
**THIS CIRCULAR IS IMPORTANT AND
REQUIRES YOUR IMMEDIATE ATTENTION**

If you are in any doubt as to any aspect of this circular, or as to the action to be taken, you should consult a licensed securities dealer, bank manager, solicitor, professional accountant or other professional adviser.

If you have sold or transferred all your shares in Cathay Pacific Airways Limited, you should at once hand this circular to the purchaser or transferee or to the bank, licensed securities dealer or other agent through whom the sale or transfer was effected for transmission to the purchaser or transferee.

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CATHAY PACIFIC AIRWAYS LIMITED

(Incorporated in Hong Kong with limited liability)

(Stock Code: 00293)

- (1) CONNECTED TRANSACTIONS**
 - (i) ACQUISITION OF DRAGONAIR SHARES**
 - (ii) ALLOTMENT AND ISSUE OF CATHAY SHARES**
- (2) DISCLOSEABLE TRANSACTION**
ACQUISITION OF DRAGONAIR SHARES
- (3) DISCLOSEABLE TRANSACTION**
ACQUISITION OF AIR CHINA H SHARES
- (4) INCREASE IN AUTHORISED SHARE CAPITAL**
- (5) ALLOTMENT AND ISSUE OF CATHAY SHARES**
PURSUANT TO LISTING RULE 13.36(1)(a)

Independent financial adviser: ING Bank N.V.



CATHAY PACIFIC

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A letter from the Independent Board Committee containing its recommendation to the independent shareholders of the Company is set out on page 18 of this circular. A letter from ING Bank N.V., the independent financial adviser, containing its advice to the Independent Board Committee and the independent shareholders of the Company is set out on pages 19 to 35 of this circular.

A notice convening the EGM to be held on 22nd August 2006 at 11:00 a.m. at the Pacific Place Conference Centre, Level 5, One Pacific Place, 88 Queensway, Hong Kong is set out on page 41 of this circular. Whether or not you are able to attend the EGM, please complete the enclosed form of proxy in accordance with the instructions printed thereon and return it to the share registrar of the Company, Computershare Hong Kong Investor Services Limited, 46th Floor, Hopewell Centre, 183 Queen's Road East, Hong Kong as soon as possible and in any event not later than 48 hours before the time appointed for the holding of the EGM or any adjourned meeting thereof. Completion and return of the form of proxy will not preclude you from attending and voting in person at the EGM or any adjourned meeting thereof and, in such event, the relevant form of proxy shall be deemed to be revoked.

DEFINITIONS

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

| | |
|--|---|
| Air China | Air China Limited, a company incorporated in the People's Republic of China and whose H shares are listed on the Exchange as its primary listing venue and on the Official List of the UK Listing Authority as its secondary listing venue |
| Air China H Shares | H shares of RMB1.00 each in the capital of Air China |
| Board or Cathay Board | the board of directors of Cathay |
| Business Day | a day (other than a Saturday or Sunday) on which banks are open for business in Hong Kong |
| Cathay or CX or Company | Cathay Pacific Airways Limited, a company incorporated in Hong Kong and whose shares are listed on the Exchange |
| Cathay Directors or Directors | the directors of Cathay |
| Cathay EGM or EGM | the extraordinary general meeting of Cathay to be held to seek approval of shareholders of Cathay referred to this circular |
| Cathay Share Capital | the issued share capital of Cathay from time to time |
| Cathay Shareholders | SPAC, CITIC Pacific, Air China and CNAC Limited |
| Cathay Shares | ordinary shares of HK\$0.20 each in the capital of Cathay |
| CITIC Pacific | CITIC Pacific Limited, a company incorporated in Hong Kong and whose shares are listed on the Exchange |
| CNAC Limited | China National Aviation Company Limited, a company incorporated in Hong Kong and whose shares are listed on the Exchange |
| Companies Ordinance | Companies Ordinance (Chapter 32 of the Laws of Hong Kong) |
| Completion | completion of the offer for Dragonair Shares, sale and purchase of Cathay Shares and subscription of Air China H Shares as referred to in the letter from the Board in this circular under the headings "Description of the Transaction – Purchase of Dragonair Shares and issue of new Cathay Shares"; "Description of the Transaction – Purchase of Cathay Shares" and "Description of the Transaction – Acquisition of additional Air China H Shares" respectively |
| Connected Transactions | the acquisition of Dragonair Shares by Cathay from SPAC and CITIC Pacific and the allotment and issue of new Cathay Shares by Cathay to SPAC and CITIC Pacific, in each case under the Restructuring Agreement |
| Dragonair | Hong Kong Dragon Airlines Limited, a company incorporated in Hong Kong |
| Dragonair Minority Shareholders | each holder of Dragonair Shares other than SPAC, CITIC Pacific, CNAC Limited or Cathay, or any person who holds Dragonair Shares on their behalf, holding in aggregate 13,552,750 Dragonair Shares |
| Dragonair Shares | ordinary shares of HK\$1.00 each in the capital of Dragonair |
| Exchange | The Stock Exchange of Hong Kong Limited |
| Executive | the Executive Director of the Corporate Finance Division of the SFC |
| Group | the Company and its subsidiaries |

| | |
|------------------------------------|---|
| Independent Board Committee | an independent committee of the Cathay Board comprising Peter Lee, Raymond Or, Jack So and Tung Chee Chen, all of whom are independent non-executive directors of Cathay |
| Joint Announcement | the joint announcement issued by Air China, Cathay, CNAC Limited, CITIC Pacific and SPAC on 8th June 2006 regarding, <i>inter alia</i> , the Restructuring Agreement and the Transaction |
| Last Trading Date | 2nd June 2006, being the last trading date prior to the suspension of trading of Cathay, Air China, CNAC Limited, CITIC Pacific and SPAC on 5th June 2006 |
| Latest Practicable Date | 30th June 2006, being the latest practicable date prior to the printing of this circular for ascertaining certain information referred to in this circular |
| Listing Rules | The Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited |
| Model Code | Model Code for Securities Transactions by Directors of Listed Companies set out in Appendix 10 of the Listing Rules |
| Operating Agreement | the conditional operating agreement dated 8th June 2006 between Air China and Cathay pursuant to which Air China and Cathay have agreed to co-operate in various operational areas |
| Placing | the sale by SPAC and CITIC Pacific of Cathay Shares on or before Completion as referred to in this circular under the heading "Description of the Transaction – Placing" |
| Restructuring Agreement | the conditional restructuring agreement dated 8th June 2006 between SPAC, CITIC Pacific, CNAC Limited, Air China and Cathay in relation to the Transaction |
| SFC | Securities and Futures Commission of Hong Kong |
| SFO | Securities and Futures Ordinance (Chapter 571 of the Laws of Hong Kong) |
| Shareholders Agreement | the conditional shareholders agreement dated 8th June 2006 between SPAC, CITIC Pacific, CNAC Limited and Air China regulating their relationship as shareholders of Cathay following implementation of the Transaction |
| SPAC | Swire Pacific Limited, a company incorporated in Hong Kong and whose shares are listed on the Exchange |
| Takeovers Code | The Hong Kong Code on Takeovers and Mergers |
| Transaction | the restructuring of the shareholdings in Dragonair and Cathay and the acquisition by Cathay of additional Air China H Shares, in each case in accordance with the terms of the Restructuring Agreement, but does not include the Placing |

LETTER FROM THE BOARD

Executive Directors

Christopher Pratt (Chairman)
Robert Atkinson
Philip Chen
Derek Cridland
Tony Tyler

Non- Executive Directors

Martin Cubbon
Henry Fan
Davy Ho
James Hughes-Hallett
Vernon Moore
Carl Yung
Zhang Xianlin

Independent Non-Executive Directors

Peter Lee
Raymond Or
Jack So
Tung Chee Chen

Registered Office:

35th Floor
Two Pacific Place
88 Queensway
Hong Kong

Principal Office:

7th Floor, North Tower
Cathay Pacific City
8 Scenic Road
Hong Kong International Airport
Lantau
Hong Kong

6th July 2006

To the Shareholders

Dear Sir or Madam,

- (1) CONNECTED TRANSACTIONS**
 - (i) ACQUISITION OF DRAGONAIR SHARES**
 - (ii) ALLOTMENT AND ISSUE OF CATHAY SHARES**
- (2) DISCLOSEABLE TRANSACTION**
ACQUISITION OF DRAGONAIR SHARES
- (3) DISCLOSEABLE TRANSACTION**
ACQUISITION OF AIR CHINA H SHARES
- (4) INCREASE IN AUTHORISED SHARE CAPITAL**
- (5) ALLOTMENT AND ISSUE OF CATHAY SHARES**
PURSUANT TO LISTING RULE 13.36(1)(a)

INTRODUCTION

Reference is made to the Joint Announcement dated 8th June 2006 regarding, *inter alia*, the Restructuring Agreement entered into by the Company with Air China, CNAC Limited, CITIC Pacific and SPAC on 8th June 2006 and the Transaction.

The purposes of this circular are:

- (a) to provide you with further information relating to the Restructuring Agreement and the Transaction and other information required by the Listing Rules;
- (b) to set out the letter of advice from ING Bank N.V. to the Independent Board Committee and the independent shareholders of the Company and the recommendation and opinion of the Independent Board Committee as advised by ING Bank N.V., in each case in relation to the Connected Transactions; and
- (c) to give you notice of the EGM to consider and, if thought fit, to approve (i) the Connected Transactions and the entering into by the Company of the Restructuring Agreement for the purposes of the connected transactions rules in the Listing Rules, (ii) the allotment and issue by the Company of Cathay Shares to SPAC and CITIC Pacific under the Restructuring Agreement for the purposes of all other applicable requirements of the Listing Rules and (iii) the proposed increase of the authorised share capital of Cathay from 3,900,000,000 Cathay Shares to 5,000,000,000 Cathay Shares to facilitate the Transaction.

DESCRIPTION OF THE TRANSACTION

On 8th June 2006, Air China, Cathay, CNAC Limited, CITIC Pacific and SPAC entered into the Restructuring Agreement in relation to the restructuring of the parties' shareholdings in Cathay and Dragonair. If the Restructuring Agreement becomes unconditional, (1) Dragonair will become a wholly-owned subsidiary of Cathay, (2) Air China will become a substantial shareholder of Cathay and (3) Cathay will increase its shareholding in Air China.

The principal shareholdings in Cathay and Dragonair as at 8th June 2006 were as follows:

| | Cathay | |
|---------------|------------------|-------------|
| | Number of Shares | % of Shares |
| SPAC | 1,566,233,246 | 46.30% |
| CITIC Pacific | 859,353,462 | 25.40% |
| Public | 957,197,640 | 28.30% |
| Total | 3,382,784,348 | 100.00% |

| | Dragonair | |
|---------------------------------|------------------|-------------|
| | Number of Shares | % of Shares |
| SPAC | 38,551,808 | 7.71% |
| Cathay | 88,965,707 | 17.79% |
| CITIC Pacific | 142,482,484 | 28.50% |
| CNAC Limited | 216,447,251 | 43.29% |
| Dragonair Minority Shareholders | 13,552,750 | 2.71% |
| Total | 500,000,000 | 100.00% |

Purchase of Dragonair Shares and Issue of new Cathay Shares

Cathay has offered to acquire all the Dragonair Shares which it does not already own for a total consideration of HK\$8.22 billion (based on a valuation of Dragonair of HK\$10.00 billion or HK\$20.00 per Dragonair Share) to be satisfied by a combination of the issue of 548,045,724 new Cathay Shares at an issue price of HK\$13.50 per share and HK\$0.82 billion in cash.

Each of SPAC, CITIC Pacific and CNAC Limited accepted the offer from Cathay to acquire their Dragonair Shares immediately following the entry into the Restructuring Agreement. Since then, all other shareholders in Dragonair to whom the offer was made have accepted the offer.

The valuation of Dragonair was determined following arm's length negotiation between the parties, based on the underlying value of Dragonair, as reflected in the market price of CNAC Limited, and having regard to the trading multiples of comparable airlines, in addition to considering the benefits to Cathay of full ownership of Dragonair and potential synergies arising from a combination of the businesses. The issue price of the new Cathay Shares was determined following arm's length negotiation between the parties, in particular with reference to the current and recent average trading price of Cathay Shares.

Purchase of Cathay Shares

SPAC and CITIC Pacific have agreed to sell to Air China 40,128,292 and 359,170,636 Cathay Shares respectively. The consideration payable by Air China for such Cathay Shares is HK\$13.50 per share and was determined by the parties after arm's length negotiation, in particular with reference to the current and recent average trading price of Cathay Shares.

Placing

SPAC and CITIC Pacific have agreed to sell on or before Completion, such number of Cathay Shares as will result in the percentage of Cathay Shares held by them on Completion being 40% and 17.50% respectively and the percentage of Cathay Shares in public hands being not less than 25%.

Acquisition of Additional Air China H Shares

In December 2004, Cathay acquired a 10% interest in the share capital of Air China by subscribing for Air China H Shares when the Air China H Shares were listed on the Exchange. Cathay has agreed to subscribe in cash for an additional 1,179,151,364 Air China H Shares at an aggregate subscription price of HK\$4.07 billion, representing HK\$3.45 per Air China H Share. Immediately following (and assuming no further issue of shares by Air China before) completion of this subscription, Cathay will have a 20.00% interest in the enlarged issued share capital of Air China. Cathay understands that Air China is required under the Listing Rules to maintain 24.20% of its issued share capital in public hands and that completion of Cathay's subscription would result in approximately 21.51% of Air China's enlarged issued share capital being in public hands. In the Joint Announcement, it was indicated that Air China was seeking a waiver from this requirement in order to accommodate the subscription by Cathay for Air China H Shares. Cathay understands that the Exchange has declined to grant such waiver. Cathay further understands that Air China is considering issuing A shares or further Air China H Shares (before completion of Cathay's subscription) with a view to Cathay's subscription not causing Air China to be in breach of the requirement that it maintain 24.20% of its issued share capital in public hands. If this does not happen, Cathay and Air China may agree that Cathay, instead of subscribing in cash for 1,179,151,364 Air China H Shares, will subscribe (in the same amount of cash) for securities issued by Air China which are convertible into 1,179,151,364 Air China H Shares once such conversion would not cause Air China to be in breach of the requirement to maintain 24.20% of its issued share capital in public hands.

Immediately following Completion, Cathay will own all the shares in Dragonair and the shareholdings in Cathay are expected to be as follows:

| | Cathay | |
|---------------|------------------|-------------|
| | Number of Shares | % of Shares |
| SPAC | 1,572,332,028 | 40.00% |
| CITIC Pacific | 687,895,263 | 17.50% |
| CNAC Limited | 288,596,335 | 7.34% |
| Air China | 399,298,928 | 10.16% |
| Public | 982,707,518 | 25.00% |
| Total | 3,930,830,072 | 100.00% |

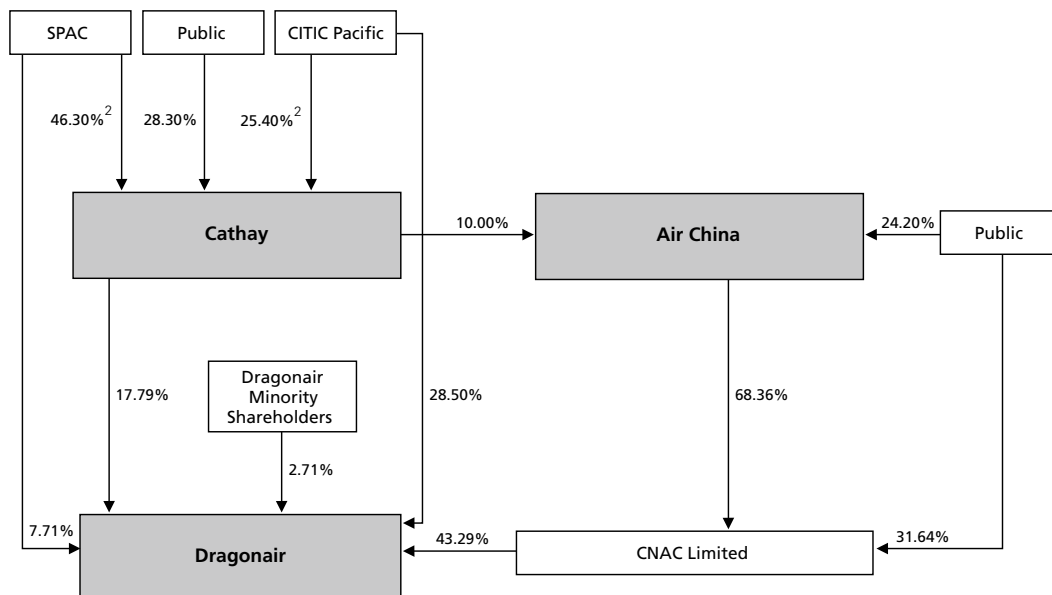
Special Dividend

Under the Restructuring Agreement, SPAC and CITIC Pacific have agreed to recommend to the Cathay Board that as soon as practicable following Completion and in any event no later than 60 days following Completion, Cathay will pay a special interim dividend of HK\$0.32 per Cathay Share, in aggregate being a payment of approximately HK\$1,258 million in cash by Cathay assuming 3,930,830,072 Cathay Shares are in issue at the relevant time. Any such special interim dividend will be financed by Cathay's internal cash resources. A further announcement will be made in relation to the payment of the special dividend when details have been finalised.

Shareholding structures of Cathay, Dragonair and Air China

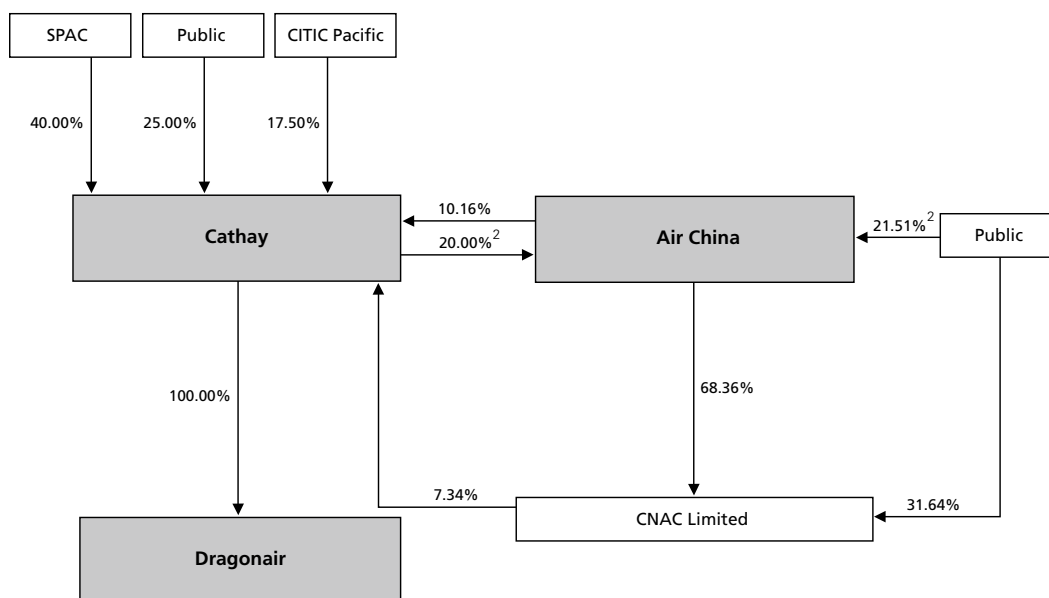
The shareholdings in Dragonair, Cathay and Air China (1) immediately prior to Completion and (2) immediately following Completion are expected to be as follows:

Shareholding structures of Cathay, Dragonair and Air China immediately prior to Completion¹



- ¹ Assuming disposal of the shares in CNAC Limited held by Cathay and referred to under "Regulatory and Listing Rules Implications – Miscellaneous" below.
- ² Assuming the sales by SPAC and CITIC Pacific of Cathay Shares referred to under "Description of the Transaction – Placing" above have not taken place.

Shareholding structures of Cathay, Dragonair and Air China immediately following Completion¹



- ¹ Assuming disposal of the shares in CNAC Limited held by Cathay and referred to under "Regulatory and Listing Rules Implications – Miscellaneous" below.
- ² Subject to adjustments as contemplated under "Description of the Transaction – Acquisition of Additional Air China H Shares" above.

SHAREHOLDERS AGREEMENT

SPAC, CNAC Limited, CITIC Pacific and Air China have entered into a shareholders agreement for the purpose of regulating their relationship with each other as shareholders of Cathay and certain aspects of the affairs of, and their shareholdings in, Cathay, following completion of the Transaction.

Under the Shareholders Agreement, the parties have agreed:

- (i) that the Cathay Board will, subject to adjustment in certain circumstances, consist of four non-executive directors nominated by SPAC, two non-executive directors nominated by each of CITIC Pacific and Air China, five executive directors nominated by SPAC and four independent non-executive directors;
- (ii) to support, including by exercise (to the extent permitted by law and the rules of the Exchange) of their respective voting rights as shareholders of Cathay, the continuation and periodic renewal of the existing management arrangements for Cathay and its subsidiaries, including the services agreement between John Swire & Sons (H.K.) Limited and Cathay, and their extension to Dragonair and its subsidiaries substantially on their current terms; and
- (iii) to support the implementation of the Operating Agreement and by exercise (to the extent permitted by law and the rules of the Exchange) of their respective voting rights as shareholders of Cathay, its continuation and any periodic renewal of it.

In addition, the parties have agreed to the following in relation to their shareholdings in Cathay:

- (i) SPAC has agreed that the beneficial interest of SPAC and its group in the Cathay Share Capital will not exceed 44.90% (49.90% if (i) CITIC Pacific and its group or (ii) Air China and its group increase their respective combined aggregate beneficial interest in the Cathay Share Capital to above 22.45%), except with the prior written consent of the other parties;
- (ii) each of (i) CITIC Pacific and (ii) Air China and CNAC Limited have agreed that the combined aggregate beneficial interest of respectively CITIC Pacific and its group and Air China and its group in the Cathay Share Capital will not exceed 29.99%, except with the prior written consent of the other parties; and
- (iii) CITIC Pacific, Air China and CNAC Limited have agreed that, except with the prior written consent of SPAC, their combined beneficial interest in the Cathay Share Capital (including those of their groups) will not exceed 40% or the percentage beneficial interest of SPAC and its group in the Cathay Share Capital (whichever is the lower).

(The undertakings by CITIC Pacific, Air China and CNAC Limited described in paragraphs (ii) and (iii) above will cease to apply if SPAC (and/or its group companies) disposes of Cathay Shares and as a result SPAC (together with its group) is beneficially interested in less than 30% of the Cathay Share Capital and Air China (together with its group) or CITIC Pacific (together with its group) is beneficially interested (whether or not as a result of such disposal by SPAC and/or its group companies) in more Cathay Shares than SPAC (together with its group). The undertaking by CITIC Pacific, Air China and CNAC Limited described in paragraph (iii) above will also cease to apply if SPAC (together with its group) is beneficially interested in 44.50% or more of the Cathay Share Capital. The undertakings by SPAC, CITIC Pacific, Air China and CNAC Limited described above will cease to apply in favour of any shareholder which is a party to the Shareholders Agreement whose beneficial interest in the Cathay Share Capital (including that of its group) is less than 15%.)

The parties to the Shareholders Agreement have also agreed that so long as a Cathay Shareholder is beneficially interested (together with its group) (directly or indirectly) in 15% or more of the Cathay Share Capital, it will not make a takeover offer for Cathay or accept a takeover offer from a third party, unless that offer has been recommended by the Cathay Board.

Operating Agreement

Air China and Cathay have also jointly announced on 8th June 2006 that they have entered into the Operating Agreement. The Operating Agreement provides for enhanced operational cooperation between Cathay and Air China, including reciprocal sales representation in the PRC and in Hong Kong, Macau and Taiwan, the operation of shared routes on a joint venture basis and an intention to start joint cargo operations in Shanghai.

CONDITIONS

Completion of the Transaction, (and the coming into effect of the Shareholders Agreement), is conditional upon satisfaction of the following conditions:-

- (A) entering into the Shareholders Agreement and implementation of the Transaction not giving rise to an obligation on any of SPAC, CITIC Pacific, Air China or CNAC Limited to make a mandatory offer to acquire all the Cathay Shares under the Takeovers Code; in this connection the Executive has confirmed that, as SPAC and CITIC Pacific are concert parties in relation to the voting rights of Cathay and together hold more than 50% of the Cathay Shares, no such obligation will arise;
- (B) Air China having obtained all necessary approvals of relevant regulatory bodies in the PRC and any other regulatory approvals;
- (C) the Listing Committee of the Exchange having granted listing of and permission to deal in:
 - (i) the new Cathay Shares to be issued to SPAC, CITIC Pacific, CNAC Limited and the Dragonair Minority Shareholders described above; and
 - (ii) the new Air China H Shares to be issued to Cathay described above;
- (D) the independent shareholders of CITIC Pacific in general meeting having passed resolutions approving the sale by CITIC Pacific of its Dragonair Shares to Cathay and the acquisition of the new Cathay Shares to be issued by Cathay to CITIC Pacific as consideration for the Dragonair Shares sold by CITIC Pacific to Cathay, in each case as a connected transaction;
- (E) the independent shareholders of CNAC Limited in general meeting having passed resolutions to approve the sale of CNAC Limited's Dragonair Shares to Cathay as a very substantial disposal and the acquisition of Cathay Shares by CNAC Limited as a very substantial acquisition;
- (F) the independent shareholders of Cathay in general meeting having passed resolution(s) to approve the acquisition of Dragonair Shares by Cathay from SPAC and CITIC Pacific and the allotment and issue of new Cathay Shares by Cathay to SPAC and CITIC Pacific, in each case as a connected transaction and the shareholders of Cathay in general meeting having passed resolution(s) to approve the increase of the authorized share capital of Cathay and the allotment and issue of new Cathay Shares to SPAC and CITIC Pacific pursuant to Rule 13.36(1)(a) of the Listing Rules;
- (G) the independent shareholders of Air China in general meeting having passed resolutions approving the sale of Dragonair Shares by CNAC Limited to Cathay, the acquisition of Cathay Shares by CNAC Limited, the acquisition by Air China of Cathay Shares from CITIC Pacific and the issue of Air China H Shares to Cathay, in each case as a connected transaction, the shareholders of Air China in general meeting having passed a resolution approving the acquisition of Cathay Shares by CNAC Limited, the acquisition by Air China of Cathay Shares from CITIC Pacific and SPAC as a major transaction (when aggregated) and the shareholders of Air China in general meeting having passed a special resolution and the shareholders of Air China in separate class meetings having passed special resolutions, in each case approving the issue of additional Air China H Shares to Cathay in accordance with Air China's articles of association and applicable Listing Rules;
- (H) Cathay being satisfied that it is entitled under Section 168 of the Companies Ordinance to acquire compulsorily all the Dragonair Shares held by each person who does not accept its offer for all the Dragonair Shares; in this connection, acceptances of the offer have been received from all shareholders in Dragonair to whom the offer was made;

- (I) Cathay being satisfied as to its due diligence investigations of Dragonair and Air China; and
- (J) Air China being satisfied as to its due diligence investigations of Cathay.

Completion of the Transaction is expected to take place on the fifth Business Day following satisfaction of these conditions.

REASONS FOR THE TRANSACTION

Cathay believes that combining the international network of Cathay with the network of Dragonair will improve Cathay's network reach, connectivity to China and between China and the rest of the world. Further, the additional operational co-operation with Air China will promote Hong Kong and Beijing Airports as major Asian/Chinese hubs improving traffic flows for Cathay, Dragonair, and Air China and connectivity and services for passenger and cargo customers. Full control of Dragonair by Cathay allows the realisation of substantial synergies. Cathay expects ownership of Dragonair and increased co-operation between Cathay (with Dragonair 100% owned) and Air China to increase connectivity, convenience and marketing and thus load factors. In addition Cathay expects cost savings within Cathay and Dragonair from the increased scale of operations, improved aircraft utilisation and from adopting best practices. The value of Dragonair as a standalone entity, the benefits of network integration and the potential synergies available to Cathay support the valuation of HK\$10 billion that the Transaction implies for 100% of the equity of Dragonair.

In recent years the Chinese aviation industry has experienced rapid growth and development: the creation of three Chinese airline groups, the continuing opening up of the market to international airlines and the increasing internationalisation of the Chinese airlines' route networks. In the context of these market developments, the shareholding structure of Dragonair has proved to be not efficient with the result that Dragonair is unable to take full advantage of potential economies of scale and the management of its business is not optimised. The rationalisation of the shareholding structure of Dragonair will benefit all the companies that are current shareholders of Dragonair and Dragonair itself. In addition, with further investments in each other, Air China and Cathay will continue to work together in exploring ways to improve their service offering, network and connectivity and developing the Chinese aviation industry.

The international network of Cathay and the principally Hong Kong - Mainland China network of Dragonair are highly complementary and together will improve Cathay's network reach, connectivity to China and between China and the rest of the world. In addition the cooperation with Air China will further the development of Beijing Capital International Airport and Hong Kong International Airport as gateways to and hubs for Mainland China and thus the Transaction will be to the benefit of the Hong Kong and Greater China aviation industry.

Increasing its shareholding in Air China ensures that Cathay will share in the synergies and benefits of co-operation that accrue to Air China. Further, Cathay will equity account for its share in Air China and will therefore include its share of the profits of Air China in its results. The acquisition price of HK\$3.45 per Air China H Share represents a 15.8% premium to Air China's initial public offering price and a 11.3% premium to the closing share price on the Last Trading Date. In light of the additional influence on Air China and with it the ability to equity account, the Cathay Directors believe that the price is an attractive level at which to increase its stake in Air China.

The proposed special dividend of HK\$0.32 per Cathay Share allows Cathay Shareholders to enjoy some of the future benefits of the Transaction immediately as a result of Completion, whilst reflecting the enlarged scale of Cathay's business with the 100% ownership of Dragonair. The dividend will not have a material impact on the gearing position of Cathay.

The Cathay Directors (other than the independent non-executive directors whose views are set out on page 18 of this circular) have considered the Transaction and are of the opinion that the Transaction and its terms are fair and reasonable and are in the interests of the shareholders of Cathay as a whole.

OTHER RELEVANT INFORMATION IN RELATION TO THE TRANSACTION**Acquisition of Dragonair Shares by Cathay**

The number of Dragonair Shares to be acquired by Cathay from each of SPAC, CITIC Pacific, CNAC Limited and the Dragonair Minority Shareholders, the number of new Cathay Shares to be issued to them as consideration and the amount of cash consideration to be paid to them are as follows:

| | Number of Dragonair Shares to be acquired | Total Consideration (HK\$) | Number of new Cathay Shares to be issued (at HK\$13.50 per share) | Number of new Cathay Shares to be issued as a percentage of issued share capital of Cathay immediately prior to Completion | Number of new Cathay Shares to be issued as a percentage of enlarged issued share capital of Cathay following Completion | Cash Consideration (HK\$) |
|---------------------------------|---|----------------------------|---|--|--|---------------------------|
| SPAC | 38,551,808 | 771,036,160 | 51,402,411 | 1.52% | 1.31% | 77,103,611.50 |
| CITIC Pacific | 142,482,484 | 2,849,649,680 | 189,976,645 | 5.62% | 4.83% | 284,964,972.50 |
| CNAC Limited | 216,447,251 | 4,328,945,020 | 288,596,335 | 8.53% | 7.34% | 432,894,497.50 |
| Dragonair Minority Shareholders | 13,552,750 | 271,055,000 | 18,070,333 | 0.53% | 0.46% | 27,105,504.50 |
| Total | 411,034,293 | 8,220,685,860 | 548,045,724 | 16.20% | 13.94% | 822,068,586.00 |

Acquisition of Cathay Shares by Air China

The number of Cathay Shares to be acquired by Air China from SPAC and CITIC Pacific Shareholders as described above under "Description of the Transaction," is as follows:

| | Number of Cathay Shares to be acquired by Air China | Number of new Cathay Shares to be issued as a percentage of issued share capital of Cathay immediately prior to Completion | Number of new Cathay Shares to be issued as a percentage of enlarged issued share capital of Cathay following Completion | Consideration (HK\$) |
|---------------|---|--|--|----------------------|
| SPAC | 40,128,292 | 1.19% | 1.02% | 541,731,942 |
| CITIC Pacific | 359,170,636 | 10.62% | 9.14% | 4,848,803,586 |
| Total | 399,298,928 | 11.80% | 10.16% | 5,390,535,528 |

New Cathay Shares

The issue price of the new Cathay Shares to be issued under the Transaction of HK\$13.50 per share was determined by the parties after arm's length negotiation, in particular with reference to the current and recent average trading price of Cathay Shares. Such issue price represents a 4.2% premium to the closing price of the Cathay Shares of HK\$12.95 on the Last Trading Date.

The new Cathay Shares will be fully paid up and rank pari passu in all respects with all other Cathay Shares in issue on the date of allotment and issue of such shares, including the right to all dividends and other distributions declared, made or paid at any time after such date.

The total number of new Cathay Shares to be issued as consideration for Dragonair Shares under the Transaction is 548,045,724, which represents approximately 16.20% of the existing Cathay Share Capital and approximately 13.94% of the Cathay Share Capital as enlarged by the issue of those shares. The Transaction will not result in a change of control of the Company.

New Air China H Shares

The issue price of the new Air China H Shares to be issued to Cathay under the Transaction of HK\$3.45 per share was determined by the parties after arm's length negotiations, representing a premium of approximately 11.3% over the closing price of approximately HK\$3.10 per Air China H Share on the Last Trading Date.

FINANCIAL INFORMATION ON DRAGONAIR, CATHAY AND AIR CHINA

Based on the audited consolidated financial statements of Dragonair for the year ended 31st December 2005, Dragonair had a net book asset value of HK\$3,155 million. Based on the audited consolidated financial statements of Dragonair for the years ended 31st December 2004 and 2005, the net profits of Dragonair before taxation and extraordinary items for those years were HK\$765 million and HK\$316 million respectively, and the net profits of Dragonair after taxation and extraordinary items for those years were HK\$637 million and HK\$300 million respectively.

Based on the audited consolidated financial statements of Cathay for the year ended 31st December 2005, Cathay had a net book asset value (excluding minority interests) of HK\$34,968 million. Based on the audited consolidated financial statements of Cathay for the years ended 31st December 2004 and 2005, the net profits of Cathay before taxation and extraordinary items for those years were HK\$4,962 million and HK\$3,968 million respectively, and the net profits of Cathay after taxation and extraordinary items for those years were HK\$4,417 million and HK\$3,298 million respectively.

Based on the audited consolidated financial statements of Air China for the year ended 31st December 2005, Air China had a net book asset value (excluding minority interests) of RMB20,092 million. Based on the audited consolidated financial statements of Air China for the years ended 31st December 2004 and 2005, the net profits of Air China before taxation and extraordinary items for those years were RMB3,560 million and RMB3,374 million respectively, and the net profits of Air China after taxation and extraordinary items for those years were RMB2,386 million and RMB2,406 million respectively.

INFORMATION ON THE PRINCIPAL BUSINESSES OF CATHAY, DRAGONAIR, SPAC, CITIC PACIFIC, CNAC LIMITED AND AIR CHINA

The principal business activities of Cathay and its subsidiary and associated companies are the operation of scheduled passenger and cargo airline services.

The principal business activity of Dragonair is the operation of scheduled passenger airline services, principally to and from Hong Kong.

The principal business activity of SPAC is investment holding.

The principal business activity of CITIC Pacific is investment holding.

The principal business activity of CNAC Limited is investment holding, including of shares in Dragonair.

The principal business activity of Air China is the operation of passenger and air cargo services and airline-related services.

REGULATORY AND LISTING RULES IMPLICATIONS

Shareholder Approval

As at the Latest Practicable Date, SPAC and CITIC Pacific beneficially held 46.30% and 25.40% of the shares in Cathay respectively. As such, they are substantial shareholders of Cathay and are connected persons of Cathay under the Listing Rules. Accordingly, the Connected Transactions, being the acquisition of Dragonair Shares by Cathay from SPAC and CITIC Pacific and the allotment and issue of new Cathay Shares by Cathay to SPAC and CITIC Pacific, constitute, in each case, a connected transaction for Cathay for the purposes of the Listing Rules. As such, they are subject to the approval of the independent shareholders of Cathay. In accordance with the Listing Rules, any connected person with a material interest in the transactions, and any shareholder with a material interest in the transactions and its associates must abstain from voting on the resolution in respect of the above transactions at the Cathay EGM. Each of SPAC and CITIC Pacific will be required to abstain from voting in respect of any Cathay Shares held by them or on their behalf as a connected person with a material interest in the transactions.

As at 8th June 2006, Cathay had an authorised share capital of 3,900,000,000 Cathay Shares, of which 3,382,784,348 Cathay Shares had been issued. The number of new Cathay Shares to be issued under the Transaction is 548,045,724. Accordingly, the Board proposes to increase the authorised share capital of Cathay from 3,900,000,000 Cathay Shares to 5,000,000,000 Cathay Shares. The proposed increase of the authorised share capital of Cathay is subject to the approval of the shareholders of Cathay by way of an ordinary resolution.

The allotment and issue of new Cathay Shares to SPAC and CITIC Pacific is subject to the approval of the shareholders of Cathay pursuant to Rule 13.36(1)(a) of the Listing Rules. In accordance with the Listing Rules, any shareholder that has a material interest in such transaction must abstain from voting on the resolution in respect of the transaction at the Cathay EGM. Each of SPAC and CITIC Pacific will be required to abstain from voting in respect of any Cathay Shares held by them or on their behalf as a shareholder with a material interest in the above allotment and issue of new Cathay Shares.

The Independent Board Committee has been constituted to advise the independent shareholders of the Company in respect of the resolution to approve the Connected Transactions. ING Bank N.V. has been appointed as independent financial adviser to advise the Independent Board Committee and the independent shareholders of the Company on the Connected Transactions.

Cathay will convene the Cathay EGM to consider and, if thought fit, to approve (i) the Connected Transactions and the entering into by the Company of the Restructuring Agreement for the purposes of the connected transactions rules in the Listing Rules, (ii) the allotment and issue by the Company of Cathay Shares to SPAC and CITIC Pacific under the Restructuring Agreement for the purposes of all other applicable requirements of the Listing Rules and (iii) the proposed increase of the authorised share capital of Cathay from 3,900,000,000 Cathay Shares to 5,000,000,000 Cathay Shares to facilitate the Transaction. Voting will be by poll.

Other regulatory matters

Based on the aggregation of the acquisition of Dragonair Shares by Cathay from each of SPAC, CITIC Pacific, CNAC Limited and the Dragonair Minority Shareholders, each of the percentage ratios set out in Rule 14.07 of the Listing Rules is more than 5% but less than 25%. Each of such percentage ratios in relation to the subscription by Cathay for additional Air China H Shares is also more than 5% but less than 25%. As such, the acquisition of Dragonair Shares by Cathay and the subscription by Cathay for additional Air China H Shares constitute discloseable transactions for Cathay for the purposes of the Listing Rules.

Cathay will finance the acquisition of Dragonair Shares by the issue of new Cathay Shares and cash from internal resources.

The allotment and issue of new Cathay Shares to CNAC Limited and the Dragonair Minority Shareholders will be issued out of the general mandate given to the Cathay Directors at the annual general meeting of Cathay on 10th May 2006.

Cathay confirms that, to the best of the Cathay Directors' knowledge, information and belief having made all reasonable enquiries, the Dragonair Minority Shareholders, Air China and CNAC Limited and their ultimate beneficial owner(s) are third parties independent of Cathay and connected persons of Cathay.

The original cost to SPAC for its shareholding in Dragonair is HK\$183,583,736. The Dragonair Shares to be sold by CITIC Pacific to Cathay were purchased at HK\$1.22 per share and HK\$1.51 per share in 1990 and 1992 respectively.

Miscellaneous

This circular is for information purposes only and does not constitute an invitation or offer to acquire, purchase or subscribe for any Cathay Shares.

Application to the Exchange will be made by Cathay for the listing of and permission to deal in the new Cathay Shares.

As at 8th June 2006, Cathay held 1.953% of the shares in CNAC Limited. It was indicated in the Joint Announcement that a privatization offer might be made for the shares in CNAC Limited. On 21st June 2006 Air China and CNAC Limited announced a pre-conditional privatization offer by Air China for CNAC Limited, to be implemented by way of a scheme of arrangement. Under Rule 25 of the Takeovers Code, Air China as offeror under the privatization offer is precluded from making arrangements with shareholders of CNAC Limited which have favourable conditions which are not to be extended to all shareholders of CNAC Limited. Given that the subscription by Cathay for Air China H Shares, the sales by SPAC and CITIC Pacific of Cathay Shares to Air China and the acquisition by Cathay of Dragonair Shares from CNAC Limited, each as contemplated by the Joint Announcement, are arrangements to which Rule 25 of the Takeovers Code may apply, Cathay has decided to cease to be a shareholder in CNAC Limited and will donate all of its shares in CNAC Limited to a number of charitable bodies independent of Cathay and SPAC and selected in accordance with Note 10 to the definition of "Acting in Concert" in the Takeovers Code. Cathay is in the process of selecting the relevant charitable bodies and is mindful of the need for the donations to be made in sufficient time for donees to be able to make up their minds how to vote on the scheme of arrangement by which, if it proceeds, the privatization offer will be implemented. Further details will be given in the document containing the privatization offer.

All references in this circular to number of Cathay Shares and percentage holding in Cathay Shares following 8th June 2006 assume there has been and will be no further issue of Cathay Shares pursuant to the exercise of share options granted under Cathay's share option scheme adopted on 10th March 1999 following 8th June 2006. All references in this circular to number of shares in Air China and percentage holding in shares in Air China following 8th June 2006 assume there has been and will be no issue of shares by Air China following such date.

EFFECT OF TRANSACTION

The Transaction will be financed by the issue of new Cathay Shares and cash from internal resources. The Transaction will therefore increase the Group's equity capital and net indebtedness. Following completion of the Transaction, the results and balance sheet of Dragonair will be consolidated with those of Cathay and the Group's share of profits or losses from Dragonair will increase from 17.79% to 100%. The Group will also increase its interest in Air China. The Transaction may result in an increase in the Group's debt-to-equity ratio. However, the Company does not expect the Transaction to have any material negative impact on the Group's operating cash flow or business operations.

Save as described above, the Transaction is not expected to have any material impact on earnings, assets and liabilities of the Group.

CATHAY EGM

There is set out on page 41 a notice convening the EGM to be held on 22nd August 2006 at 11:00 a.m. at the Pacific Place Conference Centre, Level 5, One Pacific Place, 88 Queensway, Hong Kong, at which (a) a resolution will be proposed to the independent shareholders of the Company to approve the Connected Transactions and the entering into of the Restructuring Agreement for the purposes of the connected transactions rules in the Listing Rules, (b) a resolution will be proposed to the shareholders of Cathay to approve the allotment and issue by the Company of Cathay Shares to SPAC and CITIC Pacific under the Restructuring Agreement for the purposes of all other applicable requirements of the Listing Rules and (c) a resolution will be proposed to the shareholders of Cathay to approve the proposed increase of the authorised share capital of Cathay from 3,900,000,000 Cathay Shares to 5,000,000,000 Cathay Shares to facilitate the Transaction. The voting at the EGM will be taken by poll.

In accordance with the Listing Rules, any connected person with a material interest in the Connected Transactions and any shareholder with a material interest in the Connected Transactions and its associates must abstain from voting on the resolution in respect of the Connected Transactions at the Cathay EGM. SPAC and CITIC Pacific, which beneficially held 46.30% and 25.40% respectively of the shares in Cathay as at the Latest Practicable Date, will be required to abstain from voting in respect of any Cathay Shares held by them or on their behalf as connected persons with a material interest in the transactions.

In accordance with the Listing Rules, any shareholder that has a material interest in the allotment and issue by the Company of Cathay Shares to SPAC and CITIC Pacific under the Restructuring Agreement must abstain from voting on the resolution in respect of such transaction at the Cathay EGM. Each of SPAC and CITIC Pacific will be required to abstain from voting in respect of any Cathay Shares held by them or on their behalf as a shareholder with a material interest in the above allotment and issue of Cathay Shares.

A form of proxy for use at the EGM is enclosed. Whether or not you are able to attend the EGM in person, you are requested to complete and return the form of proxy in accordance with the instructions printed thereon as soon as possible and in any event not later than 48 hours before the time appointed for the holding of the EGM or any adjourned meeting thereof. Completion and return of the form of proxy will not preclude you from attending and voting in person at the EGM or any adjourned meeting thereof and, in such event, the relevant form of proxy shall be deemed to be revoked.

RECOMMENDATION

The Cathay Directors (other than the independent non-executive directors whose views are set out on page 18 of this circular) have considered the Transaction and proposed special dividend and are of the opinion that the Transaction and its terms and the proposed special dividend are fair and reasonable and are in the interests of the shareholders of Cathay as a whole. Accordingly, the Cathay Directors (other than the independent non-executive directors whose views are set out on page 18 of this circular) recommend the relevant shareholders of the Company who are not required by the Listing Rules to abstain from voting at the EGM on the relevant resolution(s) to vote in favour of ordinary resolutions No. 1, 2 and 3 to be proposed at the EGM.

Your attention is drawn to (i) the letter from the Independent Board Committee set out on page 18 of this circular which contains its recommendation to the independent shareholders of the Company in relation to the Connected Transactions; and (ii) the letter from ING Bank N.V. set out on pages 19 to 35 of this circular which contains their advice to the Independent Board Committee and the independent shareholders of the Company in relation to the Connected Transactions and the principal factors and reasons considered by them in formulating their advice.

ADDITIONAL INFORMATION

Your attention is also drawn to the information set out in the appendix to this circular and the notice of the EGM set out in this circular.

By order of the Board

Cathay Pacific Airways Limited

Christopher Pratt

Chairman

LETTER FROM THE INDEPENDENT BOARD COMMITTEE

6th July 2006

To the independent shareholders of Cathay Pacific Airways Limited

Dear Sir or Madam,

CONNECTED TRANSACTIONS

We refer to the circular dated 6th July 2006 of the Company (the "Circular") of which this letter forms part. Terms defined in the Circular bear the same meanings herein unless the context otherwise requires.

We have been appointed to form the Independent Board Committee to consider the terms of the Connected Transactions and to advise the independent shareholders of the Company whether, in our opinion, such terms are fair and reasonable and in the interests of the Company and the shareholders as a whole. ING Bank N.V. has been appointed to advise the Independent Board Committee and the independent shareholders of the Company in respect of the terms of the Connected Transactions.

We wish to draw your attention to the letter from the Board set out on pages 4 to 17 of the Circular which contains, inter alia, information on the Restructuring Agreement and the Transaction, and the letter of advice from ING Bank N.V. set out on pages 19 to 35 of the Circular which contains its advice in respect of the terms of the Connected Transactions.

Having taken into account the advice of ING Bank N.V., we consider that the terms of the Connected Transactions are fair and reasonable and are in the interests of the Company and its shareholders as a whole. Accordingly, we recommend the independent shareholders of the Company to vote in favour of ordinary resolution No. 1 to be proposed at the EGM.

Yours faithfully,

The Independent Board Committee

Peter Lee

Raymond Or

Jack So

Tung Chee Chen

Independent Non-Executive Directors

LETTER FROM ING BANK N.V.

The following is the text of a letter received from ING Bank N.V. setting out its advice to the Independent Board Committee and the independent shareholders of the Company in respect of the Connected Transactions for inclusion in this circular.



WHOLESALE BANKING

39/F One International Finance Centre
1 Harbour View Street, Central, Hong Kong

6th July 2006

To: The Independent Board Committee and the independent shareholders of
Cathay Pacific Airways Limited

Dear Sirs,

CONNECTED TRANSACTIONS

INTRODUCTION

We refer to our appointment as the independent financial adviser to advise the Independent Board Committee and the independent shareholders of the Company in respect of the terms of (i) the acquisition of Dragonair Shares by Cathay from SPAC and CITIC Pacific (the "Acquisition"); and (ii) the allotment and issue of new Cathay Shares to SPAC and CITIC Pacific ((i) and (ii) together, the "Connected Transactions") contemplated by the Restructuring Agreement, details of which are set out in a circular (the "Circular") to the shareholders of Cathay dated 6th July 2006. This letter sets out our evaluation of the terms of the Connected Transactions, being part of the Transaction contemplated by the Restructuring Agreement, and our recommendations thereon, and is prepared for inclusion in the Circular. Unless otherwise defined, all terms defined in the Circular shall have the same meanings herein. All references in this letter to number of Cathay Shares and percentage holding in Cathay Shares following 8th June 2006 assume there has been and will be no further issue of Cathay Shares pursuant to the exercise of share options granted under Cathay's share option scheme adopted on 10th March 1999 following 8th June 2006. All references in this letter to number of shares in Air China and percentage holding in shares in Air China following 8th June 2006 assume there has been and will be no issue of shares by Air China following such date.

As set out in the letter from the Board contained in the Circular, Cathay entered into the Restructuring Agreement with Air China, CNAC Limited, CITIC Pacific and SPAC on 8th June 2006 in relation to the restructuring of the parties' shareholdings in Cathay and Dragonair. If the Restructuring Agreement becomes unconditional, (1) Dragonair will become a wholly-owned subsidiary of Cathay, (2) Air China will become a substantial shareholder of Cathay and (3) Cathay will increase its shareholding in Air China.

As at the Latest Practicable Date, SPAC and CITIC Pacific beneficially held 46.30% and 25.40% respectively of the shares in Cathay. As such, they are substantial shareholders and connected persons of Cathay under the Listing Rules. Accordingly, the Connected Transactions constitute, in each case, a connected transaction for Cathay for the purposes of the Listing Rules. As such, they are subject to the approval of the independent shareholders of Cathay. In accordance with the Listing Rules, any connected person with a material interest in the Connected Transactions, and any shareholder with a material interest in the Connected Transactions and its associates must abstain from voting on the resolution in respect of the Connected Transactions at the Cathay EGM. Each of SPAC

and CITIC Pacific will be required to abstain from voting on the ordinary resolution approving the Connected Transactions in respect of any Cathay Shares held by them or on their behalf as a connected person with a material interest in the transactions.

ING Bank N.V. is independent from, and not connected with, Cathay or any of its substantial shareholders, directors or chief executive, or any of their respective associates, and is accordingly qualified to give independent advice to the Independent Board Committee and the independent shareholders of the Company.

We were neither a party to the negotiations entered into by Cathay in relation to the Transaction contemplated by the Restructuring Agreement, nor were we involved in the deliberations leading up to the decision of the Directors to enter into the Restructuring Agreement as contemplated. We do not, by this letter, warrant the merits of the Transaction contemplated by the Restructuring Agreement, other than to form an opinion, for the purpose of Chapter 14A of the Listing Rules, on whether the entering into of the Restructuring Agreement is in the ordinary and usual course of business, the terms of the Connected Transactions contemplated by the Restructuring Agreement are fair and reasonable, on normal commercial terms and in the interests of Cathay and its shareholders as a whole.

In formulating our recommendation, we have relied on publicly available information and the statements, information and representations provided by the management of Cathay. We have assumed that all such statements, information and representations contained or referred to in the Circular provided by the management of Cathay and for which the Directors have collectively and individually accepted full responsibility, are true, accurate, and complete in all material respects at the time they were made and continue to be so at the date hereof.

We have also relied on our discussions with the Directors and members of the management of Cathay regarding the statements, information and representations contained in the Circular. We have been advised by the Directors that no material facts have been withheld or omitted from the information provided and referred to in the Circular. The Directors have further confirmed, having made all reasonable enquiries, that to the best of their knowledge and belief, there are no other facts or representations the omission of which would make any statement in the Circular, including this letter, misleading in any material respects.

We consider that we have reviewed sufficient information to reach an informed view and to justify relying on the accuracy of the information contained in the Circular to provide a reasonable basis for our advice. We are not aware of, and have no reason to suspect that, any facts or circumstances which would render the information provided or the representations made to us untrue, inaccurate or misleading in any material respects, nor do we suspect that any material facts have been omitted or withheld from the information supplied in the Circular. We have not, however, carried out any independent verification of the information provided to us by Cathay, or conducted any in-depth investigation into the business and affairs of the Group and Dragonair and their respective associates.

PRINCIPAL FACTORS AND REASONS CONSIDERED

In formulating our opinion regarding the terms of the Connected Transactions, we have considered the following principal factors and reasons:

1. *Current relationships*

Established in 1946, Cathay is an international airline registered and based in Hong Kong, offering scheduled cargo and passenger services to 97 destinations around the world, including three destinations (Beijing, Shanghai (cargo only) and Xiamen) in the People's Republic of China (the "PRC" or "Mainland China" which, for the purpose of this letter, excludes Hong Kong, Macau and Taiwan).

Established in 1985, Dragonair is an airline registered and based in Hong Kong. It operates passenger services to 36 destinations in Asia, of which 21 are to the PRC.

Cathay has a 17.79% interest in Dragonair. Cathay and Dragonair currently have limited cooperation with each other in areas including the following:

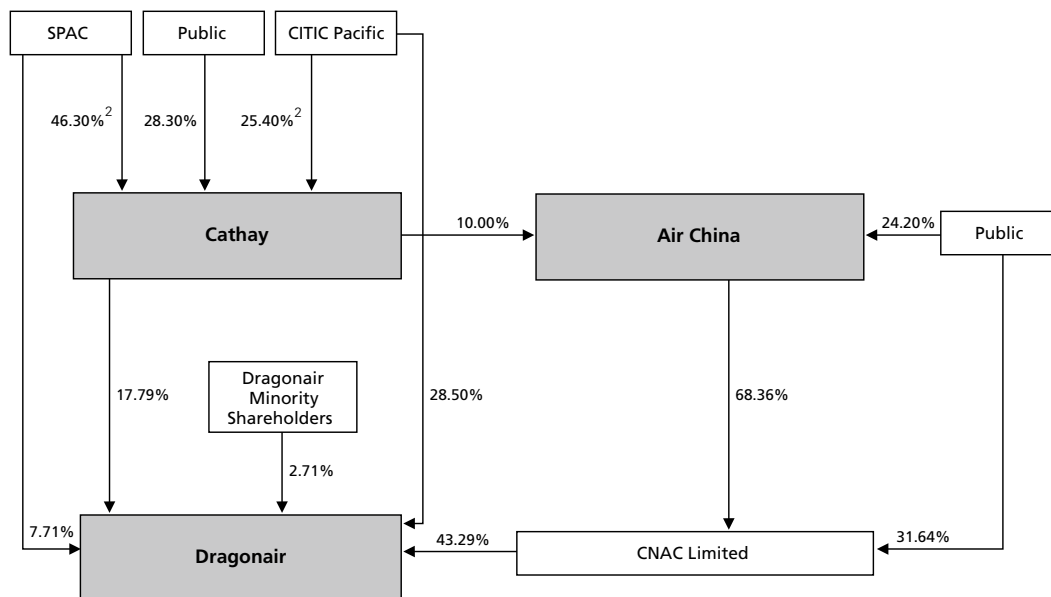
- A330 fleet management;
- Outport line maintenance with the exception of Mainland China destinations;
- Reservation system for passenger and cargo services;
- Maintenance of simulators;
- Analysis of flight safety data; and
- Information technology assistance.

Whilst the above cooperation between Cathay and Dragonair provides some benefits to each other, it is of limited scope and does not optimise the operations of both airlines. In particular, Cathay and Dragonair pursue their own objectives and compete with each other on certain destinations such as Beijing, Xiamen, Taipei, Bangkok and Tokyo Narita.

Air China is the national flag carrier of the PRC and a leading provider of air passenger, air cargo and airline related services in the PRC. It is primarily based in Beijing and serves 70 domestic and 36 international destinations. It was listed on the Exchange in December 2004 and, at the time of the global offering of H shares of Air China, Cathay acquired a 10% equity interest in Air China. Prior to Air China's listing, Air China and Cathay entered into a non-binding memorandum of understanding which, amongst other things, sets out the framework for the parties to explore opportunities for cooperation in respect of certain operational matters.

Both SPAC and CITIC Pacific are substantial shareholders of Cathay; CITIC Pacific, Cathay and SPAC are shareholders of Dragonair and Cathay has a 10% equity interest in Air China. The shareholding structures of Cathay, Dragonair and Air China immediately prior to Completion are expected to be as follows:

Chart 1: Shareholding structures of Cathay, Dragonair and Air China immediately prior to Completion¹



¹ Assuming disposal of the shares in CNAC Limited held by Cathay and referred to in the section entitled "Regulatory and Listing Rules Implications – Miscellaneous" in the "Letter from the Board" set out in the Circular.

² Assuming the sales by SPAC and CITIC Pacific of Cathay Shares referred to under "Description of the Transaction – Placing" in the "Letter from the Board" set out in the Circular have not taken place.

2. Description of the Transaction

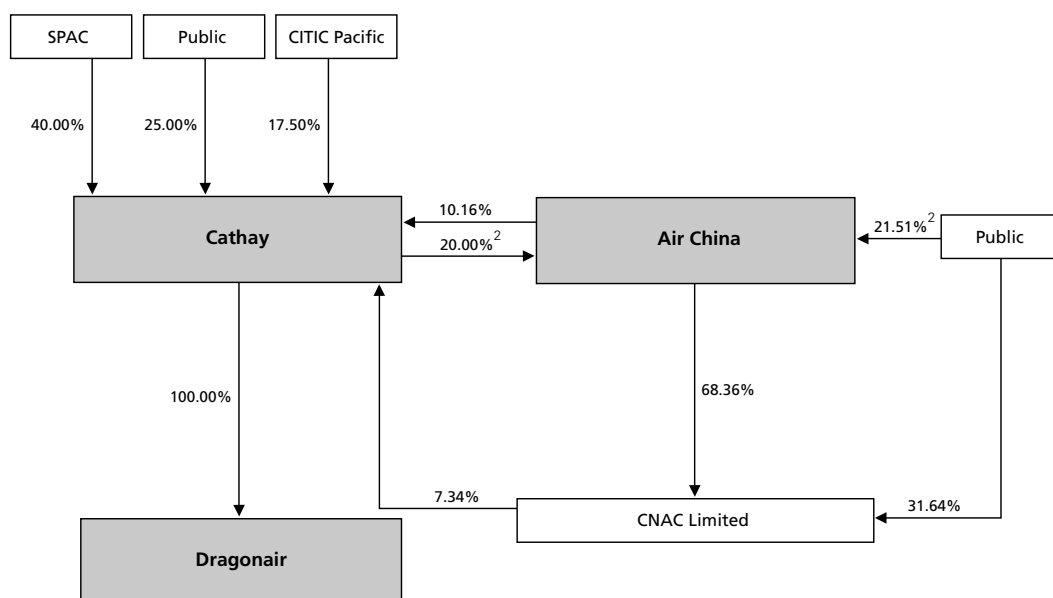
2.1 The Transaction

The Transaction, details of which are described in the “Letter from the Board” set out in the Circular, involves the restructuring of the shareholdings in Cathay and Dragonair and the subscription by Cathay of additional Air China H Shares as follows:

- the purchase of Dragonair Shares by Cathay from SPAC, CITIC Pacific, CNAC Limited and the Dragonair Minority Shareholders to be satisfied by a combination of the allotment and issue of new Cathay Shares and cash;
- the purchase of Cathay Shares by Air China from SPAC and CITIC Pacific in cash; and
- the subscription of additional new Air China H Shares by Cathay in cash.

The shareholding structures of Cathay, Dragonair and Air China immediately following Completion are expected to be as follows:

Chart 2: Shareholding structures of Cathay, Dragonair and Air China immediately following Completion¹



¹ Assuming the disposal of the shares in CNAC Limited held by Cathay and referred to in the section entitled “Regulatory and Listing Rules Implications – Miscellaneous” in the “Letter from the Board” set out in the Circular.

² Subject to adjustments as contemplated in the section entitled “Description of the Transaction – Acquisition of Additional Air China H Shares” in the “Letter from the Board” set out in the Circular.

2.1.1 Connected Transactions

As at the Latest Practicable Date, SPAC and CITIC Pacific are substantial shareholders and connected persons of Cathay under the Listing Rules. Accordingly, the acquisition of the 7.71% and 28.50% interests in Dragonair by Cathay respectively from SPAC and CITIC Pacific, and the allotment and the issue of new Cathay Shares respectively to SPAC and CITIC Pacific constitute connected transactions for Cathay for the purposes of the Listing Rules. Our advice, set out in the section of this letter headed “Recommendation”, is limited to the Connected Transactions.

It should be noted, however, that Completion is conditional, *inter alia*, on the passing of resolutions by the independent shareholders of the Company to approve the Connected Transactions.

2.2 Reasons for the Connected Transactions

The background to, and reasons for, the Transaction, including the Connected Transactions, are set out in the “Letter from the Board” of the Circular. In summary, factors identified by the Board in respect of the Connected Transactions include:

- The international network of Cathay and the principally Hong Kong-Mainland China network of Dragonair are highly complementary and together will improve Cathay’s network reach and connectivity between the PRC and the rest of the world;
- Full control of Dragonair by Cathay allows the realisation of substantial synergies. Cathay expects ownership of Dragonair and increased co-operation between Cathay (with Dragonair 100% owned) and Air China to increase connectivity, convenience and marketing, and thus load factors and revenues. In addition, Cathay expects cost savings within Cathay and Dragonair from the increased scale of operations, improved aircraft utilisation and adopting best practices; and
- In the context of the recent development and rapid growth in the PRC aviation industry, the shareholding structure of Dragonair has not proved to be efficient, resulting in Dragonair being unable to take full advantage of potential economies of scale and the management of its business not being optimised. The rationalisation of the shareholding structure of Dragonair will benefit the current shareholders of Dragonair and Dragonair itself.

The Directors also identified other reasons for the Transaction including:

- The cooperation with Air China will further the development of Beijing Capital International Airport and Hong Kong International Airport as gateways to, and hubs for, the PRC; and
- Increasing Cathay’s shareholding in Air China ensures that Cathay will share in the synergies and benefits of co-operation that accrue to Air China.

3. Operating and financial performance of Dragonair

The following table sets out certain publicly available operating information and audited financial information about Dragonair for the two years ended 31st December 2005:

Table 1: Operating and financial information of Dragonair

| | 2004 | 2005 | Increase/(decrease) |
|------------------------------------|------------|------------|---------------------|
| Operating Statistics | | | |
| Revenue passengers carried | 4,793,099 | 5,260,923 | 9.76% |
| Cargo carried (tonnes) | 342,413 | 385,339 | 12.54% |
| Income Statement (HK\$'000) | | | |
| Total revenues | 9,084,574 | 10,855,228 | 19.49% |
| Profit before income tax | 765,142 | 315,620 | (58.75%) |
| Profit for the year or net profit | 636,515 | 300,442 | (52.80%) |
| Balance sheet (HK\$'000) | | | |
| Total assets | 11,503,693 | 11,123,861 | (3.30%) |
| Total liabilities | 8,289,796 | 7,968,605 | (3.87%) |
| Total equity | 3,213,897 | 3,155,256 | (1.82%) |

Sources include annual report of CNAC Limited for the year ended 31st December 2005 and "Letter from the Board" of the Circular

Revenue increased by 19.49% in 2005 due to higher volumes for both passenger and cargo carried by Dragonair and higher yield for passenger services. However, in line with higher jet fuel prices globally, Dragonair's system-wide fuel price increased by 43.4% in 2005, resulting in net profit decreasing by 52.80% to HK\$300 million during that year. Fuel accounted for 26% of total operating costs of Dragonair in 2005, being 6.8 percentage points higher than the proportion for 2004.

Between 31st December 2004 and 31st December 2005, total assets and total equity decreased by 3.30% and 1.82%, respectively, primarily because of dividend distribution to the shareholders. Total liabilities decreased by 3.87% principally because of lower amounts of payables under aircraft financing leases.

The financial information set out above represents the historical financial performance of Dragonair on a standalone basis and does not reflect any revenue or cost synergies that could arise from the Acquisition.

4. The Acquisition Price

Cathay has offered to acquire all the Dragonair Shares which it does not already own (that is, 82.21% of issued Dragonair Shares) for a total consideration of HK\$8.22 billion to be satisfied by a combination of the allotment and issue of 548,045,724 new Cathay Shares at an issue price of HK\$13.50 per share and HK\$822,068,586 in cash.

The Acquisition therefore values 100% of the equity of Dragonair at HK\$10 billion or HK\$20 per Dragonair Share (the "Acquisition Price"). The Acquisition Price represents 33.28 times Dragonair's net profit in 2005 and 3.17 times its book value as at 31st December 2005.

5. Comparable Analysis

5.1 Comparable companies

As part of our analysis of the Acquisition Price, we have compared the valuation multiples represented by the Acquisition Price with selected listed Chinese and other listed Asian airline companies (the "Comparables"). The Comparables have been selected after taking into consideration, *inter alia*, their scope of business and operating environment relative to Dragonair.

While the valuation multiples of Comparables reflect the current market sentiments towards the sector and provide some guidance on valuation, such analysis does not take into account differences in accounting policies and standards, regulatory and operating environments, tax treatments and other unique characteristics amongst the Comparables and Dragonair. In addition, market prices of the Comparables do not reflect the premium typically required to obtain control (as in the case of the Acquisition) since they reflect the trades of non-controlling blocks of shares.

We set out in the following table the price earnings ("PER") and price to book ("P/B") ratios of the Comparables based on their respective relevant share prices as at the Latest Practicable Date and publicly available historical financial data, and those represented by the Acquisition Price:

Table 2: Valuation Multiples of the Comparables

| Comparables | Place | PER ⁽¹⁾ | | P/B ⁽²⁾ | |
|---|-------------|--------------------|--------------|--------------------|-------------|
| | | 2004 | 2005 | 2004 | 2005 |
| Cathay Pacific Airways | Hong Kong | 10.38 | 13.94 | 1.40 | 1.31 |
| Air China – H share | The PRC | 12.69 | 13.11 | 1.83 | 1.57 |
| China Eastern Airlines – H share | The PRC | 16.72 | nm | 0.83 | 0.88 |
| China Southern Airlines – H share | The PRC | nm | nm | 0.68 | 0.80 |
| Singapore Airlines | Singapore | 10.14 | 12.50 | 1.28 | 1.19 |
| Malaysian Airline System | Malaysia | 6.57 | nm | 1.05 | 1.66 |
| Thai Airways | Thailand | 5.75 | 13.69 | 1.15 | 1.00 |
| China Airlines | Taiwan | 11.43 | 83.87 | 0.91 | 1.00 |
| EVA Airways | Taiwan | 13.92 | 35.28 | 1.05 | 1.06 |
| Asiana Airlines | Korea | 4.38 | 37.55 | 1.34 | 1.29 |
| Korean Airlines | Korea | 4.80 | 12.56 | 0.65 | 0.62 |
| Qantas Airways | Australia | 8.13 | 7.86 | 0.89 | 0.94 |
| Air New Zealand | New Zealand | 5.41 | 8.83 | 0.59 | 0.76 |
| Average | | 9.19 | 23.92 | 1.05 | 1.08 |
| Dragonair based on the Acquisition Price Hong Kong | | 15.71 | 33.28 | 3.11 | 3.17 |

Notes:

(1) PERs are calculated based on the respective share prices as at the Latest Practicable Date in the case of the Comparables and HK\$20.00 (being the Acquisition Price per Dragonair Share) in the case of Dragonair, divided by the respective earnings per share ("EPS") for the 12-month period ended 31st December. EPS are calculated based on the respective earnings for the 12-month period ended 31st December divided by the number of shares in issue as at 31st December of each year, except in the case of Thai Airways for 2005 which is based on the number of shares in issue as at 31st March 2006, the date of its latest available reported results.

(2) P/B multiples are calculated based on the respective share prices as at the Latest Practicable Date in the case of the Comparables and HK\$20.00 in the case of Dragonair, divided by the respective book values per share as at 31st December, except in the case of Thai Airways for 2005 which is based on the book value per share as at 31st March 2006, the date of its latest available reported results. Book values per share are calculated based on the respective book values as at 31st December divided by the number of shares in issue as at 31st December of each year, except in the case of Thai Airways for 2005 which is based on its book value as at 31st March 2006 divided by the number of shares in issue as at 31st March 2006, the date of its latest available reported results.

(3) "nm" denotes not meaningful – China Eastern Airlines and Malaysian Airline System incurred losses for the year ended 31st December 2005, and China Southern Airlines incurred losses for the years ended 31st December 2004 and 2005.

The Acquisition Price represents 33.28 times Dragonair’s net profits in 2005, compared with an average of 23.92 times for all the Comparables.

The Acquisition Price also represents 3.17 times Dragonair’s book value as at 31st December 2005, compared with an average of 1.08 times for all the Comparables.

The valuation multiples represented by the Acquisition Price are generally higher than those of the Comparables as the financial data of Dragonair does not include the revenue and cost synergies of the Acquisition or any control premium, which have been reflected in the Acquisition Price.

Solely for illustration purposes, if we apply the average multiples of the Comparables in Table 2 to the relevant financial results of Dragonair in 2005 (net profit for 2005 of HK\$300 million and total equity of HK\$3,155 million as at 31st December 2005), we arrive at a standalone equity value for Dragonair of approximately between HK\$3.4 billion (based on the average P/B multiple) and HK\$7.2 billion (based on the average PER), compared with the Acquisition Price of HK\$10 billion.

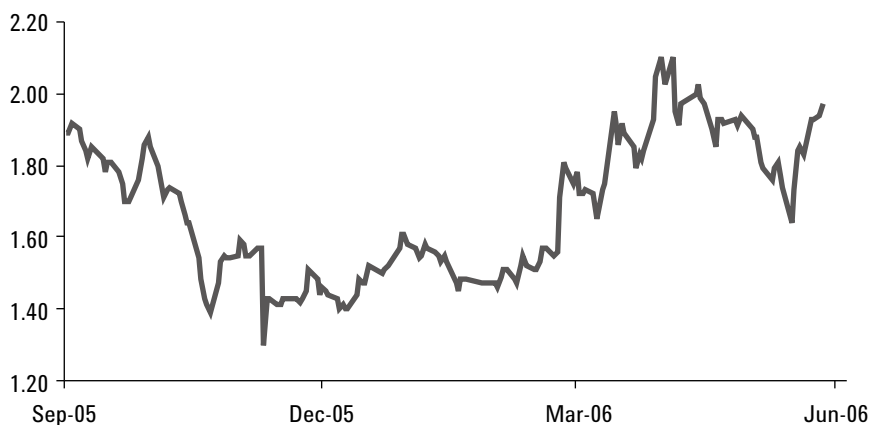
5.2 CNAC Limited

The standalone equity value of Dragonair could also be inferred from the market value of CNAC Limited prior to the Joint Announcement.

For the year ended 31st December 2005, CNAC Limited recorded net profit of HK\$211.9 million, of which HK\$130.1 million (or 61.4% of net profits) was equity accounted from its 43.29% equity interest in Dragonair.

The following chart sets out the share price performance of CNAC Limited over 180-days prior to the Joint Announcement:

Chart 3: Share price performance of CNAC Limited over 180-day period prior to the Last Trading Day



Source: Bloomberg

Based on the 180-day average closing price prior to the Last Trading Day of HK\$1.67 per share and 3,312.7 million shares of CNAC Limited in issue as at the day prior to the Joint Announcement, we arrive at a market value of CNAC Limited of HK\$5,534 million.

By applying the proportion of CNAC Limited’s net profits in 2005 contributed by its investment in Dragonair to CNAC Limited’s market value, it could be inferred that the market was valuing CNAC Limited’s 43.29% equity interest in Dragonair at HK\$3,398 million or 100% equity interest in Dragonair at HK\$7,849 million.

5.3 Comparable Transactions

We have reviewed acquisitions of airlines since 2000. We have selected the transactions in Asia Pacific which resulted in the acquiror obtaining control after the transaction (the “Comparable Transactions”) as is the case for the Acquisition. We would like to highlight that the Comparable Transactions must each be judged on their own commercial and financial merits. The price that any acquiror is prepared to pay in any particular acquisition depends on various factors such as the potential synergies that the offeror can gain from its investment in the target company, the presence of competing bids for the target company, prevailing market conditions, attractiveness and profile of the target company’s underlying business and assets, size of consideration, existing level of control in the target company and general economic and business risks. This analysis merely serves as a general reference for the valuation multiples in the airline industry of comparable transactions in Asia Pacific.

For illustration purposes only, we note that the average PER offered in the Comparable Transactions, as shown in Table 3, is close to the 2005 PER of 33.28 represented by the Acquisition Price while the P/B multiple of the Comparable Transactions is lower than that represented by the Acquisition Price of 3.17 times in 2005.

Table 3: The Comparable Transactions

| Date Announced | Target | Target Nation | Acquirer | PER | P/B multiple |
|--------------------|--------------------------|---------------|-------------------------------|--------------|--------------|
| 28th January 2005 | Virgin Blue Holdings Ltd | Australia | Patrick Corp Ltd | 12.70 | 3.35 |
| 12th November 2001 | Japan Air System Co Ltd | Japan | Japan Airlines Co Ltd | 26.41 | 2.22 |
| 4th October 2001 | Air New Zealand Ltd | New Zealand | New Zealand government | nm | 2.10 |
| 10th October 2000 | Hazelton Airlines Ltd | Australia | Ansett Australia Holdings Ltd | 77.55 | 1.64 |
| Average | | | | 38.89 | 2.33 |
| Dragonair | | | | 33.28 | 3.17 |

Source: SDC Financials

This section analyses the standalone equity value of Dragonair. We shall examine in Sections 6 to 10 the synergies that could arise from the Acquisition.

6. Rapidly growing and increasingly competitive aviation market in the PRC

The PRC is the fastest growing air travel and air cargo market in the world. According to the China Statistical Year Book 2005 compiled by the National Bureau of Statistics of China, during the period between 1996 and 2004, the total passenger market in the PRC grew by a compound annual growth rate (“CAGR”) of 11.28%, to over 178 billion revenue passenger-kilometres per year. Air cargo grew even faster, at a CAGR of 13.88%.

According to the analysis in “Boeing – World demand for commercial airplanes – current market outlook 2005” conducted by Boeing Commercial Airplanes, the outbound air passenger market in the PRC is expected to continue to grow rapidly at a CAGR of 7.36% for the period of 2005 to 2024 reflecting the increasing economic importance and affluence of the PRC.

Despite the attractive growth opportunities, the PRC and Hong Kong aviation markets are facing increasing competition following liberalisation of the aviation markets. The PRC has in recent years gradually opened its aviation market to international, Hong Kong and Macau based airlines by allowing more carriers to operate passenger and cargo flights to and from the PRC, and by increasing the frequency of such flights. Hong Kong has adopted an approach of progressive liberalisation of air services under the bilateral regime with a view to expanding its air links and promoting competition. We also note that other Hong Kong based airlines such as CR Airways Limited, in conjunction with Hainan Airlines Co., Ltd., and Oasis Hong Kong Airlines plan to expand or launch operations in Hong Kong later this year, thereby intensifying competition.

7. PRC gap in Cathay's network

Given the potential and importance of the PRC market, Cathay believes that accelerated access to the PRC market is vital to its future growth and success given that its foreign competitors are expanding their direct services into the PRC, and airlines in the PRC are steadily increasing international flight frequencies.

Cathay has developed an extensive and profitable passenger and cargo network throughout Asia Pacific and to Europe, North America, Australasia, the Middle East and South Africa. However, there is a significant gap in this network in the PRC. In 1990, Cathay and SPAC respectively acquired a 30% and 5% equity interest in Dragonair with the plan that Dragonair would fill Cathay's gap in the PRC. The purchase of the 35% stake in Dragonair led to a restructuring of the Hong Kong airline industry; in addition to commercial and technical cooperation, in 1990 Cathay Pacific transferred its Beijing and Shanghai routes to Dragonair as part of a corporate strategy in which a primary focus of Dragonair was to develop the PRC routes. In 1996, Cathay reduced its equity interest in Dragonair to 17.79% whilst SPAC increased its equity interest in Dragonair to 7.71%.

Thereafter, Cathay attempted to build its own network in the PRC beginning, in 2002, with flights to Beijing, Shanghai and Xiamen. Despite significant efforts over the past few years, its network to date is still limited to two daily passenger flights to Beijing, three weekly passenger flights to Xiamen and 12 weekly cargo flights to Shanghai. Passenger flights to Shanghai have still not been permitted. In 2005, flights to the PRC accounted for 3.9% of Cathay's total number flights. Although the Mainland/HKSAR Air Service Arrangement may allow Cathay some passenger access to Shanghai, this is expected to be restricted to a limited frequency for the foreseeable future. Given a shortage of slots at Pudong and Beijing airports, any new Cathay flights may also be required to operate at unattractive times.

Amongst the foreign airlines, Dragonair operates the most extensive network in the PRC. It flies to 21 destinations in the PRC with 16 daily flights to Shanghai, eight daily flights to Beijing and 126 weekly flights to the other 19 cities. Dragonair was voted "Airline of the year in China" in 2002, 2003 and 2004. In 2005, scheduled flights to the PRC accounted for 68% of passengers and 40.1% of cargo tonnage carried by Dragonair.

With the Acquisition, Cathay will gain immediate access to Dragonair's extensive network and well regarded operations in the PRC (in contrast to its slower and painstaking organic growth efforts since 2002). This will plug the PRC gap in Cathay's global network, and enable it to increase its exposure to one of the world's most rapidly growing aviation markets and to obtain meaningful traffic rights in that increasingly competitive market.

8. Highly complementary networks to generate revenue synergies

As one of the leading airlines globally, Cathay currently offers scheduled cargo and passenger services to 97 passenger and cargo destinations around the world, including Asia Pacific, Australasia, Europe, North America, Middle East and South Africa.

Dragonair currently operates an extensive network in the PRC, offering scheduled passenger and cargo services to 21 destinations in the PRC, with another 15 destinations outside the PRC.

The following table sets out the respective and combined destinations of Cathay and Dragonair:

Table 4: Total number of destinations served by Cathay and Dragonair including own aircraft and code-share arrangements

| | Passenger | | | Cargo | | | Passenger and Cargo | | |
|--------------------|-----------|-----------|----------------------|-----------|-----------|----------------------|---------------------|-----------------------|----------------------|
| | Cathay | Dragonair | Combined (note 1) | Cathay | Dragonair | Combined (note 1) | Cathay (note 2) | Dragonair (note 2) | Combined (note 1) |
| Mainland China | 2 | 21 | 21 | 1 | 2 | 2 | 3 | 21 | 21 |
| Non-Mainland China | 83 | 8 | 88 | 34 | 8 | 35 | 94 | 15 | 99 |
| Total | 85 | 29 | 109 | 35 | 10 | 37 | 97 | 36 | 120 |

Source: Cathay

Notes: (1) Common destinations served by both Cathay and Dragonair are counted as one destination.

(2) Common destinations for passenger and cargo flights are counted as one destination.

The networks of the two airlines have limited overlaps, and offer each other access to numerous new destinations.

With the completion of the Acquisition, the combined Cathay-Dragonair will be uniquely positioned to capitalise on the attractive growth opportunities in the PRC aviation market as Cathay will be able to direct inbound PRC traffic from its global network into the PRC network of Dragonair, while Dragonair, on the other hand, will be able to feed outbound PRC traffic into Cathay's extensive global network.

The benefits of integrating the two highly complementary networks will include the following:

- **Pricing flexibility.** By being able to offer improved end-to-end inbound and outbound connections for the PRC, Cathay will be better positioned to offer more attractive fares (through, *inter alia*, reducing interlining fees between itself and Dragonair) to passengers to increase asset utilisation and adjust its pricing in a timely manner in response to changing market conditions. Save for the fuel surcharge which is subject to the approval by the Hong Kong government, the fares are determined by Cathay and Dragonair in accordance with market conditions;
- **Network expansion.** With the Acquisition, the number of destinations served by Cathay (with Dragonair as a wholly-owned subsidiary) will increase to 120, which will provide customers of both Cathay and Dragonair with a wider choice of destinations that could stimulate demand. The complementary networks of Cathay and Dragonair will also provide growth opportunities to both airlines. In addition, with improved access to the PRC, Cathay can be expected to benefit from carrying more traffic through Hong Kong into and out of the PRC, which would further enhance its load factors and develop Hong Kong International Airport as a hub for the PRC;
- **Enhanced connectivity.** With the Acquisition, Cathay and Dragonair could coordinate their flight schedules so as to minimise transit time for passengers connecting to each other's flights, thereby increasing the attractiveness of travelling on Cathay and Dragonair into and out of the PRC. Cathay and Dragonair could also have more code share arrangements on their routes, providing greater convenience to their customers. Code sharing is a marketing arrangement whereby an airline places its designator code on a service operated by another airline. When selling such a service, the marketing carrier is required to inform passengers that the service will be operated by another carrier; and

- **Network optimization.** By coordinating and combining the flights between the two airlines, Cathay and Dragonair will collectively be able to optimise aircraft utilisation and fuel economy, increase load factors and yields, rationalize manpower requirements and minimize the risk of over-capacity and overlaps.

As a result of all these factors, the Directors believe that they will be able to offer a significantly improved product to their customers in terms of both pricing and convenience. This is expected to have a positive impact on the load factors (that is, the percentage of capacity that is actually purchased) and yields (that is, price charged for carriage) for both the existing Cathay routes and the newly acquired Dragonair routes.

Furthermore, as can be seen from Table 5 below, Cathay currently achieves higher passenger load factors across its network of flights than Dragonair. The Directors believe that this is due to a combination of factors including a superior revenue management system, better scheduling, a more experienced marketing team and a more developed online sales capability. The Directors therefore believe that there is scope for increasing the load factors of Dragonair and Cathay with direct positive benefit to its revenue and profitability.

The following table compares the load factors of Cathay and Dragonair for 2004 and 2005:

Table 5: Load Factor for Cathay and Dragonair

| | Cathay | | Dragonair | |
|-----------|--------|-------|-----------|-------|
| | 2004 | 2005 | 2004 | 2005 |
| Passenger | 77.3% | 78.7% | 64.9% | 64.4% |
| Cargo | 68.7% | 67.0% | 76.2% | 72.5% |

Source: Annual reports of Cathay and CNAC Limited for the year ended 31st December 2005.

Notes: Passenger load factor means the percentage of seats available that are actually purchased by passengers. Cargo load factor means the percentage of available cargo space that is actually purchased by customers.

As shown in the above table, Cathay has higher passenger load factors than Dragonair but has lower cargo load factors than Dragonair. The higher cargo load factor for Dragonair reflects strong demand for cargo traffic in the PRC. The cargo load factor of Dragonair, however, decreased by 3.7 percentage points to 72.5% in 2005 as a result of a significant increase in cargo capacity in the market.

Improvements in load factors have significant impact on revenues. The following table sets out the annualised revenue effect for Cathay on changes in load factors for the year ended 31st December 2005:

Table 6: Annualised revenue effect on changes in load factor for Cathay

| | For the year ended 31st December 2005 | | |
|--|---------------------------------------|---------------------------|--------------------------|
| | Cathay HK\$ million | Dragonair HK\$ million | Combined HK\$ million |
| + 1 percentage point in passenger load factor | 383 | 89 | 472 |
| + 1 percentage point in cargo and mail load factor | 173 | 57 | 230 |

Sources: Annualised revenue effects for Cathay are extracted from its annual report for the year ended 31st December 2005; annualised revenue effects for Dragonair are derived from public information of Dragonair

Solely for illustration purposes, if the Acquisition were to increase the passenger as well as cargo and mail load factor of Cathay and Dragonair by 1% in 2005, Cathay and Dragonair would have enjoyed an aggregate increase of approximately HK\$700 million in revenue.

9. Economies of scale generating cost synergies

Operating expenses account for a high percentage of the revenues of airlines and their ability to control costs is crucial to ensuring profitability. The following table sets out the operating expenses of Cathay and Dragonair for the year ended 31st December 2005:

Table 7: Operating expenses for Cathay and Dragonair in 2005

| | Cathay | Dragonair | Combined |
|------------------------------------|--------------|--------------|--------------|
| Total turnover (HK\$ million) | 50,909 | 10,855 | 61,764 |
| Operating expenses (HK\$ million) | 46,766 | 10,472 | 57,238 |
| Operating expenses/turnover | 91.9% | 96.5% | 92.7% |

Sources: Annual reports of Cathay and CNAC Limited for the year ended 31st December 2005

As shown in the table above, Cathay's operating expenses as a percentage of turnover (the "Operating Cost Ratio") is lower than that of Dragonair in part due to its larger scale. This is also reflected in the cost per available tonne kilometre ("ATK") ratio which amounted to HK\$2.19 for Cathay and an estimated HK\$3.49 for Dragonair in 2005. ATK is a measure of overall capacity, measured in tonnes available for the carriage of passengers, excess baggage, cargo and mail on each sector multiplied by the sector distance.

The integration of Cathay and Dragonair could result in cost savings opportunities including the following:

- **Common platforms.** With the Acquisition, Cathay and Dragonair will be able to achieve costs savings by consolidating their marketing, operating and management platforms and sharing their fixed costs. These would include areas such as distribution and reservation systems, joint marketing and advertising campaigns, call centres, information technology systems and head office functions;
- **Joint purchasing.** The combined larger operations of Cathay and Dragonair after the Acquisition should be able to command more attractive terms by combining their purchases in areas such as aircraft procurement, catering, aircraft maintenance (such as landing gear, tyres and avionics, and maintenance and engineering services) and airport handling services;
- **Adopting best practices.** Further operational efficiencies could be realised, and service levels and customer satisfaction enhanced, by learning and implementing each other's best practices; and
- **Capacity rationalisation.** As mentioned in Section 8 above, combined fleet planning could reduce aircraft and manpower requirements, increase utilisation and decrease costs.

Solely for illustration purposes, assuming that Cathay is able to achieve its present Operating Cost Ratio of 91.9% after the Acquisition, compared with 92.7% on a combined basis, it will be able to reduce the combined operating costs by approximately HK\$480 million.

10. Risk factors pertaining to the Acquisition

The Acquisition represents a major investment by Cathay in the PRC aviation market. As mentioned in Section 6 "Rapidly growing and increasingly competitive aviation market in the PRC" above, the PRC is the fastest growing air travel and air cargo market in the world. Although the PRC aviation market is expected to continue to grow rapidly, there is no certainty that the market will develop as expected.

The aviation authorities in Mainland China and Hong Kong may also decide to liberalise access by Hong Kong carriers to all destinations in the PRC. The Board, however, considers that even if this was to occur, Cathay would find it difficult to replicate the network operated by Dragonair within a short period of time. In addition, as many of the Mainland China airports are also highly congested, there would be very few slots available at productive times of the day for several years to come.

We also note that while the Board believes there is scope for significant revenue and cost synergies as illustrated in Sections 8 and 9 above, there is no certainty that these will be achieved as anticipated nor how quickly they will be delivered nor what incremental costs will be required to achieve them.

11. Cooperation with Air China

The Transaction will strengthen the relationship between Cathay and Air China as follows:

- Cathay will increase its equity interest in Air China by subscribing for an additional 1,179,151,364 Air China H Shares in cash; and
- Air China will become a substantial shareholder of Cathay with an aggregate direct and indirect interest of 17.5% through:
 - the purchase of 40,128,292 and 359,170,636 Cathay Shares from SPAC and CITIC Pacific, respectively, to give it a 10.16% direct interest in Cathay; and
 - a 7.34% indirect interest held through CNAC Limited, in which it has a 68.36% shareholding, arising through the sale of Dragonair Shares by CNAC Limited to Cathay for a combination of new Cathay Shares and cash. Air China and CNAC Limited jointly announced on 21st June 2006 that, subject to Completion, Air China will make proposals to privatise CNAC Limited by way of a scheme of arrangement.

In October 2004, Air China and Cathay entered into a non-binding memorandum of understanding which, amongst other things, sets out the framework for exploring opportunities for cooperation in respect of certain operational matters. To carry into effect certain of these matters, on 8th June 2006, Air China entered into the Operating Agreement with Cathay covering certain key areas including:

- **Sales and marketing.** Cathay will be responsible for passenger sales for Air China in Hong Kong, Macau and Taiwan, and Air China will be responsible for passenger sales for Cathay in Mainland China. Cathay believes that this will strengthen its sales distribution in Mainland China given Air China's extensive and long established sales network in Mainland China;
- **Code share and joint ventures.** Air China and Cathay will operate all the passenger services of Cathay and Air China between Hong Kong and Mainland China under a code-share arrangement. In addition, Air China and Cathay will, over time, operate all shared routes between Hong Kong and Mainland China as joint venture routes under revenue and cost pooling arrangements; and
- **Cargo joint venture.** Air China and Cathay intend to establish a jointly-owned cargo airline based in Shanghai, with respective equity interests of 51% and 49%.

We believe that Cathay and Dragonair (as a wholly-owned subsidiary of Cathay) will benefit from the closer cooperation between Cathay and Air China. Moreover, there are prospects for the realignment and co-ordination of the passenger networks of Cathay and Air China, which will assist in further developing and maintaining Hong Kong International Airport as a gateway to, and a hub for, the PRC, thus generating more passenger traffic for both Cathay and Dragonair which are "home carriers" of Hong Kong. Accordingly, Hong Kong will be better placed to compete with other airports such as Singapore, Bangkok, Seoul and Tokyo, all of which are trying to become major hubs for the PRC as their "home carriers" channel traffic between the PRC and their global networks.

12. Allotment and issue of new Cathay Shares

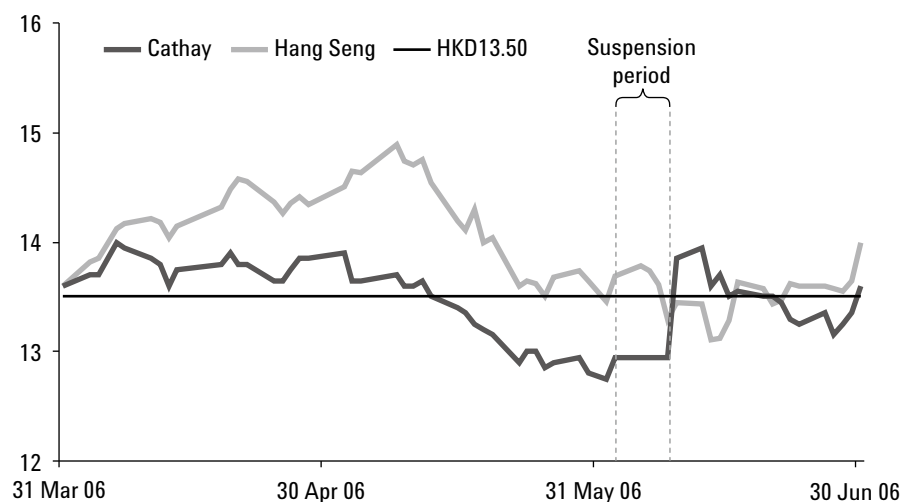
The allotment and issue of new Cathay Shares to SPAC and CITIC Pacific as part consideration of the Acquisition constitute connected transactions for Cathay for the purposes of the Listing Rules.

We note that:

- 90% of the consideration for the Acquisition will be satisfied by way of new Cathay Shares and 10% by cash. This ratio applies to SPAC, CITIC Pacific, CNAC Limited and the Dragonair Minority Shareholders;
- as mentioned in the "Letter from the Board" set out in the Circular, the issue price of HK\$13.50 for each new Cathay Share was determined by the parties after arm's length negotiation, in particular with reference to the current and recent average trading prices of the Cathay Shares. Such issue price represents :
 - a 4.2% premium to the closing share price of Cathay of HK\$12.95 on the Last Trading Date;
 - a premium of 2.1% to the average closing share price of Cathay of HK\$13.23 for the one-month period prior to the Last Trading Day;
 - a premium of 0.1% to the average closing share price of Cathay of HK\$13.49 for the two-month period prior to the Last Trading Day;
 - a discount of 0.8% to the average closing share price of Cathay of HK\$13.61 for the three-month period prior to the Last Trading day;
 - a discount of 2.5% to the average closing share price of HK\$13.85 on the trading day immediately following the date of the Joint Announcement on 8th June 2006; and
 - a discount of 0.7% to the average closing share price of Cathay of HK\$13.60 on the Latest Practicable Date.

The following chart shows the share price performance of Cathay from 31st March 2006 to the Latest Practicable Date and the relative share price performance of Cathay compared to the Hang Seng Index during the same period:

Chart 4: Share price performance of Cathay over the last three months



Source: Bloomberg

The net debt to equity ratio of Cathay was 26% as at 31st December 2005. Cathay will pay HK\$0.82 billion in cash consideration for the Acquisition and HK\$4.07 billion for the subscription of additional Air China H Shares to increase its interest in Air China from 10% to 20% (subject to adjustments as contemplated under "Description of the Transaction – Acquisition of Additional Air China H Shares" in the "Letter from the Board" set out in the Circular"). Furthermore, under the Restructuring Agreement, SPAC and CITIC Pacific have agreed to recommend to the Cathay Board for the payment of a special interim dividend of HK\$0.32 per Cathay Share. If the recommendation is accepted by the Cathay Board, a special dividend of HK\$1,258 million will be paid by Cathay. Based on the above, the net debt to equity ratio of Cathay (with Dragonair as a wholly-owned subsidiary) is estimated to be approximately 39% before and approximately 42% after taking into consideration the special interim dividend. The Directors have confirmed that this level of debt to equity ratio is considered acceptable in comparison with the airline industry in general.

The high proportion of share consideration versus cash consideration will enable Cathay to maintain a strong balance sheet after the Acquisition, and the willingness of the shareholders of Dragonair to accept such arrangement could also indicate their confidence in the prospects of Cathay after Completion.

We note, however, that the share consideration will result in approximately 13.9% dilution of shareholding of Cathay's minority shareholders. The total number of new 548,045,724 Cathay Shares to be issued as consideration for the Acquisition represents approximately 13.9% of the Cathay Share Capital as enlarged by the issue of those shares (on the basis that new Cathay Shares will be issued to all Dragonair Minority Shareholders).

RECOMMENDATION

Having analysed and considered the principal factors set out above, we would draw your attention to the following key factors, which should be read in conjunction with, and interpreted in, the full context of the Circular, in arriving at our conclusion:

1. The acquisition of 7.71% and 28.50% interests in Dragonair by Cathay from SPAC and CITIC Pacific respectively and the allotment and issue of new Cathay Shares to SPAC and CITIC Pacific respectively as part consideration are Connected Transactions which are an integral part of the Transaction. Upon Completion, Dragonair will be a wholly owned subsidiary of Cathay.
2. The offer price of HK\$20.00 per Dragonair Share values the 100% equity interest of Dragonair at HK\$10 billion. The Acquisition Price of HK\$10 billion represents 15.71 times and 33.28 times Dragonair's net profits for 2004 and 2005 respectively and 3.17 times its net asset value as at 31 December 2005. The PER for 2004 and 2005 are based on historical earnings of Dragonair which did not reflect any revenue and cost synergies that could arise from the Acquisition.
3. Based on various valuation methodologies, we arrive at a standalone equity value for Dragonair (excluding control premium) of approximately HK\$3.4 billion (based on average P/B multiple of the Comparables), HK\$7.2 billion (based on the average PER of the Comparables) and HK\$7.8 billion (inferred from the market value of CNAC Limited). The additional value being paid by Cathay in the Acquisition Price takes into consideration anticipated revenue and cost synergies.
4. Cathay believes that accelerated access to the high growth PRC market, in which it currently has a limited presence, is vital to its future growth and success. With the Acquisition, Cathay will gain immediate access to Dragonair's extensive network and well regarded operation in the PRC, which will plug the PRC gap in its global network, and enable it to increase its coverage of one of the world's most rapidly growing aviation markets and to obtain meaningful traffic rights in that increasingly competitive market.
5. The extensive international network of Cathay and the predominantly Hong Kong-PRC network of Dragonair are highly complementary. The Acquisition will enable Cathay to feed the traffic from its international network into Dragonair's short-haul services in the PRC, and *vice versa*. Following Completion, Cathay and Dragonair will serve a total of 120 destinations worldwide.

6. The Directors are confident of Cathay's ability to generate significant revenue synergies from the Acquisition. These would principally come from improved load factors as a result of (i) more attractive and flexible pricing in response to market conditions; (ii) offering a larger number of destinations to the combined customer base of Cathay and Dragonair; (iii) reduced transit time between Cathay and Dragonair flights; and (iv) combined flight planning between the two airlines, which will also rationalise aircraft and manpower requirements and minimise the risk of over-capacity and overlaps.
7. The Acquisition will enable Cathay to reduce the operating costs of Dragonair through the sharing of common platforms with Cathay. In addition, the combined larger operations of Cathay and Dragonair after the Acquisition should be able to command better terms by combining their purchases in areas such as aircraft procurement, catering, aircraft maintenance and airport handling services.
8. Further synergies could also arise with the cross shareholdings between Cathay and Air China and the Operating Agreement entered into between the two parties covering areas including (i) cross-selling each other's products in their respective home markets; (ii) operating all the passenger services of Cathay and Air China between Hong Kong and the PRC under a code-share arrangement; and (iii) establishing a jointly-owned cargo airline based in Shanghai.
9. 90% of the consideration for the Acquisition will be satisfied by way of the issue of new Cathay Shares and 10% by way of cash. This ratio applies to SPAC, CITIC Pacific, CNAC Limited and the Dragonair Minority Shareholders. The high proportion of share consideration will enable Cathay to maintain a strong balance sheet after the Acquisition.
10. The issue price of HK\$13.50 per new Cathay Share was determined by the parties after arm's length negotiations, and represents a 4.2% premium to the closing price of the Cathay Shares of HK\$12.95 on the Last Trading Date. Cathay's share price increased by 6.9% on the trading day following the Joint Announcement on 8th June 2006. The closing share price of Cathay as at the Latest Practicable Date represents a 0.7% premium over the issue price of the new Cathay Shares.
11. The share consideration will result in a 13.9% dilution in the shareholding of Cathay's minority shareholders. The net debt to equity ratio of Cathay will also increase as a result of the Acquisition, the subscription for additional new Air China H Shares in cash, and the possible payment of a special dividend.

Based on the above, we are of the opinion that the entering into of the Restructuring Agreement is in the ordinary and usual course of business, and that the terms of the Connected Transactions contemplated by the Restructuring Agreement are fair and reasonable, on normal commercial terms and in the interests of Cathay and its shareholders as a whole. Accordingly, we would advise the independent shareholders of the Company, as well as recommend the Independent Board Committee to advise the independent shareholders of the Company, to vote in favour of ordinary resolution No. 1 in respect of the Connected Transactions to be proposed at the EGM.

Yours faithfully,
For and on behalf of
ING Bank N.V.
Malcolm E.O. Brown
Managing Director

APPENDIX – GENERAL INFORMATION

RESPONSIBILITY STATEMENT

This document includes particulars given in compliance with the Listing Rules for the purpose of giving information with regard to the Company.

The Directors jointly and severally accept full responsibility for the accuracy of the information contained in this document and confirm, having made all reasonable enquiries, that to the best of their knowledge and belief, opinions expressed in this document have been arrived at after due and careful consideration and there are no other facts not contained in this document, the omission of which would make any statements herein misleading.

MATERIAL ADVERSE CHANGE

The Directors confirm that, as at the Latest Practicable Date, the Directors are not aware of any material adverse change in the financial or trading position of the Group since 31st December 2005, being the date to which the latest published audited accounts of the Company were made up.

DISCLOSURE OF INTERESTS

(a) Share Interests of Directors and Chief Executive

Save as disclosed below, as at the Latest Practicable Date, none of the Directors or chief executive of the Company had any interests or short positions in the shares, underlying shares and debentures of the Company or any associated corporation (within the meaning of the SFO), which (a) were 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 they have taken or deemed to have taken under such provisions of the SFO); or (b) were required pursuant to section 352 of the SFO to be entered in the register referred to therein; or (c) were required, pursuant to the Model Code to be notified to the Company and the Stock Exchange.

Interests in shares of Cathay Pacific (all being long positions)

| Name of Director | Capacity | Number of ordinary shares in the Company | Percentage of issued capital |
|------------------|------------------|---|---------------------------------|
| Philip Chen | Beneficial Owner | 9,000 | 0.00027% |
| Derek Cridland | Beneficial owner | 17,000 | 0.00050% |
| Tony Tyler | Beneficial Owner | 5,000 | 0.00015% |

(b) Substantial shareholders

Save as disclosed below, the Directors and chief executive of the Company are not aware that there was any party who, as at the Latest Practicable Date, had an interest or short position in the shares and underlying shares (including options) of the Company which would fall to be disclosed to the Company under Divisions 2 and 3 of Part XV of the SFO:

Interests in shares of Cathay Pacific (all being long positions)

| Name | Number of ordinary shares | Percentage of issued capital | Type of Interest | (Note) |
|---------------------------|---------------------------|------------------------------|--|--------|
| Swire Pacific Limited | 1,566,233,246 | 46.30% | Beneficial owner | |
| John Swire & Sons Limited | 1,566,233,246 | 46.30% | Attributable interest | (a) |
| CITIC Pacific Limited | 859,353,462 | 25.40% | Beneficial owner and attributable interest | (b) |

Note: As at the Latest Practicable Date:

- (a) John Swire & Sons Limited ("Swire") and its wholly owned subsidiary John Swire & Sons (H.K.) Limited were deemed to be interested in the 1,566,233,246 shares of the Company directly held by Swire Pacific Limited by virtue of the Swire group's direct or indirect interests in shares of Swire Pacific Limited representing approximately 31.34% of the issued share capital and approximately 53.59% of the voting rights;
- (b) CITIC Pacific Limited was beneficial owner of 71,600,000 shares of the Company. In addition, each of CITIC Pacific Limited and its wholly owned subsidiary Super Supreme Company Limited had an attributable interest in 787,753,462 shares of the Company which were held by their wholly owned subsidiaries as follows: 214,851,154 shares held by Custain Limited, 191,922,273 shares held by Easerich Investments Inc., 189,057,762 shares held by Motive Link Holdings Inc., and 191,922,273 shares held by Smooth Tone Investments Ltd.
- (c) Following the entering into of the Restructuring Agreement:
- (i) China National Aviation Holding Company, the holding company of Air China and CNAC Limited, was deemed interested in a total of 741,343,256 shares of the Company, including 288,596,335 shares to be issued by the Company to CNAC Limited, 40,128,292 shares to be acquired by Air China from SPAC and 359,170,636 shares to be acquired by Air China from CITIC Pacific upon Completion;
- (ii) CITIC Pacific Limited was deemed interested in a total of 1,049,330,107 shares of the Company, including 189,976,645 shares to be issued by the Company to CITIC Pacific upon Completion; and
- (iii) Swire, John Swire & Sons (H.K.) Limited and SPAC were deemed interested in a total of 1,617,635,657 shares of the Company, including 51,402,411 shares to be issued by the Company to SPAC upon Completion.

(c) Details of options granted by the Company

The Company adopted a share option scheme (the "Scheme") on 10th March 1999 under which options to subscribe for 68,327,000 shares of the Company at the exercise price of HK\$7.47 per share were granted on 15th March 1999 to flight deck crew who paid HK\$1 each on acceptance of their share options. The Scheme has been closed and no share options are available for issue under the Scheme. None of the Directors or chief executive was granted any share options under the Scheme.

Other than in limited circumstances, the options in relation to 50% of the shares became exercisable on 15th March 2002, and the balance on 15th March 2004. The options will, except in limited circumstances, be exercisable until 14th March 2009.

As at the Latest Practicable Date, options to subscribe for 13,855,500 shares of the Company were outstanding, the details of which are as follows:

| Date of grant | Number of share options outstanding as at the Latest Practicable Date | Option period | Subscription price per share HK\$ |
|---------------|---|-------------------------|-----------------------------------|
| 15/03/1999 | 13,855,500 | 15/03/1999 – 14/03/2009 | 7.47 |

(d) Substantial shareholders in the Company's subsidiaries

So far as is known to any Director or chief executive of the Company, as at the Latest Practicable Date, the following persons were interested in 10% or more of the issued capital carrying rights to vote at general meetings of the following subsidiaries of the Company:

| Name of subsidiary | Name of shareholder | Number and class of shares held | Percentage of shareholding |
|---|-----------------------------------|---------------------------------|----------------------------|
| Abacus Distribution Systems (Hong Kong) Limited | PCCW Enterprises Limited | 5,778,945 ordinary shares | 37.04% |
| AHK Air Hong Kong Limited | DHL Worldwide Express BV | 36,268,000 "B" ordinary shares | 40% |
| CLS Catering Services Limited | LSG Lufthansa Services GmbH | 132,032 common shares | 40% |
| Hong Kong Airport Services Limited | Hong Kong Dragon Airlines Limited | 30 ordinary shares | 30% |
| HAS GSE Solutions Limited | Hong Kong Dragon Airlines Limited | 3 ordinary shares | 30% |

(e) Directors' interests in competing businesses

Christopher Pratt and Zhang Xianlin are respectively a director and a supervisor of Air China. Henry Fan, Tony Tyler and Zhang Xianlin are directors of Dragonair. As at the Latest Practicable Date, Air China and Dragonair compete or are likely to compete either directly or indirectly with the business of the Company as they operate airline services to certain destinations which are also served by the Company. Christopher Pratt and Zhang Xianlin are not directly involved in the management of Air China's business. Henry Fan, Tony Tyler and Zhang Xianlin are not directly involved in the management of Dragonair's business.

The Directors consider that the Group is capable of and does carry on its business independently of, and on an arm's length basis with, the competing businesses of Air China and Dragonair.

(f) Other interests of Directors

Philip Chen, Martin Cubbon, Davy Ho, James Hughes-Hallett and Christopher Pratt are all directors of Swire Pacific Limited. They are also employees of the John Swire & Sons Limited group ("Swire Group"), as are Robert Atkinson and Tony Tyler. Henry Fan, Vernon Moore and Carl Yung are directors and employees of CITIC Pacific Limited. Swire Pacific Limited, John Swire & Sons Limited and CITIC Pacific Limited are substantial shareholders of the Company, as noted above.

The Company has an agreement for services (the "JSS Agreement") with John Swire & Sons (H.K.) Limited ("JSSHK"), pursuant to which JSSHK provides advice and expertise of the directors and senior officers of the Swire Group, full or part time services of members of the staff of the Swire Group, other administrative and similar services and such other services as may have been agreed from time to time.

In return for these services, JSSHK receives annual service fees calculated as 2.5% of the Company's consolidated profit before taxation and minority interests after certain adjustments. The Company also reimburses the Swire Group for all the expenses incurred in the provision of the services at cost.

The JSS Agreement took effect from 1st January 2005 and will terminate on 31st December 2007. However it is renewable for successive periods of three years thereafter unless either party to it gives to the other notice of termination of not less than three months expiring on any 31st December.

As directors and employees of the Swire Group, Robert Atkinson, Philip Chen, Martin Cubbon, Davy Ho, James Hughes-Hallett, Christopher Pratt and Tony Tyler are interested in the JSS Agreement (and any extension of such agreement to Dragonair and its subsidiaries).

(g) Interests in assets

As at the latest Practicable Date, none of the Directors and the expert whose name is referred to in the paragraph headed "Consent and Expert" in this appendix has or has had any interest, direct or indirect, in any assets which have been, since 31st December 2005, being the date to which the latest published audited accounts 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.

(h) Service contracts

None of the Directors has any existing or proposed service contract with any member of the Group which is not expiring or terminable by the Group within one year without payment of compensation (other than statutory compensation).

LITIGATION

The Company files tax returns in many jurisdictions and in certain of these the returns have remained in dispute for a number of years. Provisions have been made to cover the expected outcome of the disputes to the extent that outcomes are likely and reliable estimates can be made. However, the final outcomes are subject to uncertainties and resulting liabilities may exceed provisions.

The Company is the subject of investigations in respect of its air cargo operations by the European Commission and United States Department of Justice and has been cooperating with the authorities in their investigations. The focus of the investigations appears to be on issues relating to pricing and competition. The Company is represented by legal counsel in connection with the investigations.

The Company has been named as a defendant in a number of civil class action complaints in the United States and is aware of two recently filed civil complaints in Canada, all of which relate to Company imposed surcharges. The Company is represented by legal counsel and intends to defend these actions.

The investigations and civil actions are ongoing and the outcomes are subject to uncertainties. The Company is not in a position at the present time to assess any potential liabilities and cannot therefore make any provisions.

Except as disclosed above, there were no litigation or claims of material importance pending or threatened against any member of the Group as at the Latest Practicable Date.

CONSENT AND EXPERT

ING Bank N.V. has given and has not withdrawn its written consent to the issue of this circular with the inclusion of its letter as set out in this circular and references to its name in the form and context in which they respectively appear in this circular.

QUALIFICATION OF EXPERT

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

| | |
|----------------------|--|
| Name | ING Bank N.V. |
| Qualification | A registered institution under the SFO, registered for Type 1 (dealing in securities), Type 4 (advising on securities) and Type 6 (advising on corporate finance) of the regulated activities. |

ING Bank N.V. has confirmed to the Company that as at the Latest Practicable Date, ING Bank N.V. did not have any shareholding interest, directly or indirectly, in any member of the Group nor the right (whether legally enforceable or not) to subscribe for or to nominate any person to subscribe for securities in any members of the Group.

DOCUMENTS AVAILABLE FOR INSPECTION

Copies of the Restructuring Agreement, Shareholders Agreement and Operating Agreement are available for inspection by Shareholders during normal business hours at the registered office of the Company at 35th Floor, Two Pacific Place, 88 Queensway, Hong Kong on weekdays other than public holidays up to and including 21st July 2006.

POLL PROCEDURE

Under the articles of association of the Company, at any general meeting, on a show of hands every member present in person shall have one vote and on a poll every member present in person or by proxy shall have one vote for every fully paid up share of which he is the holder. A resolution put to the vote of a meeting shall be decided on a show of hands unless, before or on the declaration of the result of the show of hands or on the withdrawal of any other demand for a poll, a poll is duly demanded. Article 72 of the Company's articles of association provides that, subject to the provisions of the Companies Ordinance, a poll may be demanded by:

- (i) the chairman of the meeting; or
- (ii) at least three members present in person or by proxy and entitled to vote at the meeting; or
- (iii) any member or members present in person or by proxy and representing in the aggregate not less than one-tenth of the total voting rights of all members having the right to attend and vote at the meeting; or
- (iv) any member or members present in person or by proxy and holding shares conferring a right to attend and vote at the meeting on which there have been paid up sums in the aggregate equal to not less than one-tenth of the total sum paid up on all shares conferring that right.

MISCELLANEOUS

1. The secretary of the Company is David Fu. He holds a Master of Arts degree from Oxford University and is an associate member of The Hong Kong Institute of Chartered Secretaries and The Institute of Chartered Secretaries and Administrators.
2. The qualified accountant to the Company is Robert Atkinson. He holds a Bachelor of Arts (Honours) degree from Nottingham University and is a Fellow of the Institute of Chartered Accountants in England and Wales and the Hong Kong Institute of Certified Public Accountants.
3. The registered address of the Company is at 35th Floor, Two Pacific Place, 88 Queensway, Hong Kong. The head office of the Company is at 7th Floor, North Tower, Cathay Pacific City, 8 Scenic Road, Hong Kong International Airport, Lantau, Hong Kong.
4. The Company's share registrars and transfer office is Computershare Hong Kong Investor Services Limited, 46th Floor, Hopewell Centre, 183 Queen's Road East, Hong Kong.

NOTICE OF EXTRAORDINARY GENERAL MEETING

NOTICE OF MEETING

NOTICE IS HEREBY GIVEN that an Extraordinary General Meeting of the shareholders of Cathay Pacific Airways Limited will be held at the Pacific Place Conference Centre, Level 5, One Pacific Place, 88 Queensway, Hong Kong on 22nd August 2006 at 11:00 a.m. for the purpose of considering and, if thought fit, passing, with or without modifications, the following resolutions as ordinary resolutions:

ORDINARY RESOLUTIONS

1. THAT the Connected Transactions and the entering into by the Company of the Restructuring Agreement (a copy of which agreement has been produced to the meeting marked "A" and signed by the chairman of the meeting for the purpose of identification) are hereby approved for the purposes of the connected transactions rules in the Listing Rules (terms defined in the circular to shareholders of the Company dated 6th July 2006 having the same meanings when used in this resolution).
2. THAT the allotment and issue by the Company of Cathay Shares to SPAC and CITIC Pacific under the Restructuring Agreement are hereby approved for the purposes of all other applicable requirements of the Listing Rules (terms defined in the circular to shareholders of the Company dated 6th July 2006 having the same meanings when used in this resolution).
3. THAT subject to the resolutions herein numbered 1 and 2 being passed as Ordinary Resolutions of the Company, the authorised share capital of the Company be increased from HK\$780,000,000 to HK\$1,000,000,000 by the creation of additional 1,100,000,000 ordinary shares of HK\$0.20 each, such ordinary shares to rank pari passu upon issue in all respects with the ordinary shares of HK\$0.20 each in issue on the date of allotment, including the right to all dividends and other distributions declared, made or paid at any time after such date.

By order of the Board

David Fu

Company Secretary

Hong Kong, 6th July 2006

Notes:

1. *Any member entitled to attend and vote at the meeting convened by the above notice is entitled to appoint one or more proxies to attend and, on a poll, vote instead of him. A proxy need not be a member of the Company.*
2. *All proxies must be deposited with the Registrars, Computershare Hong Kong Investor Services Limited, 46th Floor, Hopewell Centre, 183 Queen's Road East, Hong Kong, not less than 48 hours before the time appointed for the meeting or any adjourned meeting thereof.*
3. *The vote at the Extraordinary General Meeting will be taken by poll.*