANSACTION

As Macau Asia Express, Groupax and ST-CNAC are newly established companies with no significant assets and liabilities, assuming other things remain the same, the completion of the Shun Tak Subscription and the future contribution of capital as contemplated in the MAX JV Agreement and the Groupax JV Agreement did not and will not have any net effect on the assets and liabilities of the Group.

Since the Company will control the board of directors of Macau Asia Express, Macau Asia Express will remain a subsidiary of the Company under the laws of Macau. However, since the Company does not have unilateral control over Macau Asia Express (as certain matters relating to, inter alia, the adopting of the business plan, budget and accounts of Macau Asia Express require the approval of at least 75% of all directors of Macau Asia

## LETTER FROM THE BOARD

Express under the MAX JV Agreement and the Company does not have control over 75% of all directors of Macau Asia Express), the financial results of the Macau Asia Express Group will be accounted for by proportionate consolidation into the consolidated accounts of the Company in accordance with the Hong Kong Financial Reporting Standards.

### INFORMATION ON THE GROUP

The Group is principally engaged in the provision of air transportation services through Dragonair and NX, airline catering services, airport ground handling services and logistics services. For the two years ended 31 December 2003 and 2004, the Group recorded an audited loss attributable to shareholders of the Company of approximately HK\$18,747,000 and an audited profit attributable to shareholders of the Company of approximately HK\$367,470,000, respectively. The unaudited total asset value of the Group as at 30 June 2005 was approximately HK\$4,088,759,000.

### INFORMATION ON SHUN TAK

Shun Tak is an indirect wholly-owned subsidiary of Shun Tak Holdings Limited. Shun Tak Holdings Limited which is a company listed on the Stock Exchange and holding a number of business activities principally consisting of shipping, hospitality and property development.

### ADDITIONAL INFORMATION

Your attention is also drawn to the information set out in the appendix to this circular.

Yours faithfully,  
For and on behalf of the Board  
**Kong Dong**  
*Chairman*

**RESPONSIBILITY STATEMENT**

This circular includes particulars given in compliance with the Listing Rules for the purposes of giving information with regard to the Company. The Directors collectively and individually accept full responsibility for the accuracy of the information contained in this circular and confirm, having made all reasonable enquiries, that to the best of their knowledge and belief there are no other facts, the omission of which would make any statement herein misleading.

**DISCLOSURE OF INTERESTS**

- (a) Apart from the interests of the Directors in the share options of the Company which are separately disclosed in (b) below, as at the Latest Practicable Date, none of the directors and the chief executive of the Company had any interest or deemed interest in the long and short positions in the shares, underlying shares and debentures of the Company or any of its associated corporation (within the meaning of Part XV of the SFO) which are required to be notified to the Company and the Stock Exchange pursuant to Divisions 7 and 8 of Part XV of the SFO (including interests and short positions which he is taken or deemed to have under such provisions of the SFO); or are required pursuant to section 352 of the SFO to be entered in the register referred to therein; or as otherwise notified to the Company and the Stock Exchange pursuant to the Model Code for Securities Transaction by Directors of Listed Companies (together the "Discloseable Interest").
- (b) As at the Latest Practicable Date, the Directors had personal interests in share options granted under the Company's employee share option scheme as follows:

Directors	Number of share options	Exercise period	Exercise price HK\$	Percentage of Issued Share Capital
Chuang Shih Ping	33,126,000	26 October 2003 to 25 October 2009	1.14	1.00%
Zhang Xianlin	33,126,000	26 October 2003 to 25 October 2009	1.14	1.00%
Tsang Hing Kwong, Thomas	33,126,000	26 October 2003 to 25 October 2009	1.14	1.00%
Gu Tiefei	5,000,000	26 October 2003 to 25 October 2009	1.14	0.15%

Save as disclosed in (a) and (b) above, as at the Latest Practicable Date, none of the Directors had any Discloseable Interest.

- (c) None of the Directors has a service contract with any member of the Group which is not determinable within one year without payment of compensation (other than statutory compensation).

#### **DIRECTORS' INTEREST IN COMPETING BUSINESS**

Mr. Kong Dong, an executive Director and Chairman of the Company, is the Deputy General Manager of CNAH, which is the ultimate holding company of the Company and the Vice Chairman and a non-executive director of Air China. CNAH is a state-owned enterprise established in the PRC, Air China is a joint stock limited company incorporated in the PRC, shares of which are listed on the Stock Exchange and the London Stock Exchange. Air China is engaged in the business of passenger and cargo air transportation services and CNAH is its ultimate holding company. As such the business activities of CNAH and Air China compete, or are likely to compete, either directly or indirectly, with the business of the Group.

Nevertheless, Mr. Kong is not directly involved in managing Air China's business. The Group is therefore capable of carrying on such business independently of, and at arm's length from the said competing business.

## INTERESTS OF SHAREHOLDERS

Save as disclosed herein, as at the Latest Practicable Date, as far as is known to the Directors and the chief executive of the Company, the following persons have an interest or short position in the shares or underlying shares of the Company which would fall to be disclosed to the Company under Divisions 2 and 3 of Part XV of the SFO or who are directly or indirectly interested in 10% or more of the nominal value of any class of share capital carrying rights to vote in all circumstances at general meetings of any member of the Group:–

**Interest in the Company**

	Capacity	Number of ordinary shares	Percentage of the issued share capital
<b>Substantial Shareholders</b>			
CNAH	Attributable interest	2,264,628,000 (note 1)	68.4%
Air China	Beneficial owner	2,264,628,000 (note 2)	68.4%
<b>Other Persons</b>			
Best Strikes Limited	Beneficial owner	187,656,000	5.6%
On Ling Investments Limited	Attributable interest	322,856,000 (note 3)	9.7%
Novel Investments Holdings Limited	Attributable interest	322,856,000 (note 3)	9.7%
Novel Enterprises (BVI) Limited	Attributable interest	322,856,000 (note 3)	9.7%
Novel Enterprises Limited	Attributable interest	322,856,000 (note 3)	9.7%
Novel Credit Limited	Attributable interest	322,856,000 (note 3)	9.7%
Novel Holdings (BVI) Limited	Attributable interest	322,856,000 (note 3)	9.7%
Westleigh Limited	Attributable interest	322,856,000 (note 3)	9.7%

*Note 1:* A state-owned enterprise established in the People's Republic of China. It owns approximately 51.16% of the total issued share capital of Air China and the entire issued share capital of China National Aviation Corporation (Group) Limited, a company incorporated in Hong Kong, which in turn owns approximately 14.64% of the total issued share capital of Air China. Accordingly, its interests in the Company duplicate with those interest of Air China.

*Note 2:* A joint stock limited company incorporated in the PRC with its H shares listed in Hong Kong and London. China National Aviation Corporation (Group) Limited, the Company's former immediate controlling shareholder, transferred its approximately 69% shareholding interest in the Company to Air China in September 2004 by way of a capital contribution in return for Air China's non-H foreign shares, as such Air China becomes the immediate controlling shareholder of the Company. Its interest in the Company duplicates with those interests of CNAH.

*Note 3:* 5.6% of the interest held by these companies in the Company duplicates with Best Strikes Limited's interest in the Company. The interest of these companies in the Company also duplicate each other.

### Interest in Air Macau

	<b>Percentage of the issued share capital</b>
Servicos, Administracao e Participacoes, Limitada	20%
Sociedade de Turismo e Diversoes de Macau	14%

Save as disclosed above, as at the Latest Practicable Date, no other person has an interest or short position in the shares or underlying shares of the Company which would fall to be disclosed to the Company under Divisions 2 and 3 of Part XV of the SFO or who is directly or indirectly interested in 10% or more of the nominal value of any class of share capital carrying rights to vote in all circumstances at general meetings of any member of the Group.

### LITIGATION

As at the Latest Practicable Date, neither the Company nor any of its subsidiaries was involved in any litigation or claim of material importance and there was no litigation or claim of material importance known to the Directors to be pending or threatened against the Company or any of its subsidiaries.

### GENERAL

- (i) The English language text of this document shall prevail over the Chinese language text.
- (ii) The Secretary of the Company is Mr. Li Man Kit, ACIS, ACS.
- (iii) The qualified accountant of the Company appointed pursuant to Rule 3.24 of the Listing Rules is Mr. Ng Wai Shun, Johnson, CPA, FCCA, ACIS, ACS.
- (iv) The Company's share registrars and transfer office is Computershare Hong Kong Investor Services Limited, 46th Floor, Hopewell Centre, 183 Queen's Road East, Wanchai, Hong Kong.
- (v) The registered office of the Company is at 5th Floor, CNAC House, 12 Tung Fai Road, Hong Kong International Airport, Lantau, Hong Kong.