



中航興業有限公司

CHINA NATIONAL AVIATION COMPANY LIMITED

(於香港註冊成立之有限公司)

(incorporated in Hong Kong with limited liability)

(股份代號 Stock Code: 1110)

2006

中期報告

INTERIM REPORT



The Board of Directors (the “Directors”) of China National Aviation Company Limited (the “Company”) is pleased to present the unaudited condensed consolidated interim financial information (“Interim Financial Information”) of the Company and its subsidiaries (collectively the “Group”) for the six months ended 30th June, 2006. The consolidated income statement, consolidated statement of recognised income and expense and consolidated cash flow statement of the Group for the six months ended 30th June, 2006, and the consolidated balance sheet as at 30th June, 2006 of the Group, all of which are unaudited and condensed, along with selected explanatory notes, are set out on pages 11 to 32 of this report.

MANAGEMENT DISCUSSION AND ANALYSIS

Review of Operations

During the first half of 2006, the Group successfully capitalised on the growing demand for business and leisure travel within the region and recorded a continuous increase in both passenger volume and cargo volume for its airlines. However, the record high fuel prices impacted the Group’s results significantly.

The Group’s aviation-related businesses also posted healthy growth, with airline-catering businesses remaining the major driving forces. This sector contributed to 10 percent of the Group’s turnover and 28.7 percent of the profit attributable to equity holders of the Company. The diversified business portfolio has enhanced the Group’s resilience in coping with the ever-changing market environment, and is conducive to the future development of the Group.

For the six months ended 30th June, 2006, turnover of the Group increased by 19.4 percent to HK\$1,431.2 million. Because of the adverse effects of escalating fuel prices, the Group incurred HK\$0.92 million operating loss during this period. Profit attributable to equity holders of the Company amounted to HK\$43.5 million, representing a 64.6 percent decrease compared with HK\$123 million in same period last year. Basic earnings per share were HK1.31 cents (six months ended 30th June, 2005: HK3.71 cents).

Air Macau Company Limited (“Air Macau”)

In the first half of 2006, soaring fuel prices continued to influence the operation of Air Macau as system-wide fuel prices increased by 24.7 percent over the same period last year. Fuel hedging program was used to offset partially the negative impact caused by surging fuel prices. The Air Macau management also employed stringent cost control measures to contain operating costs.

Passenger revenue surged by 17.5 percent over the same period in 2005 to MOP956.5 million (2005: MOP814.2 million). This increase was mainly driven by the 10.7 percent rise in passenger flights operated in the first half of 2006, to 9,993 flights versus 9,027 flights operated during the same period in 2005. Revenue passenger kilometres (“RPK”) grew by 23.8 percent from 1,149.5 million in 2005 to 1,423 million in 2006. Total passengers carried in the first half of 2006 reached 1,160,158, a growth of 18.3 percent over the same period of last year. The passenger load factor rose by 5.1 percentage points in the first half of 2006 to 74.2 percent from 69.1 percent in 2005, whereas yield per passenger declined slightly in the first half of 2006 by 0.4 percent to MOP771 from MOP774 in 2005.



Freighter revenue generated in the first half of 2006 was MOP369.3 million, compared with MOP298 million in the same period of 2005, representing a healthy growth of 23.9 percent. The number of freighter flights operated also went up by 13.3 percent from 2,439 in 2005 to 2,764 in 2006. The demand for cargo continued to grow steadily in 2006, leading to a rise of 25.3 percent in cargo tonnage in the first half of 2006. A total of 80,839.1 tonnes were carried in the first half of 2006 compared with 64,524.4 tonnes in the same period of 2005. Cargo tonne kilometres (“CTK”) strengthened by 28.6 percent from 110 million in 2005 to 141.5 million in 2006. The cargo load factor dropped by 1.3 percentage points in the first half of 2006 from 65.2 percent in 2005 to 63.9 percent in 2006; cargo yield also fell by 1.8 percent in the first half of 2006 to MOP5.3 from MOP5.4 in 2005.

As of 30th June, 2006, Air Macau operated a fleet of 19 aircraft, of which 14 were passenger aircraft from the Airbus family comprised of seven A321s; one A320; five A319s and one A300-600R wide-bodied aircraft, which joined the fleet on 15th June, 2006. The size of the freighter fleet stood at five, all of which are A300-B4F aircraft.

In March 2006, Air Macau commenced operation into Hangzhou with a service of four weekly flights. Two more destinations, Guiyang and Changsha, were added to the network in April. In June, Air Macau started cargo services on the route of Macau–Pudong–Xiamen–Macau. At present, Air Macau’s passenger network covers a total of 17 destinations in Asia, 12 of which are to China mainland. Freighter services include a total of four destinations.

Hong Kong Dragon Airlines Limited (“Dragonair”)

Dragonair recorded a loss of HK\$43.3 million in the first half of 2006 compared with a profit of HK\$95.2 million during the same period last year. Higher fuel prices affected the results of Dragonair significantly, due to a 32 percent increase in fuel prices system-wide over the same period last year.

Fuel costs accounted for 29.0 percent of total operating costs during the review period, up by 5.9 percentage points from the same period last year. Fuel hedging program and the imposition of passenger and cargo fuel surcharge helped to mitigate part of the adverse impact of soaring fuel prices. Dragonair management also took various measures to reduce the dead weight of aircraft and change aircraft operational procedures to cut fuel consumption.

Dragonair continued to exercise tight controls over other operating costs with unit costs before fuel dropping by 8.0 percent to HK\$2.3 per ATK.

Passenger revenue rose to HK\$2,965.1 million up 8.5 percent over the same period in 2005 due to an increase in passenger service capacity to China mainland. The number of passengers reached 2.6 million, representing a 10.2 percent increase, and the passenger load factor also increased by 0.5 percentage points to 64.6 percent. Passenger yield decreased by 1.5 percent to HK\$0.877 per RPK. Dragonair started a new passenger service to Shenyang via Dalian three times a week in March 2006, serviced by A320 aircraft.

Cargo revenue was HK\$1,987.5 million, up by 7.5 percent from the same period in 2005. Dragonair carried 188,000 tonnes of cargo in the first half of 2006, representing a growth of 4.6 percent due to increase in passenger services, and the New York freighter service commenced operation in April 2005. Moreover, the cargo load factor increased by 0.4 percentage points to 72.0 percent. However, cargo yield dropped by 6.7 percent to HK\$2.8 per CTK, mainly because of intensifying market competition and an increase in long haul freighter service with lowering yields on a per kilometer basis. From April 2006 onwards, Dragonair increased the number of scheduled B747 freighter services to Frankfurt from three times a week to four times a week, to meet growing market demand.



As at 30th June, 2006, Dragonair operated scheduled passenger and cargo services to 37 destinations, of which 23 are in China mainland and 14 are in Asia, Europe, United Kingdom and the USA.

Two A330 aircraft under operating leases were delivered, one in January and one in April 2006 respectively. However, the decision not to launch a Sydney passenger service has resulted in surplus capacity. In view of this decision, two more A330s, in addition to one A320 and one A330, were wet leased to Air China in February and April 2006 respectively. Furthermore, one A320 under operating lease was returned to ILFC in June 2006. Dragonair's fleet in service amounted to thirty-three aircraft including nine A320s, six A321s, twelve A330s, one B747-200F, three B747-300SFs and two wet lease freighters as of the end of June 2006. For future expansion in passenger and cargo services, one A330 under operating lease is to be delivered in October 2006, and our first two B747-400 Boeing Converted Freighters will be delivered in October and December 2006.

The Dragonair management is committed to providing good services to its customers and enhancing its position as the airline of choice to the Mainland. The company's effort was recognised with the 'Best Airline – China' award for the fifth consecutive year in 2006, by the renowned international Skytrax passenger survey.

Despite a tough business environment with soaring fuel prices and fierce market competition, as well as the entry of new players into the China market, Dragonair's management remains optimistic about the airline's future. As the market leader for operations between China mainland and Hong Kong, Dragonair operates the largest number of routes between the two places, and in particular the highest daily frequency of services into both Shanghai and Beijing. The airports in both cities are now slot constrained throughout the day. We expect more traffic to be fed into Dragonair from Cathay Pacific's global network, with better schedule integration and competitive pricing arrangements between the two airlines.

Beijing Air Catering Co., Ltd. ("BACL")

During the first half of 2006, the number of flights catered by BACL increased by 15.6 percent while the number of in-flight meals served increased by 14.3 percent. BACL handled 40,639 meals daily on average during the review period. It remains the largest in-flight caterer in Beijing Capital International Airport with an approximately 75.2 percent market share.

Construction of a catering building in Beijing Capital International Airport is expected to commence in November 2006. BACL is well positioned to capture the growing demand for in-flight catering services.

Southwest Air Catering Company Limited ("SWACL")

During the first half of 2006, SWACL provided in-flight catering services for 13,324 flights, an increase of 15 percent from the same period last year. The total number of in-flight meals served increased by 16 percent to over 1.87 million. It remains the largest in-flight caterer in Chengdu Shuangliu International Airport with a market share of approximately 70 percent.

With more new airlines commencing operations in Chengdu, coupled with the expansion of existing airlines, SWACL expects further business growth in the second half of 2006.

LSG Lufthansa Service Hong Kong Limited ("LLSHK")

Compared to the first half of 2005, the number of meals served and the number of flights catered by LLSHK increased by 12.7 percent and 9.6 percent respectively, thanks to strong air traffic demand and new customers in 2006.



Due to contribution from LLSHK's two-pronged approach of price increases on one side and various cost savings measures for containing operating costs on the other, the profit margin in the first half of 2006 slightly improved by 0.4 percent compared to the same period in the previous year.

Continuing revenue and volume growth is expected in the second half of 2006 in the light of growing air traffic demand, and with new airlines commencing operations in Hong Kong.

Jardine Airport Services Limited (“JASL”)

In the first half of 2006, the consolidated turnover of JASL increased by 10.8 percent mainly due to increasing flight frequencies handled. JASL handled 35,862 aircraft movements, an increase of 10.9 percent over the same period in 2005, and maintained approximately 49 percent of the third-party ground handling market at Hong Kong International Airport (“HK Airport”). Jardine Air Terminal Services Limited (“JATS”) handled 49,438 aircraft movements, an increase of 16 percent compared with the same period of 2005, representing an approximately 62 percent share of the third-party ramp handling market at the HK Airport.

Given the strong support and business connections of its shareholders, JASL will continue to explore new business opportunities in China mainland and is confident to secure these opportunities.

Menzies Macau Airport Services Limited (“Menzies Macau”)

For the six months ended 30th June, 2006, Menzies Macau handled 11,799 aircraft turns, representing an increase of 13.6 percent over the same period in 2005.

Cargo volume handled by Menzies Macau increased by 9.2 percent compared with the same period in 2005. However, 53 percent of the cargo volume was transfer cargo with much lower handling charges than those of cargo terminating in Macau. As a result, the total revenue for the first half of 2006 grew slightly by 2.5 percent.

With a new airline starting operations in Macau in the fourth quarter of 2006, Menzies Macau looks forward to sustaining its successful performance in the second half of 2006.

Tradeport Hong Kong Limited (“Tradeport Hong Kong”)

Tradeport Hong Kong continued growing during the first half of 2006. At the end of June 2006, capacity utilisation of the Logistics Centre reached 91 percent against 75 percent in June 2005. Consolidated revenue for the first half of 2006 was HK\$32.8 million, up 15 percent from the same period last year.

Outlook

In June 2006, the Company announced the entering into of the restructuring agreement for the disposal of all its equity shares in Dragonair, in return for the acquisition of a 7.34 percent shareholding in Cathay Pacific Airways Limited. It will provide the Group with an income source from a listed company with dominant market presence. The transaction will consolidate and optimise resources, align the shareholding structure of Dragonair, facilitate its healthy development in the long term. In addition, the synergies created from the combination of the two airlines will not only be limited to saving costs and leveraging operations, but also further gains from the geographical advantages of its position in the Greater China Region. The Group will continue to be engaged in air transportation services, airline catering services, airport ground handling services and logistics services.



In view of the intensifying competition in China's aviation industry combined with soaring fuel prices, airline companies are facing unprecedented challenges. In the future, we will continue to streamline our business operations and tighten cost-control measures. Macau's booming tourism market will offer enormous development potential for Air Macau and the Group's low-cost carriers. The debut of the commercial flights by Macau Asia Express Limited in mid-2007 will provide travelers with affordable flight services. This also represents a noteworthy step towards growth for the Group in light of the new industry landscape. The Group will also strengthen its position in the airline-catering business and further develop its aviation-related business, with a particular focus in China mainland.

Looking ahead, the Asian aviation industry will continue to face tremendous changes driven by market consolidation and an increasing number of new entrants, while industry prospects remains overshadowed by high fuel costs. Recent changes in our business structure have given us a strong impetus to grow and stay competitive. The Group will strive to capture new business opportunities arising from the fast growing aviation and travel business in the region, and will strive to broaden our income base.

Financial Review

Liquidity and Financial Resources

The Group generally financed its operations with cash flow generated internally. As at 30th June, 2006, the Group had cash and cash equivalents of a total amount of approximately HK\$1,031 million and net current assets of approximately HK\$2,082 million. The Group consistently maintained a strong working capital during the six months ended 30th June, 2006. As at 30th June, 2006, the current liabilities of the Group was approximately HK\$719 million.

Share Capital

There were no options granted or exercised during the period, and 104,378,000 options remained outstanding as at 30th June, 2006.

As at 30th June, 2006, 3,312,680,000 shares were in issue (31st December, 2005: 3,312,680,000 shares).

Contingent Liabilities and Commitments

As at 30th June, 2006, the Group had given a guarantee to a bank for loan facilities granted to an associate totalling HK\$20,000,000 (31st December, 2005: HK\$20,000,000).

As at 30th June, 2006, the Group had given a guarantee to a bank for loan facilities granted to a jointly controlled entity of RMB32,250,000 (equivalent to approximately HK\$31,311,000). Loans of RMB30,000,000 (equivalent to approximately HK\$29,126,000) were drawn down by the jointly controlled entity as at 30th June, 2006 (31st December, 2005: HK\$38,450,000). The Group's proportionate share of bank loans of HK\$17,476,000 had been included in the unaudited condensed consolidated balance sheet as at 30th June, 2006 (31st December, 2005: HK\$23,070,000).



In February 2001, the Group together with the Tradeport Logistics Centre consortium partners jointly gave a guarantee to the Airport Authority Hong Kong in respect of their obligations to provide sufficient funding for the development of the Tradeport Logistics Centre. On 17th March, 2004, the Airport Authority Hong Kong agreed to reduce the maximum liability limit from approximately HK\$780 million to approximately HK\$312 million. The Directors are of the opinion that, had the Group been required to perform its obligation under the guarantee in the event of default of all of the consortium partners, the maximum amount of the contingent liabilities assumed, including the Group's estimated share of capital commitments of approximately HK\$78 million, would have been approximately HK\$312 million.

As at 30th June, 2006, the Group had committed to make additional capital contribution to a jointly controlled entity, Macau Asia Express Limited, with an aggregate amount of up to approximately HK\$58,491,000.

The Group's attributable share of capital expenditure contracted for by the Group's jointly controlled entities at the balance sheet date but not yet incurred is as follows:

	30th June, 2006	31st December, 2005
	HK\$'000	HK\$'000
Property, plant and equipment	5,667	3,966

Charge on Assets

The shares of Tradeport Hong Kong held by the Group were pledged as securities for a banking facility granted to Tradeport Hong Kong.

Financial Assistance to Affiliated Companies and their Proforma Combined Balance Sheet

Pursuant to Chapter 13 of the Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong Limited ("Listing Rules"), a proforma combined balance sheet of those affiliated companies with financial assistance from the Group and the Group's attributable interest in those affiliated companies are presented below.

Affiliated companies comprise the Group's associates and a jointly controlled entity. As at 30th June, 2006, the total financial assistance is HK\$427,977,000, which represented the loans to affiliated companies totalling HK\$64,666,000 and guarantees given to affiliated companies of HK\$363,311,000. These exceed 8% of the Group's total assets as at 30th June, 2006.

	As at 30th June, 2006	
	Proforma combined balance sheet	The Group's attributable interest
	<i>HK'000</i>	<i>HK\$'000</i>
Non-current assets	505,207	174,743
Current assets	63,667	29,616
Current liabilities	(67,726)	(34,690)
Non-current liabilities	(270,714)	(67,679)
Shareholders' advances	(237,509)	(64,666)
	(7,075)	37,324



Foreign Exchange and Currency Risks

The Group generates a portion of its revenue from ticket sales in certain foreign jurisdictions giving rise to exposures to fluctuation in foreign exchange rates. The Group continuously monitors its foreign currency positions and does not consider that it has a significant exposure to foreign exchange risk from any currency.

Human Resources

The bulk of human resources of the Company and their remuneration, amongst others, are covered by a management services agreement concluded with the Company's fellow subsidiary, China National Aviation Corporation (Group) Limited. Likewise, China National Aviation Corporation (Macau) Limited also concluded a management services agreement with CNAC (Macau) Aviation Limited. Both agreements were negotiated under normal commercial terms and conditions.

Air Macau, a 51 percent held subsidiary, employs about 1,001 staff (six months ended 30th June, 2005: 928 staff). Employees remunerated packages are designed and structured based on the foregoing market conditions, relevant laws and regulations, industry practices and standard, work performance, education or professional training background and past working experience.

As at 30th June, 2006, BACL has 1,086 staff and SWACL has 670 staff.

REPURCHASE, SALE OR REDEMPTION OF SHARES

Neither the Company nor any of its subsidiaries has repurchased, sold or redeemed any of the Company's shares during the six months ended 30th June, 2006.

SUFFICIENCY OF PUBLIC FLOAT

The Company has maintained a sufficient public float throughout the six month period ended 30th June, 2006.

DIRECTORS AND CHIEF EXECUTIVE'S INTERESTS AND SHORT POSITIONS IN SHARES, UNDERLYING SHARES AND DEBENTURES

Apart from the interests of the Directors in the share options of the Company are separately disclosed in the "Share Options" below, as at 30th June, 2006, none of the directors and the chief executive of the Company and/or any of their respective associates had any interest or deemed interest in the long and short position in the shares, underlying shares and debentures of the Company or any of its associated corporation (within the meaning of Part XV of the Securities and Futures Ordinance ("SFO")) as recorded in the register required to be kept by the Company under Section 352 of the SFO; or as otherwise notified to the Company and the Stock Exchange of Hong Kong Limited (the "Stock Exchange") pursuant to Part XV of the SFO or the Model Code for Securities Transaction by Directors of Listed Companies.



DIRECTORS' INTERESTS IN COMPETING BUSINESS

Pursuant to paragraph 8.10(2) of the Listing Rules, Mr. Kong Dong disclosed that he is the Deputy General Manager of China National Aviation Holding Company ("CNAH"), the ultimate holding company of the Company, and the Vice Chairman and a non-executive director of Air China Limited ("Air China"). CNAH is a state-owned enterprise established in the People's Republic of China ("PRC"), Air China is a joint stock limited company incorporated in the PRC, shares of which are listed on the Stock Exchange, the Shanghai Stock Exchange and the London Stock Exchange. Air China is engaged in the business of passenger and cargo air transportation services and airport ground handling services and CNAH is its ultimate holding company. As such the business activities of CNAH and Air China compete, or are likely to compete, either directly or indirectly, with the business of the Group.

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

SHARE OPTIONS

A share option scheme (the "Scheme") was adopted by the Company on 29th May, 2002.

During the six months ended 30th June, 2006, no share option has been granted or exercised. As at 30th June, 2006, there were 104,378,000 share options outstanding under the Scheme, details of which are as follows:

Name of grantee	Options held at		Exercise price HK\$	Grant date	Exercise period
	1st January, 2006	and 30th June, 2006			
Chuang Shih Ping	33,126,000		1.14	25/07/2003	26/10/2003 to 25/10/2009
Zhang Xianlin	33,126,000		1.14	25/07/2003	26/10/2003 to 25/10/2009
Tsang Hing Kwong, Thomas	33,126,000		1.14	25/07/2003	26/10/2003 to 25/10/2009
Gu Tiefei	5,000,000		1.14	25/07/2003	26/10/2003 to 25/10/2009
Total		<u>104,378,000</u>			

**SUBSTANTIAL SHAREHOLDERS**

The register of interests in shares or short positions maintained under Part XV of the SFO shows that as at 30th June, 2006, the Company had been notified of the following:

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

Notes:

1. A state-owned enterprise established in the PRC. It owns approximately 51.16% of the total issued share capital of Air China Limited and the entire issued share capital of China National Aviation Corporation (Group) Limited, a company incorporated in Hong Kong, which in turn owns approximately 14.64% of the total issued share capital of Air China Limited. Accordingly its interests in the Company duplicate with those interest of Air China Limited.
2. A joint stock limited company incorporated in the People's Republic of China with its H shares listed in Hong Kong and London and A shares listed in Shanghai. China National Aviation Corporation (Group) Limited, the Company's former immediate controlling shareholder, transferred its approximately 69% shareholding interest in the Company to Air China Limited in September 2004 by way of a capital contribution in return for Air China Limited's non-H foreign shares, as such Air China Limited becomes the immediate controlling shareholder of the Company. Its interest in the Company duplicates with those interests of China National Aviation Holding Company.
3. 5.6% of the interest held by each of these companies in the Company duplicates with Best Strikes Limited's interest in the Company. The interests of these companies in the Company also duplicate each other.

Save as disclosed above, as at 30th June, 2006, no other person had an interest in the long and short position in the shares or underlying shares of the Company as recorded in the register required to be kept by the Company under Part XV of the SFO.



CORPORATE GOVERNANCE

The Board of Directors is committed to ensure that an effective self-regulatory and monitoring mechanism exists and is practised in conducting the business of the Group whenever suitable and appropriate.

The Company has complied with the code provisions set out in Appendix 14 “Code on Corporate Governance Practices” to the Listing Rules throughout the six months ended 30th June, 2006, except that the terms of reference of Audit Committee, Remuneration Committee and Nomination Committee can only be available upon request since no website of the Company was set-up.

During the first half year of 2006, no meeting has been held for both Remuneration and Nomination Committees.

MODEL CODE

The Company has adopted the Model Code set out in Appendix 10 to the Listing Rules as the code of conduct regarding securities transactions by the Directors. Having made specific enquiry of all Directors, the Company confirmed that all Directors have complied throughout the six months ended 30th June, 2006 with the required standard set out in the Model Code.

AUDIT COMMITTEE

The Audit Committee of the Company has discussed and reviewed with the Company’s management the Interim Financial Information of the Group for the six months ended 30th June, 2006, and has also discussed among themselves matters including internal control and financial reporting.

INTERIM DIVIDEND

The Directors have resolved not to declare interim dividend for the six months ended 30th June, 2006 (six months ended 30th June, 2005: HK0.8 cent per share).

By Order of the Board of Directors
KONG DONG
Chairman

Hong Kong, 29th August, 2006

**UNAUDITED CONDENSED CONSOLIDATED INCOME STATEMENT**

		Six months ended	
		30th June,	
	<i>Note</i>	2006	2005
		HK\$'000	<i>HK\$'000</i>
Turnover	3	1,431,170	1,199,150
Other revenues		3,785	27,235
Total revenues		1,434,955	1,226,385
Other gains		52,262	23,329
Staff costs		(193,236)	(155,140)
Passenger catering and service costs		(123,999)	(114,971)
Fuel costs		(408,193)	(277,603)
Route operating costs		(280,785)	(247,039)
Aircraft maintenance costs		(110,640)	(109,725)
Aircraft leases and equipment costs		(235,493)	(206,701)
Depreciation and amortisation costs		(38,698)	(37,530)
Sales and promotion costs		(37,630)	(38,336)
Other operating costs		(59,465)	(43,899)
Total operating expenses		(1,488,139)	(1,230,944)
Operating (loss)/profit	4	(922)	18,770
Finance costs	5	(504)	(1,802)
Share of profits less losses of associates		50,080	120,498
Profit before income tax		48,654	137,466
Income tax	6	(9,384)	(5,812)
Profit for the period		39,270	131,654
Attributable to:			
Equity holders of the Company		43,484	122,910
Minority interests		(4,214)	8,744
		39,270	131,654
Interim dividend	7	–	26,501
Earnings per share	8	HK cents	<i>HK cents</i>
– Basic		1.31	3.71
– Diluted		1.29	3.67

**UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEET**

	Note	Unaudited 30th June, 2006 HK\$'000	Restated 31st December, 2005 HK\$'000
ASSETS			
Non-current assets			
Property, plant and equipment	9	450,997	471,692
Land use right	9	2,233	2,274
Intangible assets	9	529,240	529,240
Interests in associates	10	313,655	1,652,454
Loans to associates		64,219	47,097
Lease and equipment deposits		62,723	60,109
Deferred income tax assets		20,709	23,427
Pledged bank deposits	14	101,220	88,943
		<u>1,544,996</u>	<u>2,875,236</u>
Current assets			
Inventories		54,205	53,273
Trade and other receivables	12	306,939	283,544
Loan to an associate		–	18,060
Derivative financial instruments		39,215	11,957
Assets classified as held for sale	13	1,369,264	–
Cash and cash equivalents	14	1,030,930	999,833
		<u>2,800,553</u>	<u>1,366,667</u>
Total assets		<u>4,345,549</u>	<u>4,241,903</u>
EQUITY			
Capital and reserves attributable to the Company's equity holders			
Share capital	15	331,268	331,268
Reserves		2,852,355	2,786,302
Proposed dividend		–	33,127
		<u>3,183,623</u>	<u>3,150,697</u>
Minority interests		<u>223,138</u>	<u>227,352</u>
Total equity		<u>3,406,761</u>	<u>3,378,049</u>
LIABILITIES			
Non-current liabilities			
Provision for overhaul and major checks		188,390	154,904
Provision for housing allowances		31,508	34,126
		<u>219,898</u>	<u>189,030</u>
Current liabilities			
Trade and other payables	16	545,253	514,623
Sales in advance of carriage		150,957	132,394
Current income tax liabilities		2,356	2,436
Short-term bank loans – unsecured		20,324	25,371
		<u>718,890</u>	<u>674,824</u>
Total liabilities		<u>938,788</u>	<u>863,854</u>
Total equity and liabilities		<u>4,345,549</u>	<u>4,241,903</u>
Net current assets		<u>2,081,663</u>	<u>691,843</u>
Total assets less current liabilities		<u>3,626,659</u>	<u>3,567,079</u>

**UNAUDITED CONDENSED CONSOLIDATED STATEMENT OF RECOGNISED INCOME AND EXPENSE**

	Six months ended	
	30th June,	
	2006	2005
	HK\$'000	HK\$'000
Share of currency translation differences of associates	52	13
Share of fair value gains on derivative financial instruments of associates	22,130	23,897
Currency translation differences	387	—
	<hr/>	<hr/>
Net income recognised directly in equity	22,569	23,910
Profit for the period	39,270	131,654
	<hr/>	<hr/>
Total recognised income for the period	61,839	155,564
	<hr/>	<hr/>
Attributable to:		
Equity holders of the Company	66,053	146,820
Minority interests	(4,214)	8,744
	<hr/>	<hr/>
	61,839	155,564
	<hr/>	<hr/>

**UNAUDITED CONDENSED CONSOLIDATED CASH FLOW STATEMENT**

	Six months ended	
	30th June,	
	2006	2005
	HK\$'000	HK\$'000
Net cash from operating activities	39,455	130,629
Net cash from investing activities	29,816	198,593
Net cash used in financing activities	(38,174)	(90,809)
Net increase in cash and cash equivalents	31,097	238,413
Cash and cash equivalents at 1st January	999,833	746,793
Cash and cash equivalents at 30th June	1,030,930	985,206
Analysis of balances of cash and cash equivalents:		
Cash at bank and in hand	425,988	350,823
Short-term bank deposits	706,162	709,010
Pledged bank deposits	(101,220)	(74,627)
	1,030,930	985,206



NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL INFORMATION

1. General information

The Company is a limited liability company incorporated in Hong Kong on 3rd February, 1997, the shares of which were listed on the Main Board of The Stock Exchange of Hong Kong Limited in December 1997. The Company, its subsidiaries, its jointly controlled entities and its associates are principally engaged in the airline operations, airport ground handling services, airline catering services, logistics and other businesses.

The address of the Company's registered office is 5th Floor, CNAC House, 12 Tung Fai Road, Hong Kong International Airport, Lantau.

This condensed consolidated financial information was approved for issue on 29th August, 2006.

2. Basis of preparation and accounting policies

This unaudited condensed consolidated financial information for the six months ended 30th June, 2006 ("Interim Financial Information") has been prepared in accordance with Hong Kong Accounting Standard ("HKAS") 34 "Interim Financial Reporting" issued by the Hong Kong Institute of Certified Public Accountants.

The Interim Financial Information should be read in conjunction with the annual financial statements for the year ended 31st December, 2005.

The principal accounting policies adopted are consistent with those of the annual financial statements for the year ended 31st December, 2005, except that as described in the annual financial statements for the year ended 31st December, 2005, the following new standards, amendments to standards and interpretations are mandatory for financial year ending 31st December, 2006.

HK(IFRIC)-Int 4 "Determining whether an Arrangement contains a Lease"

Amendments to HKAS 19 "Employee Benefits – Actuarial Gains and Losses, Group Plans and Disclosures"

Amendments to HKAS 39 "Financial Instruments: Recognition and Measurement":

- Cash Flow Hedge Accounting of Forecast Intragroup Transactions
- The Fair Value Option

Amendments, as a consequence of the Hong Kong Companies (Amendment) Ordinance 2005, to:

- HKAS 1 "Presentation of Financial Statements"
- HKAS 27 "Consolidated and Separate Financial Statements"
- HKFRS 3 "Business Combinations"

Amendments to HKAS 39 "Financial Instruments: Recognition and Measurement" and HKFRS 4 "Insurance Contracts" – "Financial Guarantee Contracts"



The adoption of HKAS 19 (Amendment) has resulted in a change in accounting policy in which the actuarial gains and losses for defined benefit pension plans are recognised in full in the year in which they occur, outside the income statement, in the statement of recognised income and expense. In prior years, actuarial gains and losses are recognised by amortising the amount by which cumulative unrecognised gains and losses exceed 10% of the greater of the assets of plan and the defined benefit obligations over the average expected future working lifetime of the active members of the plan. The following is a summary of effect of adopting the HKAS 19 (Amendment) to the Interim Financial Information:

	30th June, 2006 HK\$'000	31st December, 2005 HK\$'000
Increase in interests in associates	24,860	24,860
Increase in retained profits	24,860	24,860

Other than above, there is no material change in the principal accounting policies or presentation of financial statements and there is no material impact as a result of the adoption of the remaining new standards, amendments to standards and interpretations on the Interim Financial Information.

The following new standards, amendments to standards and interpretations, which will be relevant to the Group, have been issued but are not effective for 2006 and have not been early adopted:

	Effective for accounting periods beginning on or after
HK(IFRIC)-Int 7 "Applying the Restatement Approach under HKAS 29"	1st March, 2006
HK(IFRIC)-Int 8 "Scope of HKFRS 2"	1st May, 2006
HK(IFRIC)-Int 9 "Reassessment of Embedded Derivatives"	1st June, 2006
HKFRS 7 "Financial Instruments: Disclosures"	1st January, 2007
Amendments to HKAS 1 "Presentation of Financial Statements: Capital Disclosures"	1st January, 2007

The Group has not early adopted the above standards, interpretations and amendments in the Interim Financial Information. The Group has already commenced an assessment of the related impact to the Group but is not yet in a position to state whether substantial changes to the Group's principal accounting policies and presentation of the financial statements will be resulted.

3. Turnover and segment information

Turnover

	Six months ended 30th June, 2006 HK\$'000	2005 HK\$'000
Traffic revenues		
– Passenger services	868,954	736,672
– Cargo and mail services	418,281	343,111
Airline catering revenue	143,935	119,367
	1,431,170	1,199,150

**Primary reporting format – Business segments**

The Group, its jointly controlled entities and its associates are organised into four main business segments including airline operation, airport ground handling, airline catering, logistics and other businesses.

An analysis of the Group's revenues, results, assets and liabilities by business segments is as follows:

	Six months ended 30th June, 2006				Total HK\$'000
	Airline operation HK\$'000	Airport ground handling HK\$'000	Airline catering HK\$'000	Logistics and other businesses HK\$'000	
Segment revenues	1,291,020	-	143,935	-	1,434,955
Segment results	(21,659)	-	26,163	-	4,504
Interest income					15,831
Unallocated costs					(21,257)
Operating loss					(922)
Finance costs					(504)
Share of profits less losses of associates	(18,760)	65,134	6,175	(2,469)	50,080
Profit before income tax					48,654
Income tax					(9,384)
Profit for the period					39,270
Capital expenditure	16,603	-	2,816	-	19,419
Depreciation	32,750	-	5,907	-	38,657
Amortisation	-	-	41	-	41
Reversal of provision for impairment of trade receivables	(623)	-	-	-	(623)
					At 30th June, 2006
	Airline operation HK\$'000	Airport ground handling HK\$'000	Airline catering HK\$'000	Logistics and other businesses HK\$'000	Total HK\$'000
Segment assets	1,238,411	-	490,043	-	1,728,454
Interests in associates	-	213,443	129,851	(29,639)	313,655
Assets classified as held for sale	1,369,264	-	-	-	1,369,264
Loans to associates	-	-	-	64,219	64,219
Unallocated assets					869,957
Total assets					4,345,549
Segment liabilities	817,300	-	107,794	-	925,094
Unallocated liabilities					13,694
Total liabilities					938,788



Six months ended 30th June, 2005

	Airline operation <i>HK\$'000</i>	Airport ground handling <i>HK\$'000</i>	Airline catering <i>HK\$'000</i>	Logistics and other businesses <i>HK\$'000</i>	Total <i>HK\$'000</i>
Segment revenues	1,107,017	–	119,368	–	1,226,385
Segment results	5,477	–	16,354	–	21,831
Interest income					6,783
Unallocated costs					(9,844)
Operating profit					18,770
Finance costs					(1,802)
Share of profits less losses of associates	54,337	62,761	4,998	(1,598)	120,498
Profit before income tax					137,466
Income tax					(5,812)
Profit for the period					131,654
Capital expenditure	9,069	–	2,106	–	11,175
Depreciation	31,887	–	5,594	–	37,481
Amortisation	9	–	40	–	49
Reversal of provision for impairment of trade receivables	(790)	–	–	–	(790)

At 31st December, 2005 (Restated)

	Airline operation <i>HK\$'000</i>	Airport ground handling <i>HK\$'000</i>	Airline catering <i>HK\$'000</i>	Logistics and other businesses <i>HK\$'000</i>	Total <i>HK\$'000</i>
Segment assets	1,168,150	–	488,620	–	1,656,770
Interests in associates	1,365,917	188,807	123,676	(25,946)	1,652,454
Loans to associates	–	18,060	–	47,097	65,157
Unallocated assets					867,522
Total assets					4,241,903
Segment liabilities	741,313	–	115,658	–	856,971
Unallocated liabilities					6,883
Total liabilities					863,854

**Secondary reporting format – Geographical segments**

The Group and its jointly controlled entities operate in three main geographical areas including China mainland, Taiwan and other regions (mainly Macau, Thailand and Philippines). The airline operation business is mainly operated in places in China mainland, Taiwan and other regions. The airline catering business is operated in China mainland.

	Segment revenues		Segment results	
	Six months ended		Six months ended	
	30th June,		30th June,	
	2006	2005	2006	2005
	HK\$'000	HK\$'000	HK\$'000	HK\$'000
China mainland	648,442	551,830	21,890	(22,056)
Taiwan	665,503	607,474	(3,875)	77,695
Other regions	121,010	67,081	(13,511)	(33,808)
	<u>1,434,955</u>	<u>1,226,385</u>	4,504	21,831
Interest income			15,831	6,783
Unallocated cost			(21,257)	(9,844)
Operating (loss)/profit			<u>(922)</u>	<u>18,770</u>

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

The assets and capital expenditure of jointly controlled entities in respect of airline catering business are located in China mainland.

The assets and capital expenditure of the Group, other than those of jointly controlled entities and its aircraft fleet as mentioned in the above, are mainly located in Macau.



4. Operating (loss)/profit

The following items have been included in arriving at operating (loss)/profit:

	Six months ended 30th June,	
	2006	2005
	HK\$'000	HK\$'000
Crediting		
Reversal of provision for impairment of trade receivables	623	790
Fair value gains on derivative financial instruments	36,430	16,546
Charging		
Amortisation of intangible assets	-	9
Amortisation of land use right	41	40
Cost of inventories expensed	74,093	67,361
Depreciation of property, plant and equipment	38,657	37,481

5. Finance costs

	Six months ended 30th June,	
	2006	2005
	HK\$'000	HK\$'000
Interest expenses on short-term bank loans	504	1,802

**6. Income tax**

Hong Kong profits tax has been provided at the rate of 17.5% (six months ended 30th June, 2005: 17.5%) on the estimated assessable profit. Macau Complementary Tax has been provided at the rate of 12% (six months ended 30th June, 2005: 15.75%) on the estimated assessable profit for the period.

The Group has two jointly controlled entities in China mainland, namely Beijing Air Catering Co., Ltd. ("BACL") and Southwest Air Catering Company Limited ("SWACL"). Pursuant to the Circular (2006) No. 40 issued by the Sichuan State Tax Bureau, the income tax rate of SWACL has increased from 15% to 18% with effect from 1st January, 2006 (six months ended 30th June, 2005: 15%). BACL is subject to the income tax rate of 27% (six months ended 30th June, 2005: 27%).

Taxation outside Hong Kong and Macau has been calculated on the estimated assessable profit for the period at the rates of taxation prevailing in the countries in which the Group operates.

	Six months ended	
	30th June,	
	2006	2005
	HK\$'000	HK\$'000
Current income tax		
– Taxation outside Hong Kong and Macau	6,677	4,409
– Over provisions in prior years	(11)	(66)
Deferred income tax	2,718	1,469
	<hr/>	<hr/>
Income tax	9,384	5,812
	<hr/>	<hr/>

7. Interim dividend

	Six months ended	
	30th June,	
	2006	2005
	HK\$'000	HK\$'000
Interim dividend proposed of nil (six months ended 30th June, 2005: HK0.8 cent) per share	–	26,501
	<hr/>	<hr/>

**8. Earnings per share****Basic**

Basic earnings per share is calculated by dividing the profit attributable to equity holders of the Company by the weighted average number of shares in issue during the period.

	Six months ended 30th June,	
	2006	2005
	HK\$'000	HK\$'000
Profit attributable to equity holders of the Company	43,484	122,910
Weighted average number of shares in issue (thousands)	3,312,680	3,312,680
Basic earnings per share (HK cents per share)	1.31	3.71

Diluted

Diluted earnings per share is calculated based on the profit attributable to the equity holders of the Company and the weighted average number of shares in issue during the period, after adjusting for the number of dilutive potential shares deemed to be issued at no consideration as if all outstanding share options granted by the Company had been exercised.

	Six months ended 30th June,	
	2006	2005
	HK\$'000	HK\$'000
Profit attributable to the equity holders of the Company	43,484	122,910
Weighted average number of shares in issue (thousands)	3,312,680	3,312,680
Adjustment for assumed conversion of share options (thousands)	45,519	35,741
Weighted average number of shares for diluted earnings per share (thousands)	3,358,199	3,348,421
Diluted earnings per share (HK cents per share)	1.29	3.67

**9. Capital expenditure**

	Goodwill	Others	Total	Property,	Land
	HK\$'000	HK\$'000	intangible	plant and	use right
			assets	equipment	
			HK\$'000	(notes (i)	HK\$'000
				and (ii))	HK\$'000
				HK\$'000	
Six months ended 30th June, 2005					
Opening net book amount at					
1st January, 2005	529,240	9	529,249	495,786	2,355
Additions	-	-	-	11,175	-
Disposals	-	-	-	(139)	-
Amortisation/depreciation	-	(9)	(9)	(37,481)	(40)
	<u>529,240</u>	<u>-</u>	<u>529,240</u>	<u>469,341</u>	<u>2,315</u>
Closing net book amount at					
30th June, 2005	<u>529,240</u>	<u>-</u>	<u>529,240</u>	<u>469,341</u>	<u>2,315</u>
Six months ended 30th June, 2006					
Opening net book amount at					
1st January, 2006	529,240	-	529,240	471,692	2,274
Additions	-	-	-	19,419	-
Disposals	-	-	-	(1,457)	-
Depreciation/amortisation	-	-	-	(38,657)	(41)
	<u>529,240</u>	<u>-</u>	<u>529,240</u>	<u>450,997</u>	<u>2,233</u>
Closing net book amount at					
30th June, 2006	<u>529,240</u>	<u>-</u>	<u>529,240</u>	<u>450,997</u>	<u>2,233</u>

- (i) At 30th June, 2006, property, plant and equipment included buildings of net book amount of approximately HK\$35,216,000 (31st December, 2005: HK\$37,988,000) relating to the buildings of BACL situated on pieces of allocated land held by a related party. Air China Limited ("Air China"), the immediate holding company of the Company, is procuring to transfer those land from the related party to Air China in order to ensure Air China will legally and/or beneficially own the interests and benefits of such land. Air China agrees that BACL can continue to use the land at nominal consideration until such time Air China obtains the legal title of the land. A lease agreement would then be entered into between Air China and BACL for a term of up to 30th April, 2023 at a rent to be calculated on the basis of the original costs for obtaining such land use right. Accordingly, the Directors of the Company did not take into account any losses and costs arising from the inability to use any land currently used by BACL in the preparation of the Interim Financial Information.

Air China has further agreed to complete, at its expense, the formal procedures for transferring the building ownership rights of part of the production facilities from Air China to BACL. Such part of the production facilities were agreed to be injected by Air China into BACL as part of its initial capital contribution when BACL was established. No lease agreement has been entered between BACL and Air China.



- (ii) At 30th June, 2006, property, plant and equipment included buildings of net book amount of approximately HK\$38,290,000 (31st December, 2005: HK\$39,866,000) relating to an inflight meals production building held by SWACL which was put into use in 2004. However, SWACL was advised by Chengdu Shuangliu International Airport on 7th August, 2003 that this new inflight meals production building is situated in an area where the extension of airport premises to be located. As a result, this inflight meals production building might need to be demolished on or before 2015.

The Directors of the Company consider that this is only a suggestion proposed by Chengdu Shuangliu International Airport and so far SWACL has not received any formal notification from the relevant government authorities regarding this. Nevertheless, the Directors of the Company consider that SWACL had obtained all necessary approvals before constructing this production building and they are confident that SWACL is able to receive fair compensations from Chengdu Shuangliu International Airport should SWACL be requested to demolish the production building. The Directors of the Company consider that this matter is currently at a preliminary stage of development, accordingly, it is too early to consider any potential impact to SWACL and the Group.

10. Interests in associates

	30th June, 2006 HK\$'000	Restated 31st December, 2005 HK\$'000
Hong Kong Dragon Airlines Limited ("Dragonair") (note 13)	–	1,365,917
Others	260,947	233,829
	260,947	1,599,746

The interests in associates include unamortised goodwill of HK\$52,708,000 (31st December, 2005: HK\$52,708,000).



11. Interests in jointly controlled entities

At 30th June, 2006, the Group's proportionate share of the assets, liabilities, revenues and expenses of the jointly controlled entities are as follows:

	30th June, 2006	31st December, 2005
	HK\$'000	HK\$'000
Non-current assets	134,168	137,247
Current assets	175,867	112,206
	310,035	249,453
Non-current liability	(31,508)	(34,126)
Current liabilities	(78,121)	(88,647)
	(109,629)	(122,773)
Net assets	200,406	126,680
	Six months ended	
	30th June,	
	2006	2005
	HK\$'000	HK\$'000
Revenues	143,935	119,368
Other gains	294	93
Operating expenses	(118,851)	(103,013)
Finance costs	(504)	(1,802)
Profit before income tax	24,874	14,646
Income tax	(5,908)	(3,835)
Net profit	18,966	10,811



12. Trade and other receivables

Trade and other receivables include trade receivables from third parties, immediate holding company, an associate and related companies. The credit terms granted to sales agents and other trade customers are ranging from 15 to 90 days. The age analysis of trade receivables is as follows:

	30th June, 2006 HK\$'000	31st December, 2005 HK\$'000
Within 31 days	199,804	194,210
31 – 60 days	23,637	20,414
61 – 90 days	11,480	8,882
Over 90 days	10,377	9,752
	<u>245,298</u>	<u>233,258</u>

13. Assets classified as held for sale

On 8th June, 2006, the Company entered into a conditional agreement with Cathay Pacific Airways Limited (“Cathay”) pursuant to which the Company has agreed to dispose of the Group’s entire interest in Dragonair, an associate of the Group, to Cathay at a consideration to be satisfied by a combination of the issue of 288,596,335 new shares by Cathay at an issue price of HK\$13.50 per share and cash consideration of approximately HK\$432,894,000. This transaction was approved by the shareholders in the extraordinary general meeting held on 22nd August, 2006.

Upon completion of this transaction, the Company will hold 7.34% equity interests in Cathay and such interest will be classified as available-for-sale investment in the balance sheet and carried at fair value. At 30th June, 2006, the Group’s interest in Dragonair is presented as assets classified as held for sale.

14. Cash and cash equivalents and pledged bank deposits

Cash and cash equivalents and pledged bank deposits include HK\$292,421,000 (31st December, 2005: HK\$250,442,000) which are denominated in Renminbi and are held by the Group and its jointly controlled entities with bank accounts operating in China mainland where exchange controls apply.

**15. Share capital**

	Number of shares (Thousands)	HK\$'000
At 1st January, 2005 and 2006, 30th June, 2006	<u>3,312,680</u>	<u>331,268</u>

The authorised share capital of the Company comprises of 4,000,000,000 shares with a par value of HK\$0.1 per share. All issued shares are fully paid.

16. Trade and other payables

Trade and other payables include trade payables to third parties, an associate, a fellow subsidiary and related companies. The age analysis of trade payables is as follows:

	30th June, 2006 HK\$'000	31st December, 2005 HK\$'000
Within 31 days	193,450	191,664
31 – 60 days	43,502	47,243
61 – 90 days	27,548	17,038
Over 90 days	10,647	9,674
	<u>275,147</u>	<u>265,619</u>

17. Contingent liabilities

	30th June, 2006 HK\$'000	31st December, 2005 HK\$'000
Guarantee for banking facilities granted by bank to:		
– An associate	20,000	20,000
– A jointly controlled entity	13,835	87,475
	<u>33,835</u>	<u>107,475</u>

As of 30th June, 2006, the Group had given a guarantee to a bank for loan facilities granted to a jointly controlled entity of RMB32,250,000 (equivalent to approximately HK\$31,311,000). Loans of RMB30,000,000 (equivalent to approximately HK\$29,126,000) were drawdown by the jointly controlled entity at 30th June, 2006. The Group's proportionate share of bank loans of HK\$17,476,000 had been included in the condensed consolidated balance sheet at 30th June, 2006 (31st December, 2005: HK\$23,070,000).

**18. Commitments**

- (a) The Group is a party to an agreement with third parties (the “Consortium Partners”) in respect of the joint development and operation of Tradeport Logistics Centre at the South Commercial District of Hong Kong International Airport (the “Project”). The Group has 25% interest in the Project. The Group’s attributable share of capital commitments in respect of the Projects is approximately HK\$78,000,000 (31st December, 2005: HK\$78,000,000).

In the event of default of any of the Consortium Partners, the Group will be required to provide additional funds for the Project. The Group and the Consortium Partners have jointly given a guarantee to the Hong Kong Airport Authority in respect of their obligations to provide sufficient funding for the Project. Should the Group be required to perform its obligations under the guarantee in the event of default of all of the Consortium Partners, the maximum amount of the additional liabilities assumed, in addition to the Group’s estimated share of capital commitments as disclosed above, would be approximately HK\$234,000,000 (31st December, 2005: HK\$234,000,000).

- (b) As at 30th June, 2006, the Group had committed to make additional capital contribution to a jointly controlled entity, Macau Asia Express Limited, with an aggregate amount of up to approximately HK\$58,491,000.

(c) Capital commitments

The Group’s attributable share of capital expenditure contracted for by the Group’s jointly controlled entities at the balance sheet date but not yet incurred is as follows:

	30th June, 2006 HK\$’000	31st December, 2005 HK\$’000
Property, plant and equipment	<u>5,667</u>	<u>3,966</u>



19. Related party transactions

The Group is part of a larger group of companies under Air China and has extensive transactions and relationships with members of the Air China group. Because of these relationships, it is possible that the terms of transactions between the Group and members of Air China group are not the same as those that would result from transactions with or among other related parties or wholly unrelated parties.

Air China is controlled by China National Aviation Holding Company (“CNAH”), a state-owned enterprise which is wholly owned by the PRC government. As the Company is indirectly controlled by the PRC government, state-owned enterprises and their subsidiaries, in addition to the group companies of Air China, directly or indirectly owned by the PRC government are also related parties of the Group.

A portion of the Group’s business activities are conducted with other state-owned enterprises. For the purpose of related party transactions disclosure, the Group has identified, to the extent practicable, those corporate customers and suppliers which are state-owned enterprises based on their immediate ownership structure. It should be noted, however, that a substantial portion of the Group’s business activities are conducted in the PRC and the influence of the PRC government in the Chinese economy is pervasive. In this regard, the PRC government indirectly holds interests in many companies. In addition, a portion of the Group’s services provided are of a retail nature to end users, which include transactions with the employees of state-owned enterprises on corporate business, their key management personnel and close family members. Due to the vast volume and the pervasiveness of these transactions, the Group is unable to determine the aggregate amount of these transactions for disclosure. Therefore, the revenue from provision of services disclosed below does not include retail transactions with these related parties. However, the Group believes that meaningful information in respect of related party transactions has been adequately disclosed.



The following is a summary of significant transactions carried out with related parties in the ordinary course of business for the six months ended 30th June, 2006:

(a) Revenue, other gains and expenses

	Six months ended	
	30th June,	
	2006	2005
	HK\$'000	HK\$'000
Revenue and other gains:		
Value of tickets sold to (<i>note i</i>):		
– Immediate holding company	1,511	–
– An associate	659	565
– Fellow subsidiaries	1,367	2,880
– Related companies	423	145
Lease of an aircraft to immediate holding company	–	24,940
Sales of goods (<i>note ii</i>):		
– Immediate holding company	73,084	60,475
– An associate	6,102	5,272
– A fellow subsidiary	–	80
– Related companies	1,924	1,366
– Other state-owned enterprises (<i>note x</i>)	11,258	8,058
Interest income from state-owned banks (<i>note x</i>)	10,072	3,972
	<hr/>	<hr/>
Operating expenses:		
Management fee paid to fellow subsidiaries (<i>notes iii and iv</i>)	4,800	4,800
Landing, loading, parking and other airport charges paid to:		
– A fellow subsidiary (<i>note v</i>)	49,138	42,497
– Other state-owned enterprises (<i>note x</i>)	23,302	19,347
Ground handling costs paid to an associate (<i>note vi</i>)	66,890	63,731
Technical and ground handling costs paid to an associate (<i>note vii</i>)	1,157	1,983
Inflight meal services expenses paid to a related company (<i>note viii</i>)	29,430	24,528
Lease rental paid to fellow subsidiaries (<i>note ix</i>)	827	826
Fuel costs paid to other state-owned enterprises (<i>note x</i>)	50,007	34,200
Finance cost paid to state-owned banks (<i>note x</i>)	504	1,802
	<hr/>	<hr/>



- (i) Air tickets were sold to the related ticket sales agents in accordance with the pricing policy of the Group.
 - (ii) The inflight meal services rendered were charged at terms pursuant to agreements entered into by BACL and SWACL with relevant related parties.
 - (iii) On 28th July, 2005, the Company and China National Aviation Corporation (Group) Limited ("CNACG"), a fellow subsidiary, renewed the management services agreement with the same terms under the management services agreement dated 27th August, 2003. Pursuant to the renewed management services agreement, CNACG has agreed to provide secretarial, personnel, accounting and general office administrative services to the Group for a period of three years from 1st July, 2005 to 30th June, 2008 at a monthly fee of HK\$500,000.
 - (iv) On 4th November, 2005, China National Aviation Corporation (Macau) Company Limited ("CNAC Macau") and CNAC (Macau) Aviation Limited ("CNACAL"), a fellow subsidiary, renewed the management services agreement with the same terms under the management services agreement dated 25th March, 2002. Pursuant to the agreement, CNACAL has agreed to provide general management services including but not limited to secretarial, personnel, accounting and general office administrative services to CNAC Macau for a period of three years from 25th March, 2005 to 24th March, 2008 at a monthly fee of HK\$300,000.
 - (v) The airport related charges paid to ADA-Administrative Airport Limited ("ADA") were by reference to the tariff published by the Macau Airport.
 - (vi) The ground handling services rendered were charged at terms pursuant to agreements entered into by the Group with Menzies Macau.
 - (vii) The technical and ground handling services rendered were charged at terms pursuant to agreements entered into by the Group with Dragonair.
 - (viii) The inflight meal services rendered were charged at terms pursuant to agreements entered into by the Group with Macau Catering Services Company Limited, a 34.5% owned associate held by a minority shareholder of Air Macau.
 - (ix) The Group entered into a lease agreement with Easy Advance Limited and Wise Advice Limited, fellow subsidiaries, pursuant to which Easy Advance Limited and Wise Advice Limited lease office premises and certain car parks to the Group at a monthly rental of MOP141,800 (equivalent to approximately HK\$138,000).
 - (x) The above transactions with other state-owned enterprises and banks were entered into in accordance with the terms as set out in the agreements governing the transactions or as mutually agreed between the parties.
- (b)** On 25th August, 2004, CNACG entered into two license agreements with the Company pursuant to which CNACG has agreed to grant licenses to the Company, free of royalty, for the rights to use those trademarks in Hong Kong and Macau, respectively, so long as the Company is a direct or indirect subsidiary of China National Aviation Holding Company ("License Agreements").

No royalty charge was levied under the License Agreements in respect of the use of these trademarks during the period.



(c) Key management compensation

	Six months ended	
	30th June,	
	2006	2005
	HK\$'000	<i>HK\$'000</i>
Directors' fees	1,697	1,740
Salaries and other short-term employee benefits	3,720	3,778
	5,417	5,518

(d) Period-end balances arising from sales/purchases of goods/services with related parties comprised:

	30th June,	31st December,
	2006	2005
	HK\$'000	<i>HK\$'000</i>
Receivables from related parties		
Immediate holding company	38,108	29,412
An associate	2,218	1,088
A fellow subsidiary	–	240
Related companies	2,210	1,994
Other state-owned enterprises	6,528	6,145
	49,064	38,879
Bank deposits		
State-owned banks	653,803	823,737
Payables to related parties		
An associate	18,074	14,075
Fellow subsidiary	20,181	17,359
Related companies	5,159	4,583
Other state-owned enterprises	23,314	26,887
	66,728	62,904
Short-term bank loans		
State-owned banks	20,324	25,371



中航興業有限公司

CHINA NATIONAL AVIATION COMPANY LIMITED

香港大嶼山香港國際機場東輝路12號中航大廈5樓

5/F., CNAC House, 12 Tung Fai Road, Hong Kong International Airport, Lantau, Hong Kong