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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)

CONNECTED TRANSACTION:

**AIRPORT FEES TRANSACTION AND ITS NEW ANNUAL CAP
AND ONGOING CONNECTED TRANSACTIONS**

**Independent financial adviser to the Independent Board Committee
and the Independent Shareholders**



KingswayGroup

Kingsway Capital Limited

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DEFINITIONS

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

“ADA”	Administration of Airports Limited, a 51% owned subsidiary of CNAC (Macau) Aviation Limited (a wholly-owned subsidiary of CNACG)
“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.
“Air Macau”	Air Macau Company Limited, a company incorporated in Macau with limited liability and a 51% indirectly owned subsidiary of the Company
“Airport Charges”	the airport charges determined by the Macau Government for use of certain facilities and services at the Macau International Airport which includes, inter alia, landing charge, loading charge, parking charge, passenger charge, passenger tax, airport charge, loading bridge charge and other ancillary fees
“Airport License”	the airport license entered into between Air Macau and MIAC on 8 September 2004 and 1 March 2006 in respect to the license of certain floor space by Air Macau at the Macau International Airport
“Airport Fees”	the airport fees paid by Air Macau to MIAC pursuant to the Airport Licenses
“Airport Fees Transaction”	The continuing connected transactions between Air Macau and MIAC in relation to the Airport Charges and Airport Fees as described in the section headed “ Airport Fees Transaction ” in this circular
“associate(s)”	has the meaning ascribed thereto in the Listing Rules
“Board”	the board of Directors of the Company
“CNAC Macau”	China National Aviation Corporation (Macau) Company Limited, a wholly-owned subsidiary of the Company
“CNACAL”	CNAC (Macau) Aviation Limited, a wholly-owned subsidiary of CNACG

DEFINITIONS

“CNACG”	China National Aviation Corporation (Group) Limited, company incorporated in Hong Kong with limited liability and is wholly owned by CNAH and a substantial shareholder of Air China
“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 under the laws of Hong Kong with limited liability, whose shares are listed on the Stock Exchange
“Directors”	the directors of the Company
“Dragonair”	Hong Kong Dragon Airlines Limited, an airline operator incorporated in Hong Kong with limited liability and a 43.29% owned associated company of the Company
“Group”	the Company and its subsidiaries
“Hong Kong”	the Hong Kong Special Administrative Region of the PRC
“HK\$”	Hong Kong dollars, the lawful currency of Hong Kong
“Independent Board Committee”	the independent board committee comprising, Messrs. Lok Kung Nam, Hu Hung Lick, Henry and Li Kwok Heem, John appointed to advise the Independent Shareholders in respect of the Airport Fees Transaction and its New Annual Cap
“Independent Shareholders”	Shareholders other than those who have a material interest in the Airport Fees Transaction
“Kingsway Capital”	Kingsway Capital Limited, a licensed corporation holding a licence under the Securities and Futures Commission of Hong Kong to conduct type 6 (advising on corporate finance) of the regulated activity under the SFO and the independent financial adviser to the Independent Board Committee and the Independent Shareholders in respect of the Airport Fees Transaction and its New Annual Cap

DEFINITIONS

“Latest Practicable Date”	27 April 2006, being the latest practicable date prior to the printing of this circular for ascertaining certain information contain herein
“Listing Rules”	the Rules Governing the Listing of Securities on the Stock Exchange
“Macau”	the Macau Special Administrative Region of the PRC
“Macau Government”	the Government of Macau
“MIAC”	Macau International Airport Company
“MOP”	Macau Patacas, the lawful currency of Macau
“New Annual Cap”	the proposed new annual cap of transaction amount of the Airport Fees Transaction for the period from 1 January 2006 to 31 December 2008 as described in the section headed “New Annual Cap” in this circular
“PRC”	the People’s Republic of China
“Shareholders”	shareholders of the Company
“STDM”	Sociedade de Turismo e Diversoes de Macau, a company incorporated in Macau
“Stock Exchange”	The Stock Exchange of Hong Kong Limited
“Ticket Sales”	the sales arrangements for air tickets (including cargo transport) of Air Macau entered into between Air Macau and ticket sales agents and airline carries which include parties that are associates of CNACG or CNAH
“Ticketing Sales Master Agreement”	the master agreement entered into between Air Macau and CNAH dated 30 December 2005 containing therein the binding principles, guidelines and terms and conditions with respect to the Ticket Sales

In this circular, except as otherwise indicated, MOP has been translated into HK\$ at the rate of HK\$1.00 = MOP1.03 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

Zhao Xiaohang

Tsang Hing Kwong, Thomas

Gu Tiefei

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*

2 May 2006

CONNECTED TRANSACTION:

AIRPORT FEES TRANSACTION AND ITS NEW ANNUAL CAP AND ONGOING CONNECTED TRANSACTIONS

To the Shareholders

INTRODUCTION

Reference is made to the announcement issued by the Company dated 16 November 2005 and 20 March 2006 relating to the Airport Fees Transaction.

It was announced that the Airport Fees Transaction constitute continuing connected transactions. This is because STDM, which has a 14% shareholding interest in Air Macau, has approximately 33% shareholding in MIAC and hence, MIAC is also a connected person of the Company. As a result, the payment of the Airport Charges will constitute continuing connected transactions to the Company under the Listing Rules. The Airport Fees Transaction and its New Annual Cap are subject to the reporting, announcement and Independent Shareholders' approval requirements.

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Written approval of the Airport Fees Transaction and its New Annual Cap has been obtained from Air China, which holds approximately 69% of the entire issued share capital of the Company as at the Latest Practicable Date. Furthermore, no shareholder will be required to abstain from voting at the general meeting of the Company if the Company has to convene a general meeting for the approval of the Airport Fees Transaction and its New Annual Cap. As such, the Company can rely on Rule 14A.43 of the Listing Rules and the written approval provided by Air China constitutes a valid approval of the Airport Fees Transaction and its New Annual Cap. The Company will not be required to convene a physical meeting to approve the Airport Fees Transaction and its New Annual Cap. The Company has made an application to the Stock Exchange for dispensation from strict compliance with Rule 14A.43 of the Listing Rules.

The Independent Board Committee has been established to advise the Independent Shareholders in relation to the Airport Fees Transaction and its New Annual Cap. Kingsway Capital has been appointed as the independent financial adviser to advise the Independent Board Committee and the Independent Shareholders in relation to the Airport Fees Transaction and its New Annual Cap.

The purpose of this circular is to provide you with further information relating to the Airport Fees Transaction and its New Annual Cap. The recommendation of the Independent Board Committee to the Independent Shareholders regarding the Airport Fees Transaction and its New Annual Cap is set out on page 12 of this circular. A copy of the letter from Kingsway Capital to the Independent Board Committee and the Independent Shareholders is set out on pages 13 to 18, which follows the letter from the Independent Board Committee in this circular.

AIRPORT FEES TRANSACTION

1. Airport Charges

In Air Macau's normal and ordinary course of business, it incurs a number of airport charges on a daily basis for the use of facilities and services at the Macau International Airport. These airport charges, which are approved and published by the Macau Government, include, inter alia, landing charge, loading charge, parking charge, passenger charge, passenger tax, airport charge, loading bridge charge, and other ancillary fees.

On 17 March 2006, Air Macau and ADA, being the authorized agent responsible for the global management and provision of operational services to MIAC, including the collection of Airport Charges, entered into a legally binding acknowledgement pursuant to which it was acknowledged by Air Macau and ADA that:

- (a) MIAC provides certain facilities and services to Air Macau at a price by reference to the rates published by the Macau Government, namely, Portaria n.º 282/96/M of 11 November 1996 as revised by Portaria n.º 152/98/M, of 15 June 1998, and, Ordem Executiva n.º 36/2004, as amended, supplemented or otherwise modified from time to time (the "Macau Gazette"); and

LETTER FROM THE BOARD

- (b) payment of all amounts of the Airport Charges are due from Air Macau to ADA in accordance with the provisions set out in the Macau Gazette.

The Airport Charges relates to payment of fees to ADA/MIAC in Air Macau's ordinary course of business in compliance with the laws and regulations of Macau. Currently there is no regulatory mechanism which allows Air Macau to bind the Macau Government or ADA or MIAC to fix a duration for such transactions via commercial negotiation with the Macau Government or ADA or MIAC and therefore, the legally binding acknowledgement with respect to the Airport Charges has no fixed duration.

As soon as possible after the financial year ending 31 December 2008, the Company will, if required under the Listing Rules, re-determine the annual cap for the Airport Charges for the forthcoming three financial years, publish an announcement and/or seek Independent shareholders' approval of the Company in respect of the Airport Charges or otherwise comply with the then requirements under the Listing Rules.

2. Airport Fees

In respect of Air Macau's operation at the Macau International Airport, Air Macau has entered into two Airport Licenses on 8 September 2004 and 1 March 2006 with MIAC, each with a term of one year (which will be automatically renewed for another year unless it is terminated by either party by way of 90 days prior written notice). The current term of the Airport License dated 8 September 2004 will expire on 7 September 2006 and the term of the Airport License dated 1 March 2006 will expire on 28 February 2007. Pursuant to the Airport License dated 8 September 2004, MIAC licensed certain floor space such as ticketing and check-in counters, operation/traffic service offices, and lounges at the Macau International Airport to Air Macau. Pursuant to the Airport License dated 1 March 2006, MIAC licensed certain office area at the Macau International Airport to Air Macau. The current monthly license fee payable by Air Macau pursuant to the Airport Licenses amounts to approximately MOP 600,000 (equivalent to approximately HK\$583,000) per month (amounting to approximately MOP 7.2 million (equivalent to approximately HK\$7 million) per annum).

The amounts payable as Airport Fees are calculated by reference to rates published by the Macau Government in the government gazette.

The Airport Charges and Airport Fees for each of the four years ended 31 December 2002, 2003, 2004 and 2005 were HK\$81,045,000, HK\$51,927,000, HK\$69,337,000 and HK\$86,343,000 respectively. Such transaction amounts were within the relevant cap amount granted for the relevant financial year.

LETTER FROM THE BOARD

Both the Airport Charges and the Airport Fees are invoiced and collected by ADA, a 51% owned subsidiary of CNACAL which in turn is a wholly-owned subsidiary of CNACG, on behalf of MIAC, the developer and owner of Macau International Airport. Since the Company and CNACAL are both subsidiaries of CNAH, ADA is a connected person of the Company. Furthermore, STD M, which has a 14% shareholding interest in Air Macau, has approximately 33% shareholding in MIAC and hence, MIAC is also a connected person of the Company. As a result, the payment of the Airport Charges and Airport Fees will constitute continuing connected transactions to the Company under the Listing Rules. Since ADA does not receive any benefit or additional fee from the Group in respect to the collection of the Airport Charges and Airport Fees on behalf of MIAC, ADA, CNACAL, CNACG, CNAH and their respective associates are not deemed to have a material interest in the Airport Fees Transaction.

EXISTING WAIVER

The Company had obtained from the Stock Exchange a waiver from strict compliance with the relevant requirements of the Listing Rules in respect of the Airport Fees Transaction for the past three financial years ended 31 December 2004 (the “Existing Waiver”). The Existing Waiver expired on 31 December 2004. The caps granted under the Existing Waiver and the transaction amount of the Airport Fees Transaction for the three years ended 31 December 2002, 2003 and 2004 are set out as below. The transaction amount for the Airport Fees Transactions for the year ended 31 December 2005 is also set out below:

Description	Existing Caps	Transaction Amounts for the year ended			
		31 December			
		2002	2003	2004	2005
		(HK\$)	(HK\$)	(HK\$)	(HK\$)
Airport Fees Transaction	10% of the Group’s consolidated annual turnover for any relevant financial year	81,045,000	51,927,000	69,337,000	86,343,000
Amount of Cap under the Existing Waiver		132,942,600	122,703,100	189,071,000	N/A

LETTER FROM THE BOARD

NEW ANNUAL CAP

The Board has also considered and proposed that the following caps be set for the annual volumes of the Airport Fees Transaction for the period from 1 January 2006 to 31 December 2008:

Description	Cap Amount		
	2006 (HK\$)	2007 (HK\$)	2008 (HK\$)
Airport Fees Transaction	130 million	160 million	200 million

Basis of the Caps

The New Annual Cap is determined with reference to (a) the rates published by the Macau Government in the government gazette; (b) the previous transactions and figures which are published in the Company's annual reports in 2002 to 2005; and (c) the growth in passenger uplift as projected by the management of Air Macau. Neither ADA nor MIAC has the ability to vary such rates without the prior approval of the Macau Government.

The Airport Fees Transaction will be subject to the annual review requirement and the reporting requirement under Rules 14A.37 to 14A.41 and Rules 14A.45 and 14A.46 of the Listing Rules.

REASONS FOR ENTERING INTO THE AIRPORT FEES TRANSACTION

The Airport Fees Transaction relates to payment of fees to ADA/MAIC in Macau and is in the Group's ordinary course of business in compliance with the laws and regulations of Macau. As Air Macau is an airliner based in Macau and Macau International Airport is the only airport in Macau, it is in the ordinary course of business of Air Macau to use the facilities and services and license certain floor space at the Macau International Airport. Air Macau entered into the Airport Fees Transaction for the purpose of operating its business.

TICKET SALES

In Air Macau's ordinary course of business, sales arrangements are often entered into with ticket sales agents and airline carriers, the number of which may be varied from time to time according to the business needs of Air Macau, for the sale of air tickets (including cargo transport). Such ticket sales agents and airline carriers would include parties which are associates of CNACG or CNAH ("**Ticket Sales Parties**"), the beneficial owner of the entire issued share capital of CNACG. Since CNAH is the ultimate controlling shareholder of the Company and CNACG is a wholly-owned subsidiary of CNAH, both CNAH and CNACG and their respective associates are connected persons of the Company.

LETTER FROM THE BOARD

On 30 December 2005, Air Macau and CNAH have entered into the Ticketing Sales Master Agreement pursuant to which Air Macau has appointed CNAH and CNAH has agreed to provide or to procure its associates to provide ticket sales (including cargo transportation) and other related services to Air Macau.

REASONS FOR THE DELAY IN DISCLOSURE AND FAILURE TO OBTAIN INDEPENDENT SHAREHOLDERS' APPROVAL OF THE AIRPORT FEES TRANSACTION AND ITS ANNUAL CAP IN 2005 AND DELAY IN DISCLOSURE OF THE TICKET SALES

For the year ended 31 December 2005, the transaction amount for Airport Fees Transaction amounted to HK\$86,343,000. As the Airport Charges and Airport Fees in respect of the provision of services by MIAC pursuant to the Airport Fees Transaction would exceed the amount allowed by the de minimus rule under Rule 14A.33(3) and the exemption from Independent Shareholders' requirement rule under Rule 14A.34 of the Listing Rules, such connected transaction and its annual cap in 2005 were subject to disclosure by way of publishing an announcement and obtaining approval of the Independent Shareholders in or about January 2005. Since the Company failed to issue a timely announcement with respect to the Airport Fees Transaction and no approval from the Independent Shareholders was obtained for such transaction, the Company was in breach of Rules 14A.47 and 14A.48 of the Listing Rules.

For the year ended 31 December 2005, the transaction amount for Ticket Sales amounted to HK\$14,877,000. As the transaction amount in respect of the Ticket Sales would exceed the amount allowed by the de minimus rule under Rule 14A.33(3) of the Listing Rules, such connected transaction was subject to disclosure by way of publishing an announcement in or about January 2005. Since the Company failed to issue a timely announcement with respect to the Ticket Sales, the Company was in breach of Rule 14A.47 of the Listing Rules.

The Directors explain that the delay in disclosing details and failure to obtain Independent Shareholders' approval in respect of the Airport Fees Transaction and its annual cap in 2005 and delay in disclosing details of the Ticket Sales is due to late reporting of such transactions from the management of CNAC Macau. Such transactions were not reported to the Company until the reporting accountants of the Company reviewed the accounts of the Company in the process of preparing the interim report of the Company in 2005. Accordingly, the delay of disclosure is partly due to the unawareness of the obligation to disclose such transaction by the management of CNAC Macau and such delay could be avoided in the future by means of better communications between the management of CNAC Macau and the Company and the provision of training to the management of CNAC Macau on the relevant provisions and disclosure obligations under the Listing Rules.

Besides, the amounts payable as Airport Charges and Airport Fees are calculated in accordance with rates published in the government gazette promulgated by the Macau Government. It is given that the Airport Charges and Airport Fees are being invoiced and

LETTER FROM THE BOARD

collected by ADA on behalf of MIAC. Under no circumstances are such rates be negotiated by ADA or MIAC without the prior approval of the Macau Government, Air Macau is therefore unable to bind the Macau Government by fixing a duration for such transactions via commercial negotiations with ADA or MIAC.

Airport Charges and Airport Fees for all airliners using the services and facilities of Macau International Airport are governed by Macau airport general pricing policy, amounts of which are promulgated by the Macau Government and published in the government gazette. Due to the abovementioned reasons, MIAC, or its collecting agent, ADA, would not, or be reluctant to, issue or enter into any written agreement with any airline that uses the facilities and services at Macau International Airport. Air Macau is unable to formulate any bilateral agreement on the Airport Charges with MIAC or ADA for the purpose of complying with Rule 14A.35(1) of the Listing Rules which specifically requires a written agreement to be entered into for all non-exempted continuing connected transactions. Substantial amount of time has been spent by the Company and Air Macau in obtaining a legally binding acknowledgement with ADA for the purpose of complying with Rule 14A.35(1). Such factors have contributed to the delay in disclosing the details of the Airport Fees Transaction and the Ticket Sales and ultimately the failure to obtain Independent Shareholders' approval with respect to the Airport Fees Transactions and its annual cap in 2005.

BUSINESS OF THE GROUP

The Group is principally engaged in the provision of air transportation services through Dragonair and Air Macau, airline catering services, airport ground handling services and logistics services.

INFORMATION ON CONNECTED PERSON

MIAC is the owner of the Macau International Airport.

WRITTEN CERTIFICATE OF AIR CHINA

Written approval of the Airport Fees Transaction and its New Annual Cap has been obtained from Air China, which holds approximately 69% of the entire issued share capital of the Company as at the Latest Practicable Date. In this connection, the Company has obtained a waiver from the Stock Exchange from convening a physical meeting to approval the Airport Fees Transaction and its New Annual Cap pursuant to Rule 14A.43 of the Listing Rules.

The Airport Fees Transaction constitutes a continuing connected transaction to the Company because MIAC is owned as to 33% by STDM, the latter being a substantial shareholder of Air Macau. Therefore, MIAC is a connected person of the Company. Although the Airport Charges and the Airport Fees are invoiced and collected by ADA, a 51% indirectly owned subsidiary of CNACG, on behalf of MIAC, no benefit or additional fees are received by ADA in collection of such Airport Charges and Airport Fees.

LETTER FROM THE BOARD

The Company is of the view that both CNAH and Air China have no interest in the Airport Fees Transaction. Furthermore, since MIAC does not hold any shares in the Company, no shareholder will be required to abstain from voting at the general meeting of the Company if the Company has to convene a general meeting for the approval of the Airport Fees Transaction and its New Annual Cap. As such, the Company can rely on Rule 14A.43 of the Listing Rules and the written approval provided by Air China constitutes a valid approval of the Airport Fees Transaction and its New Annual Cap. The Company will not be required to convene a physical meeting to approve the Airport Fees Transaction and its New Annual Cap.

RECOMMENDATIONS

Kingsway Capital has been appointed as the independent financial adviser to advise the Independent Board Committee and the Independent Shareholders in respect of the Airport Fees Transaction and its New Annual Cap. Kingsway Capital considers that the terms of the Airport Fees Transaction and its New Annual Cap on the whole are fair and reasonable so far as the Independent Shareholders are concerned and the Airport Fees Transaction and its New Annual Cap are in the interests of the Company and the Shareholders as a whole. The text of the letter from Kingsway Capital containing its recommendation to the Independent Board Committee and the Independent Shareholders in relation to the Airport Fees Transaction and its New Annual Cap and the principal factors and reasons considered by Kingsway Capital in arriving at its recommendation is set out on pages 13 to 18 of this circular.

The Independent Board Committee, having taken into account the advice of Kingsway Capital, considers that the terms of the Airport Fees Transaction and its New Annual Cap on the whole are fair and reasonable so far as the Independent Shareholders are concerned and the Airport Fees Transaction and its New Annual Cap are in the interests of the Company and the Shareholders as a whole. The text of the letter from the Independent Board Committee is set out on page 12 of this circular.

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



中航興業有限公司

CHINA NATIONAL AVIATION COMPANY LIMITED

(incorporated in Hong Kong with limited liability)

(Stock Code: 1110)

2 May 2006

Dear Independent Shareholders,

**CONNECTED TRANSACTION:
AIRPORT FEES TRANSACTION AND ITS NEW ANNUAL CAP**

We refer to the circular issued by the Company on 2 May 2006, of which this letter forms a part. Terms defined in this circular shall have the same meanings when used herein.

We have been appointed by the Board as the Independent Board Committee, established to consider the Airport Fees Transaction and its New Annual Cap and to advise you as to whether the terms of the Airport Fees Transaction and its New Annual Cap are fair and reasonable and whether the Airport Fees Transaction and its New Annual Cap are in the interests of the Company and the Shareholders as a whole.

Kingsway Capital has been appointed as the independent financial adviser to advise us and the Independent Shareholders regarding the Airport Fees Transaction and its New Annual Cap. Details of the advice of Kingsway Capital, together with the principal factors and reasons taken into consideration in arriving at such advice, are set out in its letter. Your attention is also drawn to the letter from the Board and the additional information set out in the appendices to this circular.

The Independent Board Committee considers that the terms of the Airport Fees Transaction and its New Annual Cap on the whole are fair and reasonable so far as the Independent Shareholders are concerned and the Airport Fees Transaction and its New Annual Cap are in the interests of the Company and the Shareholders as a whole and has been so advised by Kingsway Capital, the independent financial adviser.

Yours faithfully,

For and on behalf of the Independent Board Committee

Lok Kung Nam

Independent Non-Executive Director

LETTER FROM KINGSWAY CAPITAL

The following is the text of a letter of advice received from Kingsway Capital to the Independent Board Committee and the Independent Shareholders for incorporation into this circular.



5/F, Hutchison House,
10 Harcourt Road, Central, Hong Kong

2 May 2006

*To: The Independent Board Committee and the Independent Shareholders of
China National Aviation Company Limited*

Dear Sirs,

CONTINUING CONNECTED TRANSACTION – AIRPORT FEES TRANSACTION

INTRODUCTION

We refer to our engagement as the independent financial adviser to the Independent Board Committee and the Independent Shareholders in relation to the Airport Fees Transaction and its New Annual Cap, details of which are contained in the circular of the Company dated 2 May 2006 (the “Circular”) of which this letter forms part. Capitalized terms used in this letter shall have the same meanings ascribed to them in the Circular unless the context otherwise requires.

As stated in the “Letter from the Board”, the Group has entered and will continue to enter into the Airport Fees Transaction with ADA and MIAC, both of them are connected persons of the Company under the Listing Rules. Pursuant to the Listing Rules, the Airport Fees Transaction constitute continuing connected transaction for the Company under Rule 14A.11(1) of the Listing Rules, and would normally be made conditional upon the approval of the Independent Shareholders at a general meeting of the Company at which any Shareholder interested in the transaction must abstain from voting. Given that (1) no Shareholder is deemed to have a material interest in the Airport Fees Transaction and required to abstain from voting to approve the Airport Fees Transaction and the New Annual Cap should a general meeting be held; and (2) the Company has obtained a written approval with respect to the Airport Fees Transaction and the New Annual Cap from Air China which, as at the Latest Practicable Date, beneficially owned approximately 69% of the issued share capital of the Company, pursuant to Rule 14A.43 of the Listing Rules, the Company has applied to and has been granted from the Stock Exchange for a waiver from the requirement to convene a general meeting to approve the Airport Fees Transaction and the New Annual Cap and permission for the Shareholders’ approval relating thereto to be given in writing.

LETTER FROM KINGSWAY CAPITAL

The Independent Board Committee comprising the independent non-executive Directors, namely Messrs. Lok Kung Nam, Hu Hung Lick, Henry and Li Kwok Heem, John, has been established to make recommendation to the Independent Shareholders as regards the Airport Fees Transaction and its New Annual Cap. We have been appointed by the Company to give our opinion in relation to the Airport Fees Transaction and its New Annual Cap for the Independent Board Committee's consideration when making their recommendation to the Independent Shareholders. In our capacity as the independent financial advisers to the Independent Board Committee and the Independent Shareholders, our role is to provide the Independent Board Committee and the Independent Shareholders with an independent opinion and recommendation as to whether the Airport Fees Transaction and its New Annual Cap are fair and reasonable so far as the interests of the Shareholders are concerned.

BASIS OF OUR OPINION

In formulating our opinion, we have relied on the information and facts supplied and representations expressed by the Directors. We have been advised by the Directors that no material facts have been omitted from the information supplied and representations expressed to us and we are not aware of any facts or circumstances which would render such information and representations untrue, inaccurate or misleading. We have assumed that the information contained and representations made or referred to in the Circular were complete, true and accurate at the time they were made and continue to be so at the date of the Circular.

We consider that we have been provided with sufficient information to enable us to reach an independent view to justify our reliance on the accuracy of the information and representations contained in the Circular and to provide reasonable basis for our opinion. We have no reason to suspect that any relevant information have been withheld, nor are we aware of any facts or circumstances which would render the information provided and the representations made to us to be untrue, inaccurate, or misleading. We have not, however, conducted an independent investigation into the business and affairs of the Group and relevant associates of MIAC and ADA.

PRINCIPAL FACTORS AND REASONS CONSIDERED

In arriving at our opinion and recommendation to the Independent Board Committee and the Independent Shareholders in relation to the Airport Fees Transaction and the New Annual Cap, we have considered the principal factors and reasons set out below:

I. Background to and reason for the Airport Fees Transaction

The Group is principally engaged in the provision of air transportation services through Dragonair and Air Macau, air catering services, airport ground handling services and logistic services.

Air Macau is an airliner based in Macau, and Macau International Airport is the only airport in Macau. MIAC is the owner of Macau International Airport.

LETTER FROM KINGSWAY CAPITAL

As set out in the “Letter from the Board”, the Directors consider that the Airport Fees Transaction are in the Group’s ordinary course of business because such transactions relate to the payment of fees to ADA/MIAC in Macau arising from (1) usage of facilities and services on a daily basis; and (2) license of certain floor space at the Macau International Airport.

Taking into account of the principal businesses of the Group, the nature of the Airport Fees Transaction and the entering of the Airport Fees Transaction enables the smooth operation of Air Macau, we are of the view that the Airport Fees Transaction is essential for Air Macau’s business.

II. Terms of the Airport Fees Transaction

The Airport Fees Transaction comprises the Airport Charges and the Airport Fees. The Airport Charges relates to payment of fees to ADA/MIAC, for the use of certain facilities and services at the Macau International Airport which includes, inter alia, landing charge, loading charge, parking charge, passenger charge, passenger tax, airport charge, loading bridge charge and other ancillary fees.

On the other hands, the Airport Fees are license fee payable by Air Macau to ADA/MIAC with respect to the license of certain floor space (including ticketing and check-in counters, operation/traffic service offices, lounges and office area) at the Macau International Airport. The current license fee payable by Air Macau amounts to approximately MOP600,000 (equivalent to approximately HK\$583,000) per month or amounting to approximately MOP7.2 million (equivalent to approximately HK\$7 million) per annum.

As stated in the “Letter from the Board”, the amounts payable as Airport Charges and Airport Fees are calculated in accordance with rates published by the Macau Government in the government gazette. According to the relevant laws and regulations of Macau, both the Airport Charges and the Airport Fees are invoiced and collected by ADA on behalf of MIAC. As confirmed by the management, ADA does not receive any benefit or additional fee from Air Macau in respect to the collection of the Airport Charges and Airport Fees on behalf of MIAC. Neither ADA nor MIAC has the ability to vary such rates without the prior approval of the Macau Government.

Currently there is no regulatory mechanism which allows Air Macau to bind the Macau Government to fix a duration or enter into any bilateral agreement for such transactions via commercial negotiation with the Macau Government or ADA or MIAC for the purpose of complying with Rule 14A.35(1) of the Listing Rules. Having considered that (i) the circumstances of the Airport Fees Transaction which terms were set by the Macau Government with virtually no room for negotiation on the side of Air Macau; (ii) a longer duration of the Airport Fees Transaction is crucial and give assurance to the smooth operation of the Group in the future; and (iii) the Airport Fees Transaction has been entered into prior to Rule 14A.35 became effective in March 2004 and the Directors confirm that the terms of the transaction have not been varied, we considered that the longer duration of the Airport Fees Transaction is beneficial to the Group and in normal business practice for this type of transaction.

LETTER FROM KINGSWAY CAPITAL

We have reviewed the relevant Macau government gazette and airport licenses and note that the amounts payable as Airport Charges and Airport Fees are governed by Macau airport general pricing policy, which are stipulated by the Macau Government in the government gazette. As advised by the management of the Company, we understand that the payment of such airport fees and airport charges are applicable to all airliners using the services and facilities of Macau Airport, and the relevant rates are also governed by the same prescribed pricing policy.

We also note that the above arrangements are acknowledged by Air Macau and ADA in a legal binding acknowledgement dated 17 March 2006 given by them that:

- (a) MIAC provides certain facilities and services to Air Macau at a price by reference to the rates published by the Macau Government, namely, Portaria n.º 282/96/M of 11 November 1996 as revised by Portaria n.º 152/98/M, of 15 June 1998, and, Ordem Executiva n.º 36/2004, as amended, supplemented or otherwise modified from time to time (the “**Macau Gazette**”); and
- (b) payment of all amounts of the Airport Charges are due from Air Macau to ADA in accordance to the provisions set out in the Macau Gazette.

III. The New Annual Cap

As stated in the “Letter from the Board” of the Circular, the transaction amount for the Airport Fees Transaction for the year ended 2005 (the “2005 Transaction”) is approximately HK\$86.3 million. The 2005 Transaction continued after the expiry of the prior waiver from strict compliance with the relevant requirements of the Listing Rules granted by the Stock Exchange in respect of the Airport Fees Transaction but has not been timely disclosed by the Company nor has prior approval thereof been obtained from the Independent Shareholders of the Company in general meeting pursuant to Chapter 14A of the Listing Rules. The failure of the Company in these regards has resulted in non-compliance with the Listing Rules. We noted that such non-compliance stemmed partly from the unawareness of the obligation to disclose the 2005 Transaction by the management of CNAC Macau and the Company is obliged to avoid the occurrence of similar event by means of better communications between the management of CNAC Macau and the Company and provision of appropriate Listing Rules training to management of CNAC Macau. Moreover, the prolonged time spent in the negotiation with MIAC and ADA on entering into written agreement for the Airport Fees Transaction as required under Rule 14A.35(1) of the Listing Rules also contributes to the non-compliance with the Listing Rules.

Set out below are the New Annual Cap for the three years ending 31 December 2008:

	2006	2007	2008
	(HK\$' million)	(HK\$' million)	(HK\$' million)
	130	160	200

LETTER FROM KINGSWAY CAPITAL

The basis of determination of the New Annual Cap as set out in the "Letter from the Board" include (a) the rates published by the Macau Government in the government gazette; (b) the historical transactions amounts as published in the Company's annual reports in 2002 to 2004; (c) the transaction amount for the year ended 31 December 2005 advised by the management of the Company; and (d) the expected growth in passenger uplift as projected by the management of Air Macau.

We have assessed the fairness and reasonableness of the New Annual Cap as follows:

(1) *The historical trend*

Set out below are the historical transaction amounts for the Airport Fees Transaction in 2003, 2004 and 2005 respectively:

2003 (HK\$' million)	2004 (HK\$' million)	2005 (HK\$' million)
51.9	69.3	86.3

As illustrated above, the Airport Fees Transaction has demonstrated a historical growth momentum during the past three years ended 2005. The transaction amounts increased by approximately 33.5% from 2003 to 2004 and increased by approximately 24.5% from 2004 to 2005, representing a compound annual growth rate of approximately 28.95% over the period from 2003 to 2005. The Directors anticipate that such growing trend will continue as a result of favourable conditions as further discussed in the sub-section below. We noted that the New Annual Cap represent a compound annual growth rate of approximately 24.03% over the period from 2006 to 2008, which is in line with the historical growth rate over the period from 2003 to 2005. In respect of the composition of the Airport Fees and Airport Charges, we have reviewed the breakdown of the historical transaction amounts and discussed with the management, we noted that over 70% of the amount of the Airport Fees Transaction stemmed from the landing charges related to the number of flights of Air Macau. According to the operational statistics of Air Macau, the number of flights of Air Macau recorded an average of approximately 29.5% increase from 14,431 in 2003 to 23,770 in 2005. The Directors anticipate the number of flights and thus the landing charges will continue to grow as a result of the upcoming favorable conditions of the Macau tourism industry in the medium term. We concur with the Directors' view that it is essential to maintain a sufficient buffer in the New Annual Cap to cope with expansion in operation of business.

(2) *The business environment of Air Macau*

As advised by the management of Air Macau, the New Annual Cap is expected to continue to grow at an average rate of approximately 24% per annum for period from 2006 to 2008.

LETTER FROM KINGSWAY CAPITAL

Macau has experienced a booming influx of visitors in the past few years. According to the published statistics of the Statistics and Census Service (the “DSEC”) of Macau Government, the total number of visitors increase from approximately 11.9 million in 2003 to 18.7 million in 2005, while visitors arrival through air transport increased from approximately 654,600 in 2003 to 1,040,100 in 2005, representing an average annual growth rate of approximately 26.2% during the period.

Moreover, the Macau tourism industry, which is the principal growth driver of the Airport Fees Transaction, is expected to maintain a sustainable growth in the next few years since (a) the continual implementation of “Individual Visit Scheme” adopted by the Central Government; (b) a number of world-class new hotels and entertainment facilities will be opened in the next few years; and (c) the ambition and efforts of the Macau Government to promote Macau into a key tourist and conference destination in the Asia Pacific region.

Having considered (i) the historical trend of the Airport Fees Transaction has demonstrated a continuous growth of Air Macau’s demand for the use of certain facilities and services at the Macau International Airport; (ii) the estimated growth rate in the New Annual Cap which is in line with that of the historical trend; and (iii) the favourable macro-environment for Macau tourism industry which is a main growth driver of the Airport Fees Transaction, we are of the view that the New Annual Cap are fair and reasonable.

RECOMMENDATION

Based on the above principal factors, in particular (i) the Airport Fees Transaction are in the Group’s ordinary course of business in compliance with the laws and regulations of Macau; (ii) the amounts payable as Airport Charges and Airport Fees are calculated in accordance with the rates published by the Macau Government in the government gazette; and (iii) ADA does not receive any benefit or additional fee from the Group in respect to the collection of the Airport Charges and Airport Fees on behalf of MIAC, we consider that the Airport Fees Transaction and its New Annual Cap are fair and reasonable to the Independent Shareholders and that the Airport Fees Transaction are in the ordinary and usual course of business, on normal commercial terms and in the interests of the Company and the Shareholders as a whole. Therefore, we would recommend the Independent Board Committee to advise the Independent Shareholders to approve the Airport Fees Transaction and the New Annual Cap if a general meeting of the Shareholders were to be convened.

Your faithfully,
For and on behalf of
Kingsway Capital Limited
Chu Tat Hoi
Director

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 interests 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) There is no contract or arrangement subsisting at the date of this circular in which any of the Directors is materially interested and which is significant in relation to the business of the Group.
- (d) As at the Latest Practicable Date, none of the Directors and the expert whose name is referred to in the paragraph headed "Consent" in this appendix has or has had any interest, direct or indirect, in any assets which have been, since 31 December, 2005, being the date to which the latest published audited account of the Group were made up, acquired or disposed of by or leased to any member of the Group, or are proposed to be acquired or disposed of by or leased to any member of the Group.
- (e) 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).
- (f) Save for the fact that the fellow subsidiaries of Kingsway Capital own in aggregate less than approximately 1% of the entire issued share capital of the Company, Kingsway Capital, the expert whose name is referred to in the paragraph headed "Consent" in this appendix does not have any shareholding in any member of the Group or the right (whether legally enforceable or not) to subscribe for or to nominate persons to subscribe for securities in any member of the Group.

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.

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
Substantial Shareholders			
CNAH	Attributable interest	2,264,628,000 (note 1)	68.4%
Air China	Beneficial owner	2,264,628,000 (note 2)	68.4%
Other Persons			
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

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

Interest in Macau Asia Express Limited

	Percentage of the issued share capital
Starpax Limited	48%

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.

CONSENT

Kingsway Capital has given and has not withdrawn its written consent to the issue of this circular with the inclusion of its opinion and/or references to its name in the form and context in which it is included.

MATERIAL ADVERSE CHANGE

The Directors are not aware of any material adverse change in the financial or trading position of the Group since 31 December, 2005, the date to which the latest published audited financial statements of the Group were made up.

LEGAL EFFECT

This circular and the enclosed proxy form are governed by and shall be construed in accordance with the laws of Hong Kong.

QUALIFICATION OF EXPERT

The following is the qualification of the expert who has given its opinion or advice which are contained in this circular:

Name	Qualification
Kingsway Capital Limited	a licensed corporation holding a licence under the Securities and Futures Commission of Hong Kong to conduct type 6 (advising on corporate finance) of the regulated activity under the SFO

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.

DOCUMENTS AVAILABLE FOR INSPECTION

Copies of the following documents are available for inspection at the offices of Baker & McKenzie at Room 1401, Hutchison House, 10 Harcourt Road, Central, Hong Kong during normal business hours up to and including 16 May 2006:

- (i) the acknowledgement entered into between Air Macau and ADA with respect to the Airport Charges;
- (ii) the Airport License; and
- (iii) the letter of advice from Kingsway Capital to the Independent Board Committee and the Independent Shareholders set out on pages 13 to 18 of this circular.