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**HAINAN AIRLINES COMPANY LIMITED**

**2005 ANNUAL REPORT**

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## CONTENTS

- I. Important Notice**
- II. Company Profile**
- III. Key Fiscal and Business Data**
- IV. Changes of Share Capital and Shareholders**
- V. Introduction to the Directors, Supervisors and Senior Management Officers**
- VI. Management Structure**
- VII. Brief Introduction to the General Meetings of shareholders**
- VIII. Report of the Board of Directors**
- IX. Report of the Board of Supervisors**
- X. Important Events**
- XI. Financial Accounting Report**
- XII. Documents for Reference**

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## I. Important Notice

1. The Board of Directors of HNA guarantees that there is no significant omission, fictitious description or serious misleading of information and take both individual and joint responsibilities for the truthfulness, accuracy and completeness of the content.
2. The entire board of directors presented the meeting of the BoD.
3. Shine Wing Certified Accountants have issued the standard auditing report.
4. Mr. Chen Feng, who is in charge of the Company, Mr. Zhang Yi who is in charge of the Company's financial works, Mr. Xie Shufeng, who is in charge of the financial institutions of the Company, hereby declare that: They guarantee the accuracy and completeness of the financial report in this report.

## II. Company Profile

1. Registered Chinese name : 海南航空股份有限公司 (shortened as 海南航空)  
Registered English name : Hainan Airlines Co., Ltd (Shortened as HNA)

2. Legal Representative: Chen Feng

3. Information of the Secretary to the Board and the Security Representative

Secretary to BoD: Zhang Shanghui

E-mail: sh\_zhang@hnair.com

BoD representative of security affairs: Lv Guangwei

E-mail: gw\_lv@hnair.com

Office Address: Haihang Development Building, 29 Haixiu Road, Haikou, Hainan, China.

Tel: 0898-66739961

Fax: 0898-66739960

4. Registered Address: 168 Airport West Road, Haikou, Hainan, China

Office Address: Haihang Development Building No.29 Haixiu Road Haikou

Zip Code: 570206

Website: <http://www.hnair.com>

Email: [webmaster@hnair.com](mailto:webmaster@hnair.com)

**5. Designated Newspapers to Publish HNA's Information:**

China Securities News, Shanghai Securities News, Wen Wei Po (Hong Kong), Securities Times

**Website Publishing the Report:** <http://www.sse.com.cn>

**Annual Report Available at:** Securities Department of HNA

**6. Stock Listed at:** Shanghai Stock Exchange

**Stock Name:** Hainan Airlines

**Stock Code:** 600221

**Stock Name:** HNA B share

**Stock Code:** 900945

**7. Miscellaneous**

**Date and place of the first incorporation registration:** October 1989 in Haikou

**Registered number of business operation certificate:** Qi Gu Qiong Zong Zi No. 008368

**Registered number of taxation certificate:** 1150805791

**Address of the Accounting Firm:**

**Domestic Accounting Firm:** Shine Wing Certified Accountants

**Office address:** 6 XinYuan Nan Lu, Chaoyang District, Beijing

**Overseas Accounting Firm:** Price Water House Coopers Public Accounting Firm

**Office address:** 10 Hysan Avenue, Causeway Bay, Hongkong

**III. Key Fiscal and Business Data**

**1. Key Fiscal and Business Data of this year:**

Monetary Unit: RMB Yuan

Total amount of Profit (RMB):	-218,697,815
Net Profit (RMB):	-215,817,924
Net profit after non-recurring profit and loss (RMB):	-287,105,924
Profit from principal business (RMB):	1,534,364,998
Profit from other operations (RMB):	97,715,237
Operating profit (RMB):	-269,556,308
Income from investment (RMB):	-15,834,919
Subsidy Income (RMB):	49,411,000
Net cash flow from operating activity (RMB):	17,282,412
Net cash increase (RMB):	3,013,251,601
Net profit (according to the International Accounting Regulation)	2,538,240,537

2. Adjustments to premium profit to the consolidated shareholders with statutory accounts in China in accordance with international accounting standards (IAS)

	Profit proportion of the shareholders RMB 1,000		Consolidated Net Assets RMB 1,000	
	Dec. 31st 2005	Dec. 31st 2004	Dec. 31st 2005	Dec. 31st 2004
As per domestic audited accounts	-215,818	90,649	1,428,639	2,712,976
As per IAS and other adjustments				
Amortization of Long-term deferred Expenses	27,703	-49,378	-201,065	-173,366
Increase in interest of finance lease	-41,378	-28,149	-270,730	-312,108
Depreciation Adjustment	12,370	45,535	-46,389	-34,019
Adjustment to the business credit	2,061	871	8,895	10,956
Influence of deferred tax		-44,218		
Income from selling the equity of affiliated and joint operation companies		20,323		-24,969
Other			-430	-430
<b>After IAS and other adjustments</b>	<b>-215,062</b>	<b>35,633</b>	<b>918,920</b>	<b>2,179,040</b>

3. Non-recurring profit and loss

Monetary Unit: RMB thousand Yuan

Non-recurring profit and loss	Amount
Profit and loss from disposal of other assets except for the Company's assets	32,639
Government subsidies in variety	38,895

Profit and loss on Trust investment	165
Non-operation income and expenditure after provision of assets decrement	-1,384
Transferred-in from the various decrement provision drawn in previous years	973
<b>Total</b>	<b>71,288</b>

#### 4. Key Fiscal Data of the Previous Three Years As of the end of the Fiscal Year

Monetary Unit: RMB Yuan

	2005	2004	Increase/Decrease (%)	2003
<b>Profit from principal business</b>	10,061,468,423	8,410,538,692	19.63	5,372,091,313
<b>Total profit</b>	-218,697,815	76,514,150	-385.83	-1,242,202,407
<b>Net profit</b>	-215,817,924	90,648,787	-338.08	-1,052,291,380
<b>Net profit after non-recurring profit and loss</b>	-287,105,924	-124,816,213	-130.02	-1,049,179,976
<b>Income per share</b>	-0.30	0.12	-338.08	-1.44
<b>Rate of return on equity (%)</b>	-7.96	6.35	-14.31	-79.86
<b>Equity ratio after non-recurring profit &amp; loss (%)</b>	-10.58	-8.74	-1.84	-79.62
<b>Equity ratio after non-recurring profit &amp; loss (weighted average) (%)</b>	-13.86	-9.09	-4.77	-56.95
<b>Net cash flow from operating activities</b>	3,013,251,601	3,194,243,082	-5.67	-644,977,250
<b>Net cash flow per share from operating activities</b>	4.13	4.37	-5.67	-0.88
	<b>Dec 31, 2005</b>	<b>Dec 31, 2004</b>	<b>Increase/Decrease (%)</b>	<b>Dec 31, 2003</b>
<b>Total assets</b>	30,690,976,784	25,327,877,356	21.17	23,320,694,920
<b>Shareholders' equity (without the minority interests)</b>	2,712,975,810	1,428,638,756	89.90	1,317,666,515
<b>Net assets per share</b>	3.72	1.96	89.90	1.80
<b>Net assets per share after adjustment</b>	2.67	1.16	130.35	1.07

5. Changes in Shareholder's Equity

Item	Share Capital	Capital Reserve	Surplus Reserve	Statutory Public Welfare Fund	Undistributed Profit	Total Shareholders' Equity
Period Beginning	730,252,801	1,058,729,373	116,002,855	53,094,720	-529,440,993	1,428,638,756
Increase	0	1,500,154,978			-215,817,924	1,284,337,054
Period End	730,252,801	2,558,884,351	116,002,855	53,094,720	-745,258,917	2,712,975,810

IV. Changes in Share Capital and Major Shareholders

I. Changes in Share Capital

1. Share Changes

Unit: Share

	Period-beginning	Bonus Share Distributed					Period-end
1. Unlisted Share							
1) Founders' share	134,836,555					134,836,555	
Incl. :							
State share	17,289,355					17,289,355	
Domestic legal person share	117,547,200					117,547,200	
2) Collection legal person share	38,735,280					38,735,280	
3) Employee share							
Total Unlisted Share	173,571,835					173,571,835	
2. Listed Share							
1) RMB Ordinary share	371,957,765					371,957,765	

2) Foreign share listed at home (B share)	184,723,201						184,723,201
Total Listed Share	556,680,966						556,680,966
3. Total share	730,252,801						730,252,801

## 2. Share Issuing and Listing

- 1) By the end of report period, in the recent three year, there is no new share issuance or listing.
- 2) Since there's no share distribution, ration, new-issuance or transferring into share capital occurred in the report period, the structure and total amount of the Company's shares kept unchanged.
- 3) At the end of the report period, there is no employee share of the Company.

## II. Shareholders

### 1. Number of shareholders and amount of shares held

Unit: Share

Total number of shareholders at the end of report period	125,247				
<b>Shareholding status of the top ten shareholders</b>					
Shareholder	Character of the Shareholder	Equity Percentage (%)	Shares Held (In share)	Amount of Non-circulation Share Held	Amount of Impawned or Frozen Shares
American Aviation LDC	Foreign shareholder	14.80	108,043,201	0	unknown
HNA Group Co., Ltd.	other	11.85	86,549,000	79,844,400	8,320,000 impawned
Hainan Qixing Industrial Investment Co., Ltd.	other	6.83	49,904,680	46,619,280	47,890,000 impawned
Hainan Jincheng State Property Administration Company Ltd.	State shareholder	2.37	17,289,355	17,289,355	unknown
Bank of Communication, Hainan Branch	other	0.89	6,480,000	6,480,000	unknown
China International Travel Agency (head office)	other	0.89	6,480,000	6,480,000	unknown
Beijing Tianye Commerce and Trade Company (head office)	other	0.59	4,320,000	4,320,000	unknown
Naito Securities Co., Ltd.	other	0.45	3,272,128	0	unknown
China Industrial Trust & Investment Company, Hainan office	other	0.44	3,240,000	3,240,000	unknown
China Education, Science & Technology Trust and Investment Company Limited	other	0.41	2,970,000	2,970,000	unknown
<b>Shareholding status of the top 10 shareholders of circulation share</b>					
Shareholders	Circulation Shares Held			Share Type	
American Aviation LDC	108,043,201			B Share	
HNA Group Co., Ltd.	6,704,600			A Share	
Hainan Qixing Industrial Investment Co., Ltd.	3,285,400			A Share	

Naito Securities Co., Ltd	3,272,128	B Share
Wu Qiang	1,745,600	A Share
Shanghai Zhongcai Guarantee Company Limited	1,339,792	A Share
He Jun	1,231,426	A Share
Hainan Hongkong & Macao International Trust & Investment Company Ltd.	1,150,848	A Share
Haikou Ai Sai Ke Industrial & Trade Company Limited	1,036,800	A Share
Zhang Guiquan	1,034,090	A Share
Note to the connected relationship or concerted action among the shareholders	The Company knows neither whether there's any connected relationship among shareholders of circulation shares nor any of them are concerted actor of Regulations on Information Disclosing of Changes in the Shares Held by the Shanghai Listed Company.	

Note: No strategic investors or ordinary legal person ranked in the top 10 shareholders of the Company through placement of new shares.

## 2. Introduction to the controlling shareholder and actual controlling party

### (1) Information of the controlling shareholder

**Name of the Company:** American Aviation LDC

**Legal representative:** Ronald O. Drake

**Date of establishment:** July 7<sup>th</sup> 1995

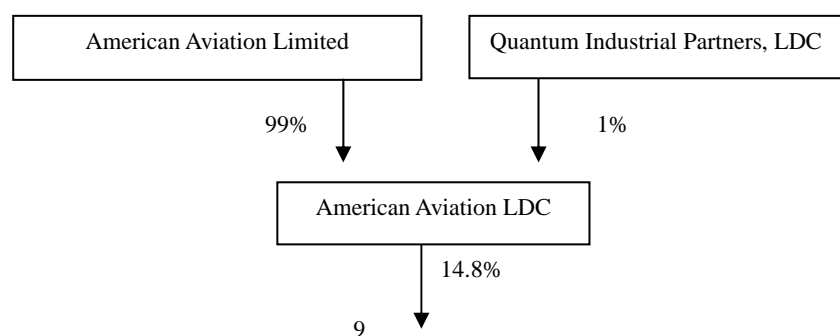
**Registration capital:** 50,000 common stock and USD 1 per share

**Main business and products:** deals with investment, obtaining and holding, on behalf of the company itself or any designated person, stocks, bonds, loan stock, bills and other securities issued or guaranteed by any government, sovereign ruler, consignor, public institution or highest authority, independent governing authority, municipal or local government across the world.

### (2) Changes in the controlling shareholder and actual controlling party

There is no change of the controlling shareholder and actual controlling party in the report period.

### (3) The chart of the assets right and controlling relations between the Company and its actual controlling party



Hainan Airlines Co., Ltd

**4. Other legal person shareholders holding over 10% shares**

Name of the Shareholder	Legal representative	Registered Capital	Date of establishment	Main business and products
HNA Group Company Limited	Chen Feng	RMB 500,000,000	Apr. 16 <sup>th</sup> 1998	Airlines transport, investment and management in airport and hotel golf court; information technology service; investment and development in real estate; import and export trade of airplane and related materials (operating according to the license); investment in energy, transport, new technology and new material.

**V. Directors, Supervisors, Senior Managers and Staff**

**I. Current directors, supervisors, senior managers and staff**

Unit: 1,000 shares

Name	Position	Sex	Age	Service Term	Shares Held at the Beginning of the Year	Shares Held at the End of the Year	Causes for Change	Total Salary Withdrawn from Company in Report Period (RMB 1,000 Yuan)
Chen Feng	Chairman	Male	53	2003-05-13 ~ 2006-05-13	41.4	41.4		243.6
Wang Jian	Vice Chairman	Male	45	2003-05-13 ~ 2006-05-13	36.2	36.2		217.2
Tan Xiangdong	Director	Male	39	2003-05-13 ~ 2006-05-13	25.9	25.9		80
Li Qing	Director	Male	49	2003-05-13 ~ 2006-05-13	37.5	37.5		195.6
Ke Deming	Independent Director	Male	71	2003-05-13 ~ 2006-05-13	----	----		80
Yang Hui	Independent Director	Male	68	2003-05-13 ~ 2006-05-13	----	----		80
Wang Zhi	Independent Director	Male	64	2003-05-13 ~ 2006-05-13	----	----		80
Ronald O. Drake	Director	Male	50	2003-05-13 ~ 2006-05-13	----	----		80
Iain Aitken	Director	Male	52	2003-05-13 ~	----	----		80

				2006-05-13				
<b>Zhang Cong</b>	Organizer of the Board of Supervisors	Male	47	2003-05-13 ~ 2006-05-13	----	----		25
<b>Li Rui</b>	Supervisor	Male	29	2003-05-13 ~ 2006-05-13	----	----		25
<b>Chen Ping</b>	Supervisor	Male	31	2003-05-13 ~ 2006-05-13	----	----		25
<b>Qian Daoyun</b>	Supervisor	Male	55	2003-05-13 ~ 2006-05-13	----	----		25
<b>Zhao Zongtao</b>	Supervisor	Male	54	2003-05-13 ~ 2006-05-13	----	----		25
<b>Zhu Yimin</b>	CEO	Male	45	2003-04-12 ~ 2006-04-12	----	----		177.5
<b>Zhao Zhongying</b>	Executive President	Male	58	2003-04-12 ~ 2006-04-12	----	----		144
<b>Wang Yingming</b>	Executive Vice-president	Male	43	2003-04-12 ~ 2006-04-12	----	----		133
<b>Zhang Yi</b>	CFO	Male	35	2003-04-12 ~ 2006-04-12	----	----		140.6
<b>Zhang Shanghui</b>	Secretary of the BoD	Male	35	2003-04-12 ~ 2006-04-12	----	----		115.6

#### Resume of the directors, supervisors and senior managers

**Chen Feng:** chairman of BoD of HNA, male, born on June 24, 1953, senior economist. He's also the Chairman of HNA Group. He was graduated from Germany Lufthansa Airlines Air Traffic Management College in 1984. Later, he obtained the master degree of business administration of Masteryherthe School of Management of Holland and in 2004, he obtained the senior management certificate of Harvard University. Having been working with the planning department of CAAC and State Air Traffic Control Bureau for many years. He had been invited to attend and make presentations at the annual meeting of the World Economy Forum and the meeting of APEC. He was the member of the Standing Committee of Hainan Provincial People's Congress, chairman of Hainan Entrepreneurs Association, chief vice director of Hainan General Chamber of Commerce and vice chairman of China Traffic & Transportation System Engineering Society. In 1996, he was granted titles as the Most Outstanding Entrepreneurs of China, National Model Worker and received the May Day Labor Medal. In 1997, he was awarded the International Outstanding Entrepreneurs Contribution Prize by Sino-US Friendship Association and US Association of Medium & Small Enterprises. In 2000, he was re-entitled as the Merit Entrepreneur of Hainan. In April 2002, he was elected to be the delegate of the 16<sup>th</sup> China Communist Party Congress, the national committee member of the 10<sup>th</sup> Chinese Political Consultative Conference and he was invited as the guest professor of several famous universities.

**Wang Jian:** vice chairman of HNA, male, born on Dec 15, 1961, MBA. He had been studied abroad at JAL and obtained AOTS and diploma of JAL. He's well experienced in the field of air transportation and finance.

**Tan Xiangdong:** Male, born on March 24, 1967, director of the BoD of HNA. He was graduated from Beijing Finance & Trade Institute and majored in finance. In 1989, he was conferred the master degree of economics. In 1999, he obtained the master degree of business and administration of American College of Insurance. He worked with World Bank Loan Office of China Rural Trust & Investment Company, Hainan World Bank Loan Office, China Xingnan Group Company and Hainan American Company Limited.

**Li Qing:** Male, born on March 18, 1957, MBA, director of the BoD of HNA. At present, he is the

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director and general manager of Shan'xi Airlines. He's well experienced in the planning and administration of civil aviation.

**Ke Deming:** Male, born on Nov 1, 1935, the independent director of HNA, senior engineer. He joined the army in 1951, graduated from the Beijing Aviation College. He worked as the vice director of CAAC.

**Yang Hui:** Male, born on Dec 27, 1938, the independent director of HNA, bachelor degree. He began to work at 1956, joined the Communist Party of China in 1980, obtained the senior accounting/auditing certificate in 1988, and in 1995 obtained the CPA (Certified Public Accountants). Mr. Yang Hui worked as the accountant of Economy and Trade Committee of Hainan Province, the head of the administration department and vice director of Economy and Trade Committee of Hainan Province, the vice head of Economy Inspection department of Hainan Province, the head of the Auditing Department of Hainan Province, the director of the Financial section of the Standing Committee of People's Congress of Hainan Province.

**Wang Zhi:** Male, born on May 20, 1942, the senior engineer, independent director of HNA. He has been the engineer of the Chen Yang Aircraft Design office, the director of the Planning department of CAAC, the standing director of China Aviation Committee, the independent director of China Southern Airlines Company and Shan Dong Airlines Company.

**Ronald O. Drake:** Male, director of the BoD of HNA. He was graduated from Cornell University and had obtained the master degree of Business and Administration of New York University. He had been worked with Soros Fund Management Company as the strategic investment director, ABN AMRO Group as the senior vice president, Merrill Lynch Group as the executive director.

**Iain Aitken :** Male, graduated from the University of Sterling in Scotland with a bachelor's degree in economics. Iain Aitken had been vice president of the Europe-America Bank in New York, and vice president of ABN-AMRO Bank NV in New York in North America. Mr. Iain Aitken had also been an advisor on North America and related affairs for ABN-AMRO Bank NV in New York and has been a senior advisor to the Managing Board of Soros Private Funds in New York since 2000.

**Zhang Cong:** Male, born on Feb 1, 1959, supervisor of HNA with the term of 2003-2006. He was graduated from China Civil Aviation College. He is the general manager of the department of project of HNA Group.

**Li Rui:** Male, born on Jan 5, 1977, supervisor of HNA with the term of 2003-2006. He worked in the securities department of HNA Group.

**Chen Ping:** Male, born on Feb 15, 1975, supervisor of HNA with the term of 2003-2006. He was graduated from Fu Dan University with bachelor degree. At present, he worked in the general administration department of HNA.

**Qian Daoyun:** Male, born on April 19, 1951, supervisor of HNA with the term of 2003-2006. He was the vice director of Communication Bank Hainan Branch.

**Zhao Zongtao:** Male, born on Feb 25, 1952, supervisor of HNA with the term of 2003-2006.

**Zhu Yiming:** Male, born on Oct 16, 1961, CEO of HNA with the term of 2003-2006, master degree. He was graduated from Xia Men University. He worked as the assistant to the general manager of Xia Men Airlines.

**Zhao Zhongying:** Male, born on Feb 28, 1948, executive president of HNA with the term of 2003-2006.

**Wang Yingming:** Male, born in 1963, vice executive president of HNA with the term of 2003-2006. He worked as the general manager of maintenance department of HNA and vice general manager of Yangtze River Express Company Limited.

**Zhang Yi:** Male, born on Dec 1, 1971, bachelor degree. In 1995, he was graduated from Wu Han University, CFO of HNA.

**Zhang Shanghui:** Male, born on Dec 13, 1971, the secretary to the Board with the term of 2003-2006.

## II. Directors and supervisors who act at the shareholder's unit

Name	Shareholder's Unit	Position	Service Term	Payment or Allowance Drawn (Yes/No)
Chen Feng	HNA Group Company Ltd	Chairman	Present-April 16 of 1998	Yes
Wang Jian	HNA Group Company Ltd	Vice chairman	Present-April 16 of 1998	Yes

Mr. Chen Feng and Mr. Wang Jian act as the chairman and vice chairman since the founded of HNA Group.

Act in the other unit

Name	Unit	Position	Service Term	Payment or Allowance Drawn (Yes/No)
Wang Zhi	Shan Dong Airlines Co., Ltd, China Southern Airlines Co., Ltd	Independent director		Yes
Ronald O. Drake	American Aviation LDC	Legal representative		Yes
Iain Aitken	Soros Private Funds	Senior consultant		Yes

## III. Annual Reward

**1. The reward of directors, supervisors and senior managers:** the reward of directors is distributed according to the Stipulation on HNA President Fund passed through on the Board Meeting and the General Meeting of Shareholders, the reward of senior managements was distributed according to the items on annual evaluation of the management and their performance during the year.

## IV. Directors and, supervisors and senior managements resigned during the report period and the reason

Name	Position	Resignation reason
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Shu Weidong	Vice executive president	Change of Post
Du Xiaopong	Vice executive president	Change of Post
Qin Jianmin	Vice executive president	Change of Post

Except above stated, there is no other directors and, supervisors and senior managements resigned during the report period.

#### V. Staff

By the end of the report period, HNA has 9102 staffs in total including 1520 pilots, 1736 light stewardess, 1388 maintenance personnel, 199 technical personnel, and the other is 4278. Among these employees, 101 people have the post graduate degrees, 2813 people have undergraduate degrees, 2968 people were graduated from junior colleges, and 3220 people received professional education. There were 53 retired employees.

### VI. Administration Structure of HNA

#### I. Current Structure

Ever since its listing, HNA has been perfecting the legal representatives administration structure, regulating its operation, and enhancing the information release, strictly in accordance with the requirement of *the Company Law*, *the Security Law*, the related regulations by CSRC and *Listing Regulation of SSE*. And here is the brief of the current administration construction:

**1. Shareholders and Meeting of Shareholders:** HNA ensures that all shareholders, especially the small and medium ones, enjoy the same status and rights equally as the major ones. The company website has been established to keep efficient communications with shareholders and make them aware of the operating situation of the Company. Regulation on shareholders meeting was formulated, and the General Meetings of Shareholders were held strictly according to *The Rules of the General Meeting of Shareholders* issued by CSRC while the shareholders were encourage to participate in the meetings and to vote as much as possible and lawyers are employed to present as witnesses. The pricing of the related business cooperation is fair, all the related business cooperation is legal and effective by strictly following the procedures of BoD and Board of Supervisors as stipulated by *Listing Regulation of SSE*.

**2. Holding Shareholders and HNA:** The holding shareholders exert their rights through General Meetings of Shareholders, and are not directly involved in the policy-making and operation and management of HNA. HNA is

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independent with the holding shareholders in staff, assets, finance, constructing and business, and the BoD, Board of Supervisors and the interior departments can run independently.

**3. Directors and BoD:** HNA employs the directors strictly according to the Articles of Association of HNA. The number and organization of directors agree with the laws, stipulation and the Articles of Association of HNA. The directors of HNA attend the meetings of BoD and meetings of shareholders seriously, and are familiar with the related laws and stipulation, and aware of their rights, obligation and responsibility as a director.

**4. Supervisors and the Board of Supervisor:** The number and organization of Board of Supervisor agree with the laws, stipulations and the Articles of Association of HNA. *Rules on Process of Board of Supervisors* has been formulated, and perfected during practice. Supervisors of the HNA perform their responsibility seriously and supervise the performance of directors, managers and other senior management personnel.

**5. Evaluation, encourage and restriction mechanism:** HNA is actively formulating a just and transparent evaluation criterion and encouraging and restriction mechanism of directors, supervisors and managers. The employments of managers are exoteric and transparent, and comply with the related laws and stipulations.

**6. Related beneficiary:** HNA safeguards the legal rights and interests of the Banks, legal representatives, customers and other interest-related parties so as to maintain the sustainable and healthy development of HNA.

**7. Information release and transparency:** The secretary to the BoD is appointed to be in charge of the information release, reception and consultation, and enhance the communication with shareholders. HNA releases the true and complete information in time according to the related laws, stipulations and constitutions of HNA so that all the shareholders enjoy the equal opportunity to get the information. HNA releases in time the detailed information and the changes of major shareholders or the actual controlling party of the Company in accordance with related regulations.

## II. Performance of the Independent directors

### 1. Performance of independent director attending the board meeting

Name of the independent director	Time of attending the meeting	Attend personally
Ke Deming	8	8
Yang Hui	8	8
Wang Zhi	8	8

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By now, the Company has three independent directors. In the report period, Mr. Key Deming, Mr. Yang Hui and Mr. Wang Zhi voted on 10<sup>th</sup> Sessions of 4<sup>th</sup> Board Meeting – 17<sup>th</sup> Sessions of 4<sup>th</sup> Meeting of BoD, they have fulfilled his obligation as an independent director.

2. Situation of demur from independent directors on the Company's related issues

In 2005, there is no any demur from independent directors on proposal of the board and other issues.

**III. Independence of the Company with HNA Group in Staff, Assets, Finance, Operation and Organization:**

1. HNA mainly deals with air passenger and cargo transportation. The production system, assisting production system and the sale system were independent from HNA Group Co., Ltd. HNA is independent from any shareholder company or related ones.

2. The Company has established the complete legal representative construction according to *The Company Law*. The general manager, deputy general manager and finance staffs do not hold any positions in the shareholders' companies or related companies, with the only exception that the Chairman of the BoD is also the Chairman of the HNA Group Co., Ltd. And in the Company the independent and complete management system and constitution were established. The Company is independent in staff from the holding shareholders.

3. The Company has its own independent flight system, auxiliary flight system, corresponding facilities and equipment, real estate and trademark, and the delimitation in industrial property rights and non-patent technology is clear. The unavoidable relating dealings are completed according to the normal commercial stipulations, and the related directors fulfill the avoiding process according to the Constitution of HNA during voting on the General Meeting of Shareholders. The Company maintains relative assets integrity from the controlling shareholders.

4. The Company has independent President Administration Office, Office of Secretary to BoD, Operation Center, Planning & Financing Department, Human Resource Department, Operation Supporting Department, Marketing & Sale Department, Flight Operations Department, and Maintenance & Engineering Department. The administration offices and operation locations are completely separated and independent.

5. The Company has an independent financial department and has established independent accounting & managing system and separate bank accounts. HNA has its own tax registration number and it is independent in finance from the controlling shareholders.

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#### **IV. Evaluation, Encouragement and Reward Mechanism to Senior Management**

The annual rewards of the senior managers are monthly distributed according to the related stipulation of salary control formulated by the Company. The Human Resource Department formulated the salary system according to the operation of the Company, and submits to BoD to be considered.

The senior management evaluation system consists of the schema of organizer evaluation, the performance survey of other staff by the President of BoD, the routine reward stipulation of the Company and the evaluation schema of the general staff.

Moreover, the Company is employing a professional agency to formulate the evaluation and reward schema such as promissory shares, staff shareholder schema and annual salary system, etc.

#### **VI. Brief Introduction to the General Meetings**

##### **1. Annual General Meeting of Shareholders**

On May 30 of 2005, it was held at the conference hall on 4th floor of Haihang Development Mansion, 29 Haixiu Rd., Haikou, Hainan province.

The resolution of the meeting was published on the China Securities News, Shanghai Securities News, Hong Kong's Wen Wei and Securities Times of May 31, 2005.

##### **2. Temporary General Meeting of Shareholders of 2005**

On May 24, 2005, the Company held the first temporary general meeting of shareholders of 2005.

The resolution of the meeting was published on the China Securities News, Shanghai Securities News, Hong Kong's Wen Wei and Securities Times of May 25 of 2005.

#### **VII. Report of Board of Directors**

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## **I . Discussion and analysis of the managements**

### **1 Review of the overall operation status in the report period**

In the fiscal year of 2005, the income from principal business of the Company reached RMB 10.061 billion Yuan, up 19.63% comparing with that of the previous year, which included the income from passenger transportation for RMB 9.125 billion Yuan, 90.7% of the income from principal business; the income from cargo transportation and surcharge on overweight baggage for RMB 312 million Yuan, 3.1% of the income from principal business; the income from aircraft charter for RMB 623 million Yuan, 6.19% of the income from principal business. The profit from principal business of the Company reached RMB 1.534 billion Yuan in 2005.

In the year of 2005, the volume of passenger transportation reached 12,801,600 person-times, up 16.91% over that of the previous year; cargo and mail air transportation reached 162,200 tons, up 13.11% over that of the previous year; the transportation turnover reached 1.81 billion ton kilometers, up 15.60% over that of the previous year.

In the report period, the Company imported thirteen aircraft, including seven B737-800 liners and six A319. By the end of December 2005, the Company had 95 aircraft, including fifty-three B737, six A319, five B767, twenty-nine D328 and two DH4.

The increase in the principal business of the Company was contributed by the increase in the transportation capacity and volume. The increase in the cost on principal business was contributed by the price rising of aviation fuels, etc. The increase in the profit from principal business and net profit was contributed by the increase in the income from principal business.

There's no significant change to the assets and profit structure in the report period.

The net cash flow of the operations of the Company was RMB 3.013 billion Yuan, decreased RMB 181 million Yuan comparing with that of the same period of last year, which was caused by the price rising of the aviation fuel. The net cash flow of the investment of the Company was RMB -3.782 billion Yuan, increased RMB -1.313 billion Yuan comparing with that of the same period of last year, which was caused by increase in aircraft purchasing. The net cash flow of capital collection of the Company was RMB 3.307 billion Yuan, increased RMB 3.896 billion Yuan comparing with that of the same period of last year, which was caused by increase in the directional ration of stocks.

### **2. Operation situation and performance of holding companies and other companies**

#### **1. China Xinhua Airlines Co., Ltd.**

The registered capital of China Xinhua Airlines Co., Ltd is RMB 1.83 billion; the business scope is approved air passenger and cargo transportation. In the report period, the income from principal business was RMB 2.65 billion Yuan and the net profit was RMB 2.64 million Yuan. The Company holds 51% equity interests.

#### **2. Chang'an Airlines Co., Ltd.**

The registered capital of Chang'an Airlines Co., Ltd. is RMB 754,390,000; the business scope is air passenger and cargo transportation in Shanxi Province and its surrounding provinces. In the report period, the income from principal business was RMB 1.201 billion Yuan and the net profit was RMB -5.67 million Yuan. The Company holds 73.51% equity interests.

#### **3. Shan'xi Airlines Co., Ltd.**

The registered capital of Shan'xi Airlines Co., Ltd. is RMB 320 million; the business scope is air passenger and cargo transportation in Shan'xi Province and its surrounding provinces. In the report period, the income from principal business was RMB 987 million Yuan and the net profit was RMB 10.25 million Yuan. The Company holds 92.51% equity interests.

### 3. Future Development Layout of the Company

1) Developing trend of aviation industry and market competition faced by the Company:

According to the prediction of the planning department of the CAAC, the yearly increase of total turnover, amount of passenger transportation, cargo and mail transportation reached 10% averagely. In the 2002 Market Prediction in China of Boeing, its predicted that China would become the second big civil aviation market within 20 years. The average increase of passenger transportation of China civil aviation would be 11% per year during 2004-2008. By 2008, the total passenger transportation volume would be 160,200,000 persons. Owing to entering into the WTO, the civil aviation industry of China speed up to open to the outside. Overseas airlines company started to enter into the air traffic market of our country and competition at the domestic civil aviation market becomes more and more severe.

2) Developing strategy and operation plan of next year:

To establish outstanding aviation brand of China will be the developing target of the Company. It will take the efficiency and profit as the working center, stick to the principle of safe production and risk prevention, improve the quality of safety, operation and management to realize the second take-off of the Company.

In 2006, the working target is set to reach passenger transportation of 15,465,400 persons, up 20% over previous year; cargo and mail transportation of 199,100 tons, up 22% over previous year; total turnover of 2,207,420,000 ton kilometers, up 23% over that of the previous year.

3) Demand of capital and its utility

It's estimated that the capital of RMB 6.86 billion Yuan will be needed to achieve the operation target of 2006, which will be collected through bank loan, short-term financial bonds, assets securitization, etc.

4) Analysis on risks which the Company facing

The long-term raising price of the aviation fuel caused certain negative influence on the operation of the Company. If the fuel price continues to raise, the future operation of the Company will face negative effect.

## II. Status of the principal business classified according to the industry and product

1. Status of the principal business classified

Principal Business	Income from Principal Business	Cost on Principal Business	Profit Percentage of Principal Business	Increase/Decrease of the Income from Principal Business	Increase/Decrease of the Cost on Principal Business	Increase and Decrease of the Profit Percentage of Principal Business
Aviation	10,061,468,423	8,211,652,702	15.25	19.63	28.98	-5.81%

Industry						
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## 2. Status of principal business classified according to its distribution

Distribution	Income of Principal Business	Increase/Decrease of the Income from Principal Business Compare with Previous Year (%)
Haikou	5,242,591,350	20.6
Beijing	2,650,498,836	-0.25
Xi'an	1,201,050,205	69.23
Taiyuan	986,788,791	42.81

## III. Investment Situation of the Company

In 2005, the Company's total investment is RMB 40,555,000 Yuan, decreased by RMB 796,938,000 (95.15%) than that in previous year.

A. Pursuant to reorganization and business development, Yunnan Xiangpeng (with former name "Shilin Airlines Co., Ltd.) was jointly established by HNA Group, Shanxi Airlines, Yunnan Shilin Airlines with monetary capital in November 2005, which has been approved by the first temporary general meeting of shareholders held on 24 January 2006. The registered capital of Yunnan Xiangpeng is 150,000 thousand: HNA Group has a 67.95% interest ( 101,927 thousand), Shanxi Airlines has a 31.38% Interest ( 47,073 thousand), and Yunnan Shilin Airlines has the rest of 0.67% interest ( 1,000 thousand). In according with the validation report (Kun Ya Hui Yan Zi No. [2005] 1-105), the process of the increased share capital has been completed on 18 November 2005. Yunnan Xiangpeng is still in organization period until the end of 2005.

B. In February and August 2005, the Company transferred its 20% interest in Beijing Tianchen Exhibition Co., Ltd. and Beijing Hengshi Real Estate Development Co., Ltd. to Xian Minsheng Real Estate Co. Ltd at the price 1,200 thousand and 5,800 thousand respectively.

Company	Scope of business	Percentage
Yunnan Xiangpeng Co., Ltd	Aviation transportation	31.38%

### 1. Usage of the collected capital

In 2005, there is no collected capital for the company. The money collected in the previous year is not used either during this period.

### 2. Introduction to non-collected capital

In the report period, there is no investment for non-collected capital.

## IV Routine Work of Board of Directors

### 1. Meeting of Board of Directors

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1.1 On Jan 27, 2005, the 10th session of the 4th Board Meeting of the Company was held, the resolution announcement was published on China Securities News, Shanghai Securities News, Securities Times and Hong Kong's Wen Wei Po of Jan 28, 2005.

1.2 On April 21, 2005, the 11th session of the 4th Board Meeting of the Company was held, the resolution announcement was published on China Securities News, Shanghai Securities News, Securities Times and Hong Kong's Wen Wei Po of April 22, 2005.

1.3 On April 27, 2005, the 12th session of the 4th Board Meeting of the Company was held, the resolution announcement was published on China Securities News, Shanghai Securities News, Securities Times and Hong Kong's Wen Wei Po of April 28, 2005

1.4 On April 29, 2005, the 13th session of the 4th Board Meeting of the Company was held, the resolution announcement was published on China Securities News, Shanghai Securities News, Securities Times and Hong Kong's Wen Wei Po of April 30, 2005.

1.5 On May 25, 2005, the 14th session of the 4th Board Meeting of the Company was held, the resolution announcement was published on China Securities News, Shanghai Securities News, Securities Times and Hong Kong's Wen Wei Po of May 26, 2005.

1.6 On August 29, 2005, the 15th session of the 4th Board Meeting of the Company was held, the resolution announcement was published on China Securities News, Shanghai Securities News, Securities Times and Hong Kong's Wen Wei Po of August 30, 2005.

1.7 On Oct 28, 2005, the 16th session of the 4th Board Meeting of the Company was held, the resolution announcement was published on China Securities News, Shanghai Securities News, Securities Times and Hong Kong's Wen Wei Po of Oct 24, 2005.

1.8 On December 23, 2005, the 17th session of the 4th Board Meeting of the Company was held, the resolution announcement was published on China Securities News, Shanghai Securities News, Securities Times and Hong Kong's Wen Wei Po of December 24, 2005.

## 2. Subsequent events on resolution of the general meeting of shareholders

On May 24, 2005, the first temporary general meeting of shareholders has authorized the Board of directors to handle the related matters of the targeted issuance. Pursuant to the authorization, the Board of Directors is negotiating with strategic

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investors.

#### V. Profit Distribution Preplan / Preplan for Capitalization of Capital Reserve in 2005

By the end of the fiscal year of 2005, the after-tax profit of the Company audited in accordance with the domestic auditing principle is RMB –215,820,000 Yuan, while after-tax profit audited in accordance with the international auditing principle is RMB-215,060,000 Yuan.

The Company will not take any profit distribution and the capital reserve will not be transferred into shares capital in this fiscal year.

#### IX. Report of the Board of Supervisors

##### Works of the Board of Supervisors:

1. On April 27 of 2005, the 3<sup>rd</sup> session of the 4<sup>th</sup> board of supervisors was held. During the meeting, the Working Report of the Board of Supervisors of 2004, the Report on the Annual Report and the Annual Report Summary of 2004 and the Report on Changing the Accounting policy were considered and passed.
2. On August 30 of 2005, the 4<sup>th</sup> session of the 4<sup>th</sup> board of supervisors was held. During the meeting, the Interim report of the Company was considered and passed.

#### X. Important Events

1. In the report period, no significant lawsuit or arbitration occurred.
2. Mergers and Assets Buying & Selling:

In the report period, no mergers and assets buying and selling occurred.

##### 3. Important Connected Transactions:

###### 3.1 Routine Productive Connected Transaction

###### (1) Connected transaction for buying goods or receiving services

Monetary unit: RMB 10,000 Yuan

Company	Nature of transaction	Principle for price	2005		Settling mode
HNA Catering Co., Ltd.	Catering Payment	Market price/ agreement price	3,472		Banking transfer
Haikou Meilan International Airport Co., Ltd.	Taking-off and landing services charges	Determined by CAAC	2,714		Banking transfer

Sanya Phoenix International Airport Co., Ltd.	Taking-off and landing service charges	Determined by CAAC	1,840	Banking transfer
Hainan Haihang Aviation Imp. & Exp. Co., Ltd.	Aviation materials agency fees	Market price/ agreement price	1,780	Banking transfer
Hainan Meilan Airport Co., Ltd.	Taking-off and landing serves charges	Determined by CAAC / Market price/ agreement price	8,605	Banking transfer
Chongqing International Renting Co., Ltd.	Renting aircrafts and engines	Market price/ agreement price	8,436	Banking transfer
Hainan Meiya Industrial Co., Ltd.	Payment for aircrafts oil fees	Market price/ agreement price	30,977	Banking transfer
HNA Group Finance Co., Ltd	Deposits	Regulated by People's Bank	1,388,754	Banking transfer
HNA Group Finance Co., Ltd	Withdrawn	Regulated by People's Bank	1,240,896	Banking transfer

(2) Connected transaction for selling goods or providing services

Monetary unit: RMB 10,000 Yuan

Company	Nature of transaction	Principle for price	2005	Settling mode
HNA Group	Trusting lending	Market price/ agreement price	5,437	Banking transfer
HNA Catering Holding Co., Ltd.	Prepayment for acquired share	Market price/ agreement price	6,120	Banking transfer
Deer Jet Co., Ltd.	Advance money of airport rents	Market price/ agreement price	17,560	Banking transfer
Yangtze River Express Co., Ltd.	Advance money for airports rents	Market price/ agreement price	11,795	Banking transfer
Xi'an Minsheng Real Estate Co., Ltd.	Transferring investment	Market price/ agreement price	700	Banking transfer

The above stated connected transactions are the necessary routine productive connected transactions.

It does affect the independence of the Company.

### 3.2 The accounts receivable and payable with related parties

Monetary unit: RMB 1,000 Yuan

Company	Relationship with the Company Relationship with the Company	The Company's Funds provided for the related companies		The related companies' Funds provided for the Company	
		Current	Balance	Current	Balance
Hainan Jiahui Investment Co., Ltd	Under Common Control	-153,374	348,024	-273,000	0

Hainan Yangpu Huanmei Industrial Co., Ltd	Under Common Control	-123	333,680	9,877	10,000
Haikou Meilan International Airport Co., Ltd	Associated Company	-187,959	9,000	-83,648	38,575
HNA Group Co., Ltd	Shareholder	-95,369	13,290	19,989	106,309
Yangtze River Express Co., Ltd	Associated Company	39,110	127,142	-295	53,989
Deer Jet Co., Ltd	Under Common Control	169,753	208,869	21,656	62,076
Hainan Haihang Import & Export Co., Ltd	Associated Company	-10,238	92,238	-18,343	30,703
Yangtze River Real Estate Group Co., Ltd	Associated Company	-55,956	117	11,700	11,700
HNA Hotel Holding Group Co., Ltd	Under Common Control	8,870	8,870		
HNA Hotel Co., Ltd	Under Common Control	3,113	24,673		
Haihang Building & Development Co., Ltd	Under Common Control	435	20,879		
Kangle Garden Hotel	Under Common Control	79,898	79,989		
Hainan Haihang Aviation Import & Export Trade Co., Ltd	Under Common Control	-14,899	6,385		
Haikou High-tech Risk Investment Co., Ltd	Under Common Control	-5,000	5,000		
Hainan Air Catering Co., Ltd	Under Common Control	-5,217	0		
Hainan Meilan International Airport Co., Ltd	Associated Company			-26,453	75,108
Hainan Meiya Industrial Co., Ltd	Subsidiy of associated Company			9,040	36,668
Hainan Air Catering Co., Ltd	Under Common Control			-4,026	21,989
Beijing Kehang Investment Co., Ltd	Under Common Control			52,500	52,500
Sanya Phoenix International Airport Co., Ltd	Under Common Control			18,535	23,076
HNA Catering Holding Co., Ltd	Under Common Control			61,200	61,200
Lucky International Tour Co., Ltd	Under Common Control			7,759	29,386
Beijing Yanjing Hotel Co., Ltd	Associated Company			-9,990	32,013
Other		11,982	26,390	10,944	22,175
Total		-214,974	1,304,546	-192,555	667,467

In the report period, the current sum of the Company's funds provided for its holding shareholder and shareholder's subsidiary companies is RMB 313,161 thousand Yuan, and the balance of the Company's funds provided for its holding shareholder and shareholder's subsidiary companies is RMB 1,304,546 thousand Yuan.

The settlement situation: the Company has signed a debt reorganization agreement with over 50 associated companies, including Hainan Jiahui Investment Co., Ltd., Jeer Jet, Hainan Haihang Aviation Imp. & Exp., and Yangtze River Express dated in January 2006. All the parties agreed to reorganize the Company's accounts receivable and payable: the total amount of deducted accounts receivable is 647,967 thousand, and the total amount of deducted accounts payable is 600,722 thousand, and the remaining amount of 47,245 thousand has been recognized as the accounts receivable due from Hainan Jiahui Investment Co., Ltd.

The Company has received the amount of 723,680 thousand due from Hainan Jiahui Investment Co., Ltd. and Hainan Yangpu Huanmei Industrial Co., Ltd. in April 2006.

Related Promise: as of the date of April 30, 2006, the balance of the occupied capital has been paid off.

Effect on the operation achievement and financial status of the Company: In January 2006, the Company has received

amount of RMB 601 million Yuan by the debt reorganization, and, the Company has received amount of RMB 704 million Yuan due from Hainan Jiahui Investment Co., Ltd. and Hainan Yangpu Huanmei Industrial Co., Ltd. in April 2006. The issue of capital occupation had been settled. Thus the related debts and claims would not influence the operation achievement and financial status of the Company.

Schedule of settling plan

Planned Payback Schedule	Settling Method	Settling Amount (Yuan)	Remark
End of Jan. of 2006	Others	600,720,000	Completed
End of April of 2006	Cash	703,820,000	Completed
Total		1,304,540,000	

**4. Trusteeship situation**

The Company has no trusteeship matter in 2005.

**5. Contract-in situation**

The Company has no contract-in matter in 2005.

**6. Leasing situation**

The Company has no leasing matter in 2005.

**7. Guarantee situation**

Monetary Unit: 1,000 RMB

Name of Guarantee	Guarantee Date (signature date)	Guaranteed Amount	Guarantee Type	Guarantee Term	Performance Status (Yes or No)	Connected Party Guarantee (Yes or No)
Haikou Meilan International Airport Company Limited		502,000	With joint responsibility		No	Yes
HNA Air Catering Company Limited		3,350	Ordinary guarantee		No	Yes
Total Guarantee in the Report Period						
Balance of Guarantee at the End of Report Period						505350
<b>Guarantee of the Company for the Controlled Subsidiaries</b>						
Total Guarantee in the Report Period						731000
Total Balance of Guarantee at the End of Report Period						731000
<b>Total Guarantee of the Company (Including Guarantee for the Controlled Subsidiaries)</b>						
Total Amount of Guarantee						1236350
Percentage of the Total Guarantee to the Net Assets of the Company						45.57%
Incl.:						
Guarantee Amount for the Shareholders, Actual Controllers and its Related Parties						505350
Direct or Indirect Debt Guarantee for the Guaranteed Party Which Assets-liability Ratio is over 70%						
Guarantee Amount which is over 50% of the Net Assets						
Total Amount of Above Three Items						505350

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**8. Entrusted financing**

In 2005, there is no entrusted financing.

**9. Other important contract**

In 2005, there is no other important contract.

**10. Promises of the Company or its shareholders holding more than 5% of the Company's total amount of shares and execution of the promises**

Since the share structure of the Company is scattered, it's difficult to take the "G Share Reform". The Company has engaged the agency and communicates with unlisted shareholders. Meantime, the additional issuance of the Company will create favorable condition for the Reform, the Company tries for entering the procedure of "G Share Reform" before June 30, 2006.

**11. Remuneration and Engagement & Dismissal of the Accounting Firms:**

In the report period, the Company continued to engage the Shine Wing Certified Accountants and Price Water House Coopers Public Accounting Firm to audit the financial statements of it. The auditing fee paid to them account for RMB 1.61 million Yuan and HK\$ 2.15 million respectively.

**12. Penalty on the Company, the Board and the Directors and correction situation**

In the report period, there is no penalty on the Company, the Board of Directors by CSRC, administrative penalty or SSE.

**13. Other Important Events:**

In the report period, there are no other important events.

## **XI. Financial Report**

**1. Report of Auditors**

**(English Translation For Reference Only)**

**TO THE SHAREHOLD OF HAINAN AIRLINES COMPANY LIMITED**

We have audited the accompanying consolidated balance sheet and balance sheet of Hainan Airlines Company Limited (hereafter "the Company") as at 31 December 2005, the related consolidated income statement and income statement, and consolidated cash flow statement and cash flow statement for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the financial statements based on our audit.

We conducted our audit in accordance with China's Independent Auditing Standards of the Certified Public Accountants. Those Standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement. The audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. The audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statements presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above conform with the Accounting Standards for Business Enterprises and the “Accounting System for Business Enterprises” promulgated by the Central Government of the People’s Republic of China and present fairly in all material respects, the financial position of the Company as at 31 December 2005 and the results of its operations and its cash flow for the year then ended.

Shine Wing Certified Public Accountants

Beijing, China

28 April 2006

## 2. Financial Statements

### Hainan Airlines Company Limited Balance Sheet As at 31 December 2005

Monetary unit: RMB Yuan

Assets	Notes	CONSOLIDATED		HOLDING COMPANY	
		2005	2004	2005	2004
<b>CURRENT ASSETS</b>					
Cash in bank & on hand		5,792,487,997	3,149,786,832	3,430,324,735	907,111,360
Short investment		30,000,000			
Notes receivable					
Dividend receivable					
Interest receivable					
Accounts receivable		422,641,761	282,625,854	7,402,711	531,880,423
Other receivables		1,913,348,852	1,954,827,569	2,611,108,388	1,522,130,407
Advances to suppliers		110,631,861	462,772,715	100,501,927	411,732,171
Subsidy receivable					
Inventories		323,701,783	338,044,172	309,577,087	319,922,005
Deferred and prepaid expenses		49,971,167	70,886,124	30,378,103	49,387,415
<b>Long term investment maturing within one year</b>					
Other current assets					
<b>Total current assets</b>		<b>8,642,783,421</b>	<b>6,258,943,266</b>	<b>6,489,292,951</b>	<b>3,742,163,781</b>
<b>LONG-TERM INVESTMENTS</b>					
Long term equity investment		858,444,018	837,493,008	2,055,557,404	2,066,078,093
Long term bond investment					
<b>Long-term investments-net value</b>		858,444,018	837,493,008	2,055,557,404	2,066,078,093
Incl. consolidation difference		111,805,010	129,467,842		
<b>FIXED ASSETS</b>					
Fixed assets - cost		24,635,678,949	19,272,480,883	15,952,931,105	14,527,202,810
Less: Accumulated depreciation		5,245,916,183	4,200,977,802	3,250,143,251	2,477,441,785
Fixed assets - net book value		19,389,762,766	15,071,503,081	12,702,787,854	12,049,761,025
<b>Less: Provision for decrement of fixed assets</b>		25,259,499	18,311,409	24,378,237	16,378,237
Fixed assets - net book value		19,364,503,267	15,053,191,672	12,678,409,617	12,033,382,788
Less: Provision for decrement of fixed assets					

Fixed assets- net book value					
Engineering materials					
Construction in progress		1,117,782,507	2,378,105,885	374,963,565	740,024,104
Disposal of fixed assets					
<b>Total fixed assets</b>		<b>20,482,285,774</b>	<b>17,431,297,557</b>	<b>13,053,373,182</b>	<b>12,773,406,892</b>
<b>INTANGIBLE ASSETS</b>					
Intangible assets		14,271,976	14,674,004		
Long-term deferred expenses		351,696,053	406,117,049	256,779,632	301,202,612
Other long-term assets		341,495,542	379,352,472	276,513,615	305,572,823
<b>Total intangible &amp; other assets</b>		<b>707,463,571</b>	<b>800,143,525</b>	<b>533,293,247</b>	<b>606,775,435</b>
<b>TOTAL ASSETS</b>		<b>30,690,976,784</b>	<b>25,327,877,356</b>	<b>22,131,516,784</b>	<b>19,188,424,201</b>

The accompanying notes form an integral part of these financial statements

**Hainan Airlines Company Limited**  
**Balance Sheet (continued)**

	CONSOLIDATED		HOLDING COMPANY	
	2005	2004	2005	2004
<b>CURRENT LIABILITIES</b>				
Short term loans	4,854,388,029	3,308,284,166	2,116,388,029	1,365,564,166
Notes payable	817,433,490	642,436,548	654,795,763	391,672,180
Accounts payable	1,533,233,355	967,918,901	1,482,462,917	1,214,890,287
Advances from customers	27,579,232	24,588,746	22,132,009	22,132,009
Accrued payroll	23,459,318	14,226,670	22,483,154	13,694,820
Staff and workers' bonus and welfare fund	3,840,802	4,185,160		
Dividends payable	26,889,152	26,891,312	26,889,152	26,891,312
Taxes payable	296,934,145	274,286,183	108,685,677	242,678,503
Other payables to government	313,907,717	145,318,235	38,058,547	24,750,841
Other payables	361,824,164	634,746,366	90,108,840	85,144,328
Accrued expenses	1,166,737,295	928,922,279	1,087,048,734	898,912,212
Sales in advance of carriage-domestic	477,140,789	329,729,616		
Sales in advance of carriage-international	12,762,948	5,648,383		
Liability estimation				
Long-term liability maturing within one year	2,054,983,724	2,032,747,432	1,498,333,721	1,402,098,632
Other current liabilities				
<b>Total current liabilities</b>	<b>11,971,114,160</b>	<b>9,339,929,997</b>	<b>7,147,386,543</b>	<b>5,688,429,290</b>
<b>LONG TERM LIABILITIES</b>				
Long term loans	13,326,240,757	11,514,594,187	10,631,972,795	10,028,757,737
Bonds payable				
Long term payable	1,766,873,007	2,180,257,775	1,510,601,937	1,892,328,462
Special accounts payable	20,000,000	20,000,000		
Other long-term liability	143,113,207	135,020,140	113,329,882	135,020,140
<b>Total long term liabilities</b>	<b>15,256,226,971</b>	<b>13,849,872,102</b>	<b>12,255,904,614</b>	<b>12,056,106,339</b>
<b>Deferred tax</b>				
Deferred tax credits				
<b>TOTAL LIABILITIES</b>	<b>27,227,341,131</b>	<b>23,189,802,099</b>	<b>19,403,291,157</b>	<b>17,744,535,629</b>
<b>Minority interest</b>				
Minority interest	750,659,843	709,436,501		
<b>OWNERS' EQUITY</b>				
Paid-in capital	730,252,801	730,252,801	730,252,801	730,252,801

Capital surplus		2,558,884,351	1,058,729,373	2,558,884,351	1,058,729,373
Reserve fund		169,097,575	169,097,575	169,097,575	169,097,575
Inclu.:Public welfare fund		53,094,720	53,094,720	53,094,720	53,094,720
Unrecognized investment loss		-15,249,816	-15,249,816		
Undistributed profits / (accumulated losses)		-730,009,101	-514,191,177	-730,009,100	-514,191,177
Inclu: Proposed cash dividends					
<b>Total owners' equity</b>		<b>2,712,975,810</b>	<b>1,428,638,756</b>	<b>2,728,225,627</b>	<b>1,443,888,572</b>
<b>TOTAL LIABILITIES AND OWNERS' EQUITY</b>		<b>30,690,976,784</b>	<b>25,327,877,356</b>	<b>22,131,516,784</b>	<b>19,188,424,201</b>

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Hainan Airlines Company Limited  
Income Statement  
For the Year 2005

Monetary unit: RMB Yuan

ITEMS	Notes	CONSOLIDATED		HOLDING COMPANY	
		2005	2004	2005	2004
<b>1. Sales revenue</b>		<b>10,061,468,423</b>	<b>8,410,538,692</b>	<b>5,242,591,350</b>	<b>4,346,952,816</b>
Less: Cost of sales		8,211,652,702	6,366,330,309	4,262,318,357	2,972,864,419
Sales tax and surtax		315,450,723	273,204,272	156,566,278	142,020,895
<b>2. GROSS PROFIT ON SALES</b>		<b>1,534,364,998</b>	<b>1,771,004,111</b>	<b>823,706,715</b>	<b>1,232,967,502</b>
Add: Income from other Operations		97,715,237	76,931,186	66,135,427	57,777,240
Less: Selling expenses		585,248,011	538,283,866	288,186,399	295,287,849
General and administrative expenses		497,436,977	421,947,769	278,782,549	265,839,264
Financial expenses/(income)		818,951,555	794,490,678	571,295,198	582,083,998
<b>3. OPERATING PROFIT / (LOSS)</b>		<b>-269,556,308</b>	<b>93,212,984</b>	<b>-248,422,004</b>	<b>146,633,631</b>
Add: Income from investments		-15,834,919	-16,667,047	-9,840,243	-60,957,365
Subsidies Income		49,411,000	13,566,646	23,122,000	8,203,646
Non-operating income		39,531,134	2,040,620	36,943,772	512,721
Less: Non-operating expenses		22,248,722	15,639,053	17,621,448	3,743,846
<b>4. TOTAL PROFIT / (LOSS)</b>		<b>-218,697,815</b>	<b>76,514,150</b>	<b>-215,817,923</b>	<b>90,648,787</b>
Less: Income tax		10,091	4,924,546		
Minority interest		-2,889,982	-19,059,183		
<b>5. NET PROFIT/(LOSS) AFTER TAX</b>		<b>-215,817,924</b>	<b>90,648,787</b>	<b>-215,817,923</b>	<b>90,648,787</b>
Add: Undistributed profit at beginning of the year		-514,191,177	-604,839,964	-514,191,177	-604,839,964
Transferred in from surplus reserve					
<b>6. Profit Available for Dividends</b>		<b>-730,009,101</b>	<b>-514,191,177</b>	<b>-730,009,100</b>	<b>-514,191,177</b>
Less: Statutory surplus reserve					
Statutory public welfare fund					
<b>7. Profit Available for Dividends to Shareholders</b>		<b>-730,009,101</b>	<b>-514,191,177</b>	<b>-730,009,100</b>	<b>-514,191,177</b>
Less: Preference dividends payable					
Voluntary earnings surplus drawn					
Common stock dividends payable					
Dividends being transferred to share capital					
<b>8. Undistributed Profit</b>		<b>-730,009,101</b>	<b>-514,191,177</b>	<b>-730,009,100</b>	<b>-514,191,177</b>

**Hainan Airlines Company Limited**  
**Cash Flow Statement**  
**For the Year 2005**

	Notes	CONSOLIDATED	HOLDING COMPANY
<b>1. Cash Flows From Operating Activities</b>			
Cash received from sales of goods or rendering of services		10,117,492,386	5,212,373,413
Refund of tax		34,404,896	5,600,000
Other cash received relating to operating activities		11,039,818,607	10,516,651,016
<b>Sub-total of cash inflows</b>		<b>21,191,715,889</b>	<b>15,734,624,429</b>
Cash paid for goods and services		4,481,482,070	1,787,737,088
Cash paid to and on behalf of employees		702,009,717	271,775,929
Income tax paid		477,143,247	276,282,819
Other cash paid relating to operating activities		12,517,829,254	11,620,417,334
<b>Sub-total of cash outflows</b>		<b>18,178,464,288</b>	<b>13,956,213,170</b>
<b>Net cash from operating activities</b>		<b>3,013,251,601</b>	<b>1,778,411,259</b>
<b>2. Cash Flows from Investing Activities:</b>			
Cash received from return of investments		75,700,000	0
Inclu: cash received from disposition of subsidiaries		61,200,000	0
Cash received from distribution of dividends or profits		1,630,378	835,425
Net cash received from disposal of fixed assets, intangible assets and other long-term assets		2,958,427	829,760
Other cash received relating to investing activities		0	0
<b>Sub-total of cash inflows</b>		<b>80,288,805</b>	<b>1,665,185</b>
Cash paid to acquire fixed assets, intangible assets and other long-term assets		3,831,991,904	1,101,202,909
Cash paid to acquire equity investments		30,000,000	0
Inclu: cash paid to acquire subsidiaries		-41,368	0
Other cash paid relating to investing activities		83,483	0
<b>Sub-total of cash outflows</b>		<b>3,862,075,387</b>	<b>1,101,202,909</b>
<b>Net cash from investing activities</b>		<b>-3,781,786,582</b>	<b>-1,099,537,724</b>
<b>3. Cash Flows from Financing Activities</b>			
Proceeds from issuing shares		1,517,004,801	1,500,000,000
Proceeds from borrowing		8,639,153,317	3,965,153,317
Other proceeds relating to financing activities		620,414,560	436,953,764
<b>Sub-total of cash inflows</b>		<b>10,776,572,678</b>	<b>5,902,107,081</b>
Cash repayments of amounts borrowed		5,148,348,743	2,531,066,518
Cash payments for distribution of dividends or profits and interest expenses		1,008,005,089	741,439,565
Other cash payments relating to financing activities		1,313,443,328	852,221,788
<b>Sub-total of cash outflows</b>		<b>7,469,797,160</b>	<b>4,124,727,871</b>
<b>Net cash from financing activities</b>		<b>3,306,775,518</b>	<b>1,777,379,210</b>
<b>4. Effect of Foreign Exchange Rate Changes on Cash</b>			
		0	0
<b>5. Net Increase in Cash and Cash Equivalents</b>			
		<b>2,538,240,537</b>	<b>2,456,252,745</b>

**Hainan Airlines Company Limited**  
**Cash Flow Statement**  
**For the Year 2005**

A.

Monetary unit: RMB Yuan

	Notes	CONSOLIDATED	HOLDING COMPANY
<b>1. Reconciliation of Net Profit to Cash Flows from the rating Activities</b>			
Net profit		-215,817,924	-215,817,924
Add: Minority interest		-2,889,982	0
Less: Unrealized Investment Loss		0	0
Add: Provision for bad debt or bad debt written off		65,984,558	61,819,685
Depreciation of fixed assets		1,092,227,418	779,336,425
Amortization of intangible assets and other long-term assets		402,027	0
Amortization of long-term deferred assets		147,723,235	128,491,979
Decrease in deferred and prepaid expenses (or deduct: increase)		20,914,957	19,009,312
Increase in accrued expenses (or deduct: decrease)		237,815,016	188,136,522
Losses arising from disposition of fixed assets, intangible assets and other long-term assets (or deduct: gains)		2,073,903	3,259,948
Losses on scrapping of fixed assets		1,639,222	0
Financial expenses		818,951,555	571,295,198
Losses arising from investments (or deduct: gains)		15,834,919	9,840,243
Deferred tax credit (or deduct: debit)		0	0
Decrease in inventories (or deduct: increase)		14,342,389	10,344,918
Decrease in operating receivables (or deduct: decrease)		788,881,723	-75,788,942
Increase in operating payables (or deduct: decrease)		25,168,585	298,483,895
Others		0	0
Net cash from operating activities		<b>3,013,251,601</b>	<b>1,778,411,259</b>
<b>2. Investing and Financing Activities that do not Involve in Cash Receipts and Payments</b>			
Transferred-in capital by debt		0	0
Negotiable bond due in one year		0	0
Capital leasing of fixed assets		0	0
Others		0	0
<b>3. Net Increase in Cash and Cash Equivalents</b>			
Cash at the end of the period		5,617,920,078	3,293,256,814
Less: cash at the beginning of the period		3,079,679,541	837,004,069
Plus: cash equivalents at the end of the period		0	0
Less: cash equivalents at the beginning of the period		0	0
Net increase in cash and cash equivalents		<b>2,538,240,537</b>	<b>2,456,252,745</b>

**Hainan Airlines Company Limited**  
**Statement of Provision**  
**For the Year 2005**

Monetary unit: RMB Yuan

**Consolidated**

Items	2004.12.31	Addition	Write-off				Total	2005.12.31
			Reserve of Provision for decrement of assets	Write-off for actual loss	Transferring due to the sale of assets	Reserve (decrease) due to other reasons		
<b>Total Amount of Provisions</b>	201,458,847	65,984,558	-	1,051,911	-	-	1,051,911	266,391,494
<b>1. Provision for bad debts</b>	162,675,069	51,623,058	-	-	-	-	-	214,298,126
Including: Account Receivable	18,581,103	197,927	-	-	-	-	-	18,779,029
Other Receivable	144,093,966	51,425,131	-	-	-	-	-	195,519,097
<b>2. Provision for loss on short-term investments</b>	-	-	-	-	-	-	-	-
Including: Investment in stock	-	-	-	-	-	-	-	-
Investment in bonds	-	-	-	-	-	-	-	-
<b>3. Provision for loss on realization of inventories</b>	5,198,370	-	-	-	-	-	-	5,198,370
Including: Goods for sales	-	-	-	-	-	-	-	-
Materials	5,198,370	-	-	-	-	-	-	5,198,370
<b>4. Provision for loss on long-term investment</b>	14,774,000	-	-	-	-	-	-	14,774,000
Including: Investment in equity	14,774,000	-	-	-	-	-	-	14,774,000
Investment in bonds	-	-	-	-	-	-	-	-
<b>5. Provision for loss of fixed assets</b>	18,311,409	8,000,000	-	1,051,911	-	-	1,051,911	25,259,498
Including: Plant & building	1,389,173	8,000,000	-	1,051,911	-	-	1,051,911	8,337,262
Equipment	16,778,237	-	-	-	-	-	-	16,778,237
<b>6. Provision for loss of intangible assets</b>	-	-	-	-	-	-	-	-
Including: Patents	-	-	-	-	-	-	-	-
Proprietary technology	-	-	-	-	-	-	-	-
<b>7. Provision for loss of construction in progress</b>	500,000	6,361,500	-	-	-	-	-	6,861,500
<b>8. Provision for loans of authority</b>	-	-	-	-	-	-	-	-

**Holding Company**

Items	2004.12.31	Addition	Write-off				Total	2005.12.31
			Reserve of Provision for decrement of assets	Write-off for actual loss	Transferring due to the sale of assets	Reserve (decrease) due to other reasons		
<b>Total Amount of Provisions</b>	130,246,113	61,819,685	-	-	-	-	192,065,798	
<b>1. Provision for bad debts</b>	100,059,507	47,458,185	-	-	-	-	147,517,692	
Including: Account Receivable	1,126,582	-					1,126,582	
Other Receivable	98,932,925	47,458,185					146,391,110	
<b>2. Provision for loss on short-term investments</b>	-	-					-	
Including: Investment in stock	-	-					-	
Investment in bonds	-	-					-	
<b>3. Provision for loss on realization of inventories</b>	5,198,370	-	-	-	-	-	5,198,370	
Including: Goods for sales	-	-					-	
Materials	5,198,370	-					5,198,370	
<b>4. Provision for loss on long-term investment</b>	8,610,000	-	-	-	-	-	8,610,000	
Including: Investment in equity	8,610,000	-					8,610,000	
Investment in bonds	-	-					-	
<b>5. Provision for loss of fixed assets</b>	16,378,237	8,000,000					24,378,237	
Including: Plant & building		8,000,000					8,000,000	
Equipment	16,378,237	-					16,378,237	
<b>6. Provision for loss of intangible assets</b>	-	-					-	
Including: Patents	-	-					-	
Proprietary technology	-	-					-	
<b>7. Provision for loss of construction in progress</b>	-	6,361,500					6,361,500	
<b>8. Provision for loans of authority</b>								

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# HAINAN AIRLINES COMPANY LIMITED

(English translation for reference only)

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

*1 January 2005 to 31 December 2005*

*(All the amounts are in thousand Yuan, except otherwise specified)*

### **I. Company Organization and Principal Activities**

1. Hainan Airlines Company Limited (hereinafter referred as “the Company”) was a joint stock limited company reorganized from the former state owned Hainan Airlines (hereinafter referred as “the State Owned Company”) by the way of share subscription in according with the approval of the Hainan Provincial Office for Joint Stock Limited Companies by its circular Qiong Gu Ban Zi No.[1992]18 in September 1992. The net assets of the State owned company amounting to 13,340,552 was determined as the State capital of the Company in according with the appraisal of Hainan Consultative & Investing Company Limited and approval of the Bureau of Finance, Hainan Province by its circular Qiong Cai Shui [1992] Guo Zi No.639. The promoters of the Company comprised 24 legal enterprises, including the State owned company, China Everbright International Trust and Investment Co. Ltd , Hainan Branch, Bank of Communication, Hainan Aviation Import & Export Co., Ltd., etc. The Company obtained its business license on 8 January 1993 and was named as “Hainan Airlines Company Limited”. The registered share capital was 250,100,000, and the total amount of shares was 250,100,000 with par share value 1.00 for each.
2. The scrip dividend for 1993 was approved by the resolution of the 2nd general meeting of shareholders held in March 1994. 50,020,000 shares were distributed and the total capital had increased to 300,120,000.
3. Pursuant to the approval of Hainan Provincial Office for Joint Stock Limited Companies by its circular Gu Ban Zi No.[1993]17 in May 1993, 96,059,448 legal person shares were listed in STAQ system. The number of legal person shares listed in STAQ system increased to 115,271,337 after the scrip dividend.
4. Pursuant to the approval of the Ministry of Foreign Trade and Economic Cooperation of PRC by its circular Wai Jing Mao Yi Han Zi No.[1995]615 on 2 November 1995, the Company issued 100,040,001 shares to American Aviation LDC at a price of USD 0.25 per share with a par value of 1.00 each. The company was changed into a Sino-foreign joint stock company limited after the issuance of shares. Among the total raised fund USD 25,000,000 (equivalent to 207,905,000 ), 100,040,001 was recognized as share capital and the remaining amount of 70,177,849.79 was recognized as capital reserve after deducting the related issuing expenses. The Company obtained a new business license in November 1996 after increasing its share capital stated above. Also its name has been changed to Hainan Airlines Company Limited and the registered capital was 400,160,001.00.
5. Pursuant to the approval of China Securities Regulatory Commission by its circular Zheng Wei Fa No. [1997]24, the Company issued 71,000 thousand B Shares at a premium price of USD 0.47 per share with a par value of 1.00 each. Among the total raised fund USD 33,370,000 (equivalent to 276,690,000 ), 71,000,000 was recognized as share capital and the remaining amount of 186,822,000 was recognized as capital reserve after deducting the related issuing expenses.

5. Pursuant to the approval of China Securities Regulatory Commission by its circular Zheng Jian Fa Xing Zi No. [1999]129, the Company issued 205 million Ordinary Shares (A Shares) at an issue price of 4.6 yuan per share with a par value of 1.00 each to the public. Among the total raised fund 943,000,000, 205,000,000 was recognized as share capital and the remaining amount of 708,745,226 was recognized as capital reserve after deducting the related issuing expenses.
7. In accordance with the profit appropriation resolution for year 1999 approved by the general meeting of shareholders on 18 May 2000, the Company distributed stock dividend at 0.8 shares per ten shares (on the basis of total number of shares 676,160,000) and cash dividend 1.00 (tax included) to all shareholders with total amount of 54,092,800 yuan and 67,616,000 respectively. The share capital of the Company increased to 730,252,801 thereafter.
8. China Everbright International Trust and Investment Co., Ltd. transferred its 4.5% interest to Hainan Airlines Group Co., Ltd. (“HNA Group”) entirely in 2004, and then the interest held by HNA Group increased from 7.3% to 11.9%. There is no other change among the shareholders with over 5% interest.
9. The Company and its subsidiaries (collectively the “Group”) are primarily engaged in the air transportation of passengers, cargo, mail and luggage over domestic and approved overseas air routes, and the ancillary business of air transportation.

#### **Basis of Preparation**

Due to the fuel prices increasing, in 2005 the Group incurred losses, and current liabilities exceed current assets. The Group’s ability to continue on a going concern basis depends on the success of its future operations in generating cash flows and obtaining the continuation and renewal of the Group’s borrowing facilities from banks. The management believes that the Group has the ability to get borrowing facilities from banks.

As mentioned in Note 11 (subsequent events after the balance sheet date), pursuant to the approval of government and the general meeting of shareholders, the Company will issue no more than 800 million short-term enterprise bond to the inter-bank bonds market with 365 days time limit.

Additional, pursuant to the approval of government, and the general meeting of shareholders, the Group will issue no more than 2,800 million legal personal shares to the domestic and foreign investors and then the Group will use the raised fund to finance its operating activities, including paying bank loans, acquiring aircrafts, etc.

The management has prepared the forecasted cash flow information for the twelve-month period from the date of their approval of these financial statements. On the basis of this cash flow information and borrowing facilities available from banks, the management is confident that the Group has sufficient funds to pay its liabilities when they fall due and to continue its operations for the foreseeable future. As a result, the management believes that it is appropriate for these financial statements to be prepared on a going concern basis.

#### **Principal Accounting Policies, Accounting Estimations and Basis of Consolidation**

##### 1. Accounting Policies Applied

The financial statements have been prepared in accordance with the Accounting Standards for Business Enterprises and the Accounting Regulations of the People’s Republic of China for Business Enterprises and its supplementary regulations. The Group also follows *the Accounting Treatment for Civil Aviation Industry* issued by the Ministry of Finance (“MOF”).

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## 2. Accounting Period

The Group's accounting year starts on 1 January and ends on 31 December.

## 3. Functional Currency

The Group adopts Renminbi (“”) as its functional currency.

## 4. Principle and Basis of Accounting

The Group adopts accrual basis. All items are recorded at actual cost upon acquisition, except assets and liabilities are initially recognized at their appraised value upon contributed to the Group.

## 5. Translation of Foreign Currency

Foreign currency transactions are translated into at the exchange rate issued by the People's Bank of China (“PBOC”) at the transaction date. Monetary assets and liabilities in foreign currencies are translated into at the exchange rate prevailing at the balance sheet day. The differences between equivalents and carrying amounts are treated as exchange differences. Exchange differences during preparation period are included in long-term amortization charges. Exchange differences of specific borrowings related to the acquisition or construction of a fixed asset should be capitalized in the period in which they are incurred when the relevant fixed asset being acquired or constructed is not ready for its intended use. Exchange differences in normal operations are included in the exchange gains and losses of the current period.

## 6. Cash Equivalents

Cash equivalents are short-term (with a holding period of less than three months), highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value.

## 7. Bad Debt Treatment

### Recognition of Bad Debts

The Group adopts the following standards in determination of bad debts:

When the debtor is bankrupt or dead, the accounts receivable that are unable to be recovered even after liquidation of the debtor's bankrupt estate or legacy;

If there is obvious evidence proving the uncollectibility of the accounts, then the bad debt loss is confirmed.

### Measurement of Bad Debts

The Group adopts allowance method for bad debts. At the end of each accounting period the company analyses the recoverability of receivable items (including accounts receivable and other receivable) and makes allowance for bad debts according to the aging method and analysis result. Allowance for bad debts is not made for the items that are surely to be recovered, including accounts receivable from related parties, prepayments, etc. The allowance for remaining accounts receivable shall refer to the following ratios.

Aging	Ratio
Within 1 year	0%
1-2 year	5%
2-3 year	10%
3-4 year	30%
4-5 year	50%

5-6 year	80%
Over 6 years	100%

In addition, the bad debt loss will be confirmed on individual base in according with the receivable percentage while the operating condition of the debtor is deterioration, insolvency or ceased.

#### 8. Inventory

The inventory of the Group mainly comprises aviation consumables, aviation on-board supplies and low cost consumables, etc. The aviation consumables are recorded at planned price and the difference between planned price and actual cost is recorded in 'Materials Cost Variance'. The aviation on-board supplies and low cost consumables are recognized at actual cost.

Aviation consumables are charged to cost according to the adjusted actual cost when put into use at the end of each month, and aviation on-board supplies are recognized as related cost while in use.

The Group will make provision for impairment of the unrecoverable aviation consumables and aviation on-board supplies which is the cost less net realizable value item by item at end of each period.

The low cost consumables are charged to cost in total while in use, except for uniform, which is amortized in fifty-fifty method.

#### 9. Long-term Investments

##### Long-term Equity Investment

##### Measurement of Long-term Equity Investment

Long-term equity investment is recognized at the initial cost of acquisition or at the agreed price of relevant parties. The cost method is applied wherever the Group holds less than 20% of the voting capital, or holds 20% or more voting capital but has no significant influence over the investee enterprise. The equity method is applied wherever the Group holds 20% or more voting capital of the investee enterprises or holds less than 20% of the voting capital but has significant influence over the investee enterprise. The investee enterprises will be included in the consolidated financial statements when the Group holds more than 50% or more voting capital of the investee enterprises (50% not included), or hold less than 50% but has real control over the investee enterprise.

##### The Amortization Method and period of Equity Investment Difference

The debit difference (referred to as "equity investment difference") between the initial investment cost and the Group's share of owners' equity of the investee enterprise should be amortized evenly over a period of 10 years or the agreed period and charged into profit and loss account of corresponding period, the credit difference should be amortized evenly over a period of no less than 10 years (including 10 years), the credit difference shall be recognized as capital reserve since 17 March 2003.

##### Provision for Impairment

The long-term investment is recorded at the lower of carrying amount and recoverable amount at the end of each period. If the recoverable amount of a long-term investment is lower than its carrying amount as a result of a continuing decline in market value or deterioration in operating conditions of the investee enterprise, the Group shall make provision for impairment on long-term investment on an individual item basis and charge into the current period.

#### 10. Fixed Assets

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Fixed assets refer to the tangible assets that holding for production, rendering services, lease or management, which include aircraft and engines, high-price rotables, improvement of fixed assets by operating lease, plant and building, machinery equipment, vehicles and other equipment related to the operation of the Group with useful lives of over one year. Fixed assets also include equipment other than the main production equipment with individual values of over 2,000 yuan and useful lives in excess of 2 years.

Fixed assets purchased or self-constructed by the Group are initially recorded at historical cost. Assets held under finance leases are recorded at the net present value of the lowest contract price.

Depreciation of fixed assets is calculated on the straight-line basis over the following useful lives, after taking into account their residual value, which is 5% of cost:

Plant and buildings	40 years
Aircraft and engines	10 to 20 years
High-price rotables	10 to 15 years
Leasehold improvements	7 years
Vehicles	10 years
Machinery and equipment	8 to 14 years

While the recoverable amount of the asset is lower than its carrying amount (caused by overcapacity, significantly declining revaluation, etc), the Group shall make provision for impairment of fixed assets at the excess of the carrying amount over its recoverable amount on an individual item basis. If one of the indications is present, the Group shall make provision for impairment of fixed assets in full amount:

Permanently withdraw from use and no future economic benefit is expected and being recognized no income during transactions;

No future economic benefit is expected for technical reasons;

Fixed assets have fully damaged without any usage-value and conversion value.

#### 11. Construction in progress

Construction in progress comprises construction in progress assets and prepayment for airplanes and aviation materials, etc. which is recognized at the actual cost on an individual item basis. The cost comprises original cost of aircraft, equipment, installation, construction and other direct costs which includes interest accrued on loans financing the capital assets and related foreign currency exchange gains or losses, prior to the date of readiness for use.

Upon completion and readiness for use, the construction-in-progress is to be transferred to the account of fixed assets and accounts to be depreciated in the next month.

The Group assesses at each reporting date whether there is any indication that the construction-in-process maybe impaired. If any of the following indications is present, the Group shall estimate the recoverable amount of the asset. While the recoverable amount of the asset is lower than its carrying amount, the Group shall make provision for impairment at the excess of the carrying amount over its recoverable amount on an individual item basis and charge to the current period. The following indications include:

The project has been suspended for long time and is not expected to restart in 2 years;

The project has been obsolescent in function and technology and it is significant uncertainty that the economic benefits associated with it will flow to the Group;

There is any other indication that the construction-in-process may be impaired.

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## 12. Borrowing costs

Borrowing costs may include: interest on borrowings, amortization of discounts or premiums relating to borrowings, ancillary costs incurred in connection with the arrangement of borrowings, and exchange differences arising from foreign currency borrowings. Borrowing costs should be recognized as an expense in the period in which they are incurred, except to the extent that they are capitalized as part of the cost of that asset while borrowing costs are directly attributable to the acquisition, construction or production of a qualifying asset. The capitalization of borrowing costs as part of the cost of a qualifying asset should commence when:

Expenditures for the asset are being incurred;

Borrowing costs are being incurred; and

Activities that are necessary to prepare the asset for its intended use or sale are in progress.

When substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are completed, the capitalization of borrowing costs should cease and the borrowing costs should be recognized as an expense in the period in which they are incurred.

## 13. Intangible Assets

### Recognition of land use rights

The acquired land use right is recorded at purchase price (including related taxes). The invested land use right is recognized at valued price.

### Amortization of land use right

Land use right is amortized over their use years on a straight-line basis.

### Provision for impairment

The intangible asset is recorded at the lower of carrying amount and recoverable amount at the end of each period. If the recoverable amount of an intangible asset is lower than its carrying amount, the Group shall make provision for impairment on intangible asset on an individual item basis and charge into the current period.

## 14. Long-term Amortization Charges

Long-term amortization charges refer to the expenses that the amortization period is over one year (not including one year), including the direct costs incurred in relation to modifying and certifying certain operating leased or financial leased aircrafts, expenses on pilot recruiting, training, etc. All long-term amortization charges are amortized evenly over 3 to 7 years based on the benefit period of each item.

## 15. Other Long-term Assets

Other long-term assets refer to deferred losses and gains of sale and leaseback agreement, which represents the deferred losses or deferred gains arisen from the aircraft and engine sale and leaseback transactions. Deferred losses or deferred gains arisen from the operating sale and leaseback transactions are amortized evenly over the lease period. Deferred losses or deferred gains arisen from the finance sale and leaseback transactions are amortized evenly over the estimated useful lives.

## 16. Leases

Leases, where the Group has substantially all the risks and rewards of ownership, are classified as finance leases. Finance leases are capitalized at the present value of the minimum lease payments at

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the inception of the lease. The minimum lease payments are recorded as payables under finance leases. The difference between the present value of the minimum lease payments and the minimum lease payments is recognized as unrecognized finance charges which shall be amortized using the effective interest rate method over the period of the lease.

All the rest of leases are classified as operating leases. Payments under operating leases are recognized as expenses on a straight-line basis over the period of the lease.

#### 17. Revenue Recognition

The Group's revenue from rendering transportation service of passengers, charter flight and cargo is recognized when the revenue and costs could be measured reliably, relevant economic benefits could flow into the Group, and the completion stage of transportation services provided could be measured reliably.

The interest income and royalty arising from the use by others of the assets held by the Group is recognized when it is probable that the economic benefits associated with the transaction will flow to the Group and the amount of the revenue can be measured reliably.

#### 18. Income tax

The Group adopts tax payable method in recognition of income tax.

#### 19. Profit Appropriation

Pursuant to related regulations and statute, the net profit of the Group is appropriated in the following order:

- (a) To cover accumulated losses;
- (b) Provision for Statutory Surplus Reserve, accounted for 10%, (The provision for Statutory Surplus Reserve can be ceased while it reaches 50% of the registered capital.)
- (c) Provision for Statutory Public Welfare Fund, accounted for 5-10%
- (d) Provision for Discretionary Surplus Reserve
- (e) Payment of dividends. According to related regulations, profit available for distribution to owners is the lower net profits after the adjustment and appropriation in according with PRC accounting regulations and International Financial Reporting Standards.

#### 20. Basis of Consolidation

The consolidated financial statements are prepared in according with Cai-Kuai-Zi No.(1995) 11 *Provisional Regulation on Consolidation of Financial Statements* issued by the Ministry of Finance, Cai-Kuai-Er-Zi No.(1996) 2 *Answer to Questions about Consolidation Scope*, and other subsidiary requirements.

The investee enterprises will be included in the consolidated financial statements wherever the Group holds more than 50% or more voting capital of the investee enterprises, or hold less than 50% but has real control over the investee enterprise.

All significant inter-company balances and transactions, and any unrealized gains arising from

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inter-company transactions, have been eliminated on consolidation.

## II. Taxation Item

### 1. Income tax

#### (1) Parent Company income tax

Pursuant to the approval of Hainan Government by its circular Qiong Fu No.[1998]27, the income tax rate of the Company is 15% for year 2005.

#### (2) Subsidiaries income tax

(a). The applicable tax rate for Hainan Golden-Deer Aviation Sales Co., Ltd. is 15% for year 2005.

(b). The applicable tax rate for Hainan Airlines VIP Flight Services Co., Ltd. is 15% for year 2005.

(c). The applicable tax rate for China Xinhua Airlines Co., Ltd. is 33% for year 2005.

(d). The applicable tax rate for Chang'an Airlines Co. Ltd, and its subsidiary Shanxi Chang'an Hainan Aviation Star Hotel Co., Ltd. is 33% for year 2005.

(e). The applicable tax rate for Shanxi Airlines Co. Ltd is 33% for year 2005.

### 2. Turnover Tax and surcharges

<b>Tax</b>	<b>Basis of computation</b>	<b>Tax rate</b>
Value added tax	Catering revenues	6%
Business tax	Traffic revenues and Ground Service Income	3%
City construction tax	* Turnover tax	7%
Education surcharge	* Turnover tax	3%

\* Pursuant to circular Qiong-Cai-Shui No. [2004] 987 approved by the Bureau of Finance and Bureau of Taxation, The Company enjoys the Preferential Policy: the Company is exempted from city construction tax and education surcharge since 1 October 2004, which is applicable to foreign investment enterprises and foreign companies.

### 3. Individual income tax

The Group withholds individual income tax which is the burden of employees.

## III. Stock-held Subsidiaries and associated Companies

Brief introduction of stock-held subsidiaries included in the consolidated statement as at 31

December 2005:

Name of Investee Company	Registered Capital	Total Investment	Share-holding Percent	Scope of Business
A Hainan Golden-Deer Aviation Sales Co., Ltd.	8,000,000	7,600,000	95%	Transportation and chartered flight agency services
B Hainan Airlines VIP Flight Service Co., Ltd.	USD 1,020,408	USD 502,408	51%	Chartered flights agency services
C China Xinhua Airlines Co., Ltd.	1,830,000,000	933,300,000	60%	Approved air passenger and cargo transportation
D Chang'an Airlines Co.,Ltd.	754,390,000	554,563,300	73.51 %	Air passenger and cargo transportation in Shanxi province and its surrounding provinces
E Shanxi Airlines Co., Ltd.	320,000,000	285,000,000	92.51 %	Air passenger and cargo branch line transportation in Shanxi province and its surrounding provinces
F Beijing Xinhua Air Catering Co., Ltd.	29,990,000	15,294,900	51%	Production and sale of pastry, food and beverage
G Shanxi Chang'an Hainan Aviation Star Hotel Co., Ltd.	25,000,000	20,000,000	80%	Hotel and catering, commodity, costume sales, typing and other office services.
H Hainan Haihang Zhongmian Duty Free Co., Ltd	1,500,000	1,050,000	70%	Sale of duty free goods and present of travel

- A. Hainan Golden-Deer Aviation Sales Co., Ltd. ("Golden Deer") is jointly established by the Company and Hainan Aviation Imp. & Exp. Trading Co., Ltd. with 95% and 5% equity interest respectively.
- B. Hainan Airlines VIP Flight Service Co., Ltd. ("VIP Flight Service") is a Sino-foreign joint venture established by the Company and Swiss Mid-Europe Airline Development Co., Ltd. with 51% and 49% equity interest respectively. Both sides have already fully contributed their portions of the registered capital.
- C. China Xinhua Airlines Co., Ltd. ("Xinhua Airlines") is jointly established by the Company, Shenhua Group Co., Ltd. and Hainan Airlines Group Co., Ltd. ("HNA Group") with registered capital 1.83 billion. The Company contributed 933.3 million to hold 51% of total equity interest. According to validation by Hainan Weixin CPA Firm, all sides have already fully contributed their portions of the registered capital up to 31 August 2001. Accordingly, China Xinhua Airlines has been included in the consolidated scope since 1 September 2001. Pursuant to the capital transfer agreement signed by the Company and HAN Group in December 2002, the Company acquired HNA Group's interest 9% of share capital in Xinhua Airlines. As a result, the Company holds 60% of total equity interest, and Shenhua Group Co., Ltd. holds the rest of 40%.
- D. Chang'an Airlines Co. Ltd. ("Chang'an Airlines") was jointly established by the Company, Chang'an Aviation Industrial Company and HNA Group with registered capital 754,390,000. The Company contributes 200 million to hold 26.51% interest. All sides have already fully contributed their portions of the registered capital on 30 October 2001, which was validated by Shan'xi Xinghua CPA Firm. Pursuant to the capital transfer agreement signed by the Company

and HAN Group on 30 October 2001, the Company acquired HNA Group's interest 9% of share capital in Shang'an Airlines. As a result, the Company holds 73.51% of total equity interest, Chang'an Aviation Industrial Company holds 13.48% and HNA Group holds the rest of 12.65%.

- E. Shanxi Airlines Co., Ltd. ("Shanxi Airlines") was jointly established by the Company, Shanxi Aviation Industrial Co., Ltd. and Chang'an Airlines Co., Ltd with registered capital 320 million. The Company contributed 285 million to own an interest of 89.06 % share capital. Shaxi Aviation Industrial Company contributed the original net assets equivalent to 20 million to own an interest of 6.25% share capital. Chang'an Airlines contributed 15 million to own an interest of 4.69% share capital. All sides have already fully contributed their portions of the registered capital on 30 September 2002, which was validated by Taiyuan Zhongyuan CPA Firm.
- F. Beijing Xinhua Air Catering Co., Ltd. ("Xinhua Catering") was jointly established by China Xinhua Airlines Co., Ltd. ("Xinhua Airlines"), a subsidiary of the Company, and Beijing Air Fushi International Investment Co., Ltd. ("Air Fushi") with registered capital 29,990 thousand in September 2002. Xinhua Airlines contributed 15,294.9 thousand in cash to own an interest of 51% registered capital. All sides have already fully contributed their portions of the registered capital on 29 November 2002, which was validated by Beijing Yongtuo CPA Firm.

Pursuant to the increased capital agreement signed between Xinhua Airlines and Konggang Fushi dated 21 May 2004, Xinhua increased its share in Xinhua Airport in amount of 45,905 thousand in cash, and Konggang Fushi increased its share in Xinhua Airport by land use right with valued amount of 27,100 thousand and in amount of 17,005 thousand in cash. The registered capital increased from 29,990 thousand to 120,000 thousand thereafter and the interest of two shareholders does not change: Xinhua Airlines has a 51% interest with a mount of 61,200 thousand, and Konggang Fushi has the rest of 49% with a mount of 58,800 thousand. The change in business license has been completed up to the end of the balance sheet date.

- G. Shanxi Chang'an Hainan Aviation Star Hotel Co., Ltd. ("Chang'an Hainan Aviation Star") was jointly established by Chang'an Airlines Co. Ltd. ("Chang'an Airlines"), a subsidiary of the Company, and Hainan Aviation Hotel (Group) Co., Ltd. ("Hainan Aviation Hotel") with registered capital 25 million in May 2003. Chang'an Airlines contributed 20 million to own an interest of 80% and Hainan Aviation Hotel contributed 5 million to own an interest of 20%.
- H. Hinan Haihang Zhongmian Duty Free Co., Ltd ("Zhongmian Company") was jointly established by the Company and China Duty Free (Group) Co., Ltd. on 21 October 2004 with registered capital 1,500,000, with 70% and 30% interest respectively. All sides have already fully contributed their portions of the registered capital at the end of 31 December 2004, which was validated by Hainan Zhongzhou CPA Firm.

#### IV. Notes to the consolidated financial statements

##### 1. Cash in Bank and on Hand

Item	31 December 2005	31 December 2004
Cash on hand	1,557	1,243
Cash in bank	3,407,933	1,459,788
Other monetary assets	2,382,998	1,688,756
Total	<u>5,792,488</u>	<u>3,149,787</u>

The balance of cash & bank on 31 December 2005 includes the deposit 2,762,413 thousand in Hainan Airlines Group Finance Co., Ltd., which accounts for 48% of the accounts.

The balance of other monetary assets includes the guarantee deposit as amount to 174,568 thousand

(including guarantee deposit for notes as amount to 133,068 thousand, guarantee deposit for forward letter of credit 41,500 thousand, these two items are recognized as cash payable related to financial activities in the consolidated cash flow statement, which causes the difference between the cash and cash equivalent in consolidated cash flow statement and cash on hand and in bank.), and bank fixed deposit as amount to 2,208,430 thousand, including 214,326 thousand which has been pledged for the Group's liabilities as security.

Following are foreign currencies at 31 December 2005

Currency	Amount	Exchange Rate	31 December 2005
USD	81,359	8.0702	656,582
HKD	152	1.0403	158
Others	185,001		3,809
Total	266,512		660,549

## 2. Current Investment

Item	31 December 2005		31 December 2004	
	Amount	Provision for Impairment	Amount	Provision for Impairment
Trust Lending	30,000	0	0	0
Total	30,000	0	0	0

Xinhua Airlines, one of the Company's Subsidiaries, consigned HNA Group Finance Co., Ltd. to lend money to HNA Group: the principal is 30,000 thousand, loan time limit is between May 2005 to May 2006, and the annual rate is 6.138%.

## 3. Receivable (Including Accounts Receivable and Other Receivable)

(1) Account receivable aging analysis:

Aging	31 December 2005			31 December 2004		
	Amount	Percentage	Provision for bad debts	Amount	Percentage	Provision for bad debts
Within one year	392,380	89		197,456	66	
1-2 years	22,430	5		78,708	26	6
2-3 years	7,385	2	35	3,400	1	29
More than 3 years	19,226	4	18,744	21,643	7	18,546
Total	441,421	100	18,779	301,207	100	18,581

The top 5 companies owe a total amount of 133,899 thousand, accounting for 30% of the total ending balance.

Account receivables due from shareholders with over 5% (include 5%) of the Company include

Hainan Airlines Group Co. as amount to 397 thousand.

(2). Other Receivables

Other receivable aging analysis:

Aging	31 December 2005			31 December 2004		
	Amount	Percentage	Provision for bad debts	Amount	Percentage	Provision for bad debts
Within 1 year	1,156,504	55	2,998	1,192,579	57	3,451
1-2 years	325,564	15	5,453	256,495	12	20,969
2-3 years	94,475	5	13,606	511,151	24	82,113
More than 3 years	532,325	25	173,462	138,697	7	37,561
Total	<u>2,108,868</u>	<u>100</u>	<u>195,519</u>	<u>2,098,922</u>	<u>100</u>	<u>144,094</u>

The top 5 companies owe a total amount of 1,057,236 thousand, accounting for 50% of the total ending balance.

The Group reclassified advance to suppliers to other receivables which leads to the fluctuation of aging between 31 December 2005 and 31 December 2004.

The balance of other receivable mainly includes receivable amount due from deposits for operating aircraft leases and customs duty and related parties etc. (See Note 8). According to the opinion of the board of directors of the Company, there is no recovery risk for receivables due from related parties and no provision should be made. Provision for bad debts is not made for the items that are surely to be recovered, including guaranteed deposit for aircraft lease, security fund for customs duty, etc. The Group makes allowance for the remainders according to the aging method and individual analysis results.

Other receivables due from shareholders holding over 5% (including 5%) interest of the Company include Hainan Airlines Group Co., Ltd in amount of 12,893 thousand.

(3). Detail Information of 100% Provision for Other Receivables

Companies	31 December 2005	Aging	Percentage	Provision for Bad Debts	Owners	Remarks
Shanxi Airlines Industry Co., Ltd	7,291	1-2 year	100%	4,292	Shanxi Airlines	Irrecoverable
Wangfu Department	11,799	5-6 years	100%	11,799	Xinhua Airlines	Irrecoverable
Aojinsen Special Equipment Co., Ltd.	4,930	5-6 years	100%	4,930	Xinhua Airlines	Irrecoverable
GE Capital Aviation Service	14,176	Over 6 years	100%	14,176	The Company	Irrecoverable
China Leasing Co., Ltd.	6,302	3-4 years	100%	6,302	The Company	Irrecoverable
Hainan Fudi Real Estate Development Co., Ltd.	10,198	2-3 years	100%	10,198	The Company	Irrecoverable
Pratt & Whitney Canada ADA Coration	17,443	4-5 years	100%	17,443	The Company	Irrecoverable

#### 4. Advance to Suppliers

Aging	31 December 2005		31 December 2004	
	Amount	Percentage	Amount	Percentage
Within 1 year	31,091	28	281,682	61
1—2 years	13,257	12	108,058	23
2—3 years	38,320	35	40,179	9
More than 3 years	27,964	25	32,854	7
Total	<u>110,632</u>	<u>100</u>	<u>462,773</u>	<u>100</u>

Compared with 31 December 2004, the amount of advance to suppliers on 31 December 2005 declines 76%, main reason is that some items with long aging have been reclassified into other receivable.

The top 5 companies owe a total amount of 92,610 thousand, accounting for 84% of the total ending balance.

There's no advance to suppliers due from shareholders holding over 5% (including 5%) interest of the Company.

#### 5. Inventories and provision for loss on realization of inventory

Item	31 December 2005		31 December 2004	
	Amount	Provision for loss on realization of inventory	Amount	Provision for loss on realization of inventory
Aviation consumables	293,067	5,115	311,355	5,115
Aviation on-board supplies	9,098	83	9,366	83
Low cost consumables	10,754	0	13,403	0
Others	15,981	0	9,118	0
Total	<u>328,900</u>	<u>5,198</u>	<u>343,242</u>	<u>5,198</u>

#### 6. Deferred and Prepaid Expenses

Items	31 December 2005	31 December 2005	Remarks
Aircraft operating lease rental	48,674	70,075	Regular balance
Others	1,297	811	Regular balance
Total	<u>49,971</u>	<u>70,886</u>	

## 7. Long-term Equity Investments

### (1). Long-term equity investment:

Items	31 December 2005	31 December 2004
Investment in associates	320,835	282,221
Other equity investment	440,579	440,578
Total	761,414	722,799
The investment difference in Xinhua Airlines	38,373	45,145
The investment difference in Chang'an Airlines	5,759	6,747
The investment difference in Shanxi Airlines	67,672	77,576
Less: Provision for impairment	14,774	14,774
Net value	858,444	837,493

### (2). Long-term equity investment breakdown:

Items	31 December 2005	31 December 2004	Share-holding Percentage	Provision for Impairment	Remarks
<b>Investment in associates</b>					
Hainan Haihang Aircraft Maintenance Co., Ltd.	28,775	28,865	48%		
Hainan Haihang Airlines Aviation Import & Export Co., Ltd.	9,498	8,113	30%		
Lucky Internantional Travel Services Co., Ltd.	18,419	19,694	44%		
Beijing Yanjing Hotel Co., Ltd.	59,764	62,652	40%		
Beijing Vision Advertising Co., Ltd.	2,886	2,764	30%		
Xinda International Transportation Agency Co., Ltd.	2,461	2,360	49%		
Beijing Hengshi Real Estate Development Co., Ltd.	0	5,469	20%		C
Beijing Tianchen Exhibition Co., Ltd.	0	1,049	20%		C
Shenzhen Aviation Hotel	2,574	2,210	25%		
Chongqing Changjiang Leasing Company Limited	39,040	39,744	40%		
Xinhua Airlines United Transportation Services Co., Ltd.	784	992	50%		
Yunnan Shilin Airlines Company Limited	8,000	8,000	54.70%	8,000	A
Hainan Airlines Group Finance Company Limited	101,561	100,309	33.33%		
Yunnan Xiangpeng Airlines Co., Ltd.	47,073	0	31.38%		B
Subtotal of investment in associates	320,835	282,221		8,000	
<b>Other Equity Investment</b>					
Hainan Aviation Hotel (Group) Co., Ltd.	58,161	58,161	19%		
Hainan Xinguo Hotel Co., Ltd.	15,000	15,000	15%		
Hainan Airlines Tourism Development Co. Ltd.	3,274	3,274	3.30%		
Hainan Meilan Airport Co., Ltd.	6,906	6,906	2.20%		

China Civil Aviation Information Network Co. Ltd.	29,860	29,860	3.39%	
Hainan Development Bank	5,000	5,000	0.30%	5,000
Yangtze River Express Co., Ltd.	10,000	10,000	5%	
Shenhua Finance Co., Ltd.	5,000	5,000	1.60%	
Haikou Meilan Airport Co., Ltd.	304,765	304,765	16.48%	
Others	2,613	2,612		1,774
<b>Subtotal of other equity investment</b>	<b>440,579</b>	<b>440,578</b>		<b>6,774</b>
<b>Total long-term equity investment</b>	<b>761,414</b>	<b>722,799</b>		<b>14,774</b>

A Yunnan Shilin Airline Co., Ltd. has not operated formally. Accordingly, it is not included in the consolidated financial statement for year 2005 and the Company makes 100% provision for impairment on this equity investment

B Pursuant to reorganization and business development, Yunnan Xiangpeng (with former name “Shilin Airlines Co., Ltd.) was jointly established by HNA Group, Shanxi Airlines, Yunnan Shilin Airlines with monetary capital in November 2005, which has been approved by the first temporary general meeting of shareholders held on 24 January 2006. The registered capital of Yunnan Xiangpeng is 150,000 thousand: HNA Group has a 67.95% interest ( 101,927 thousand), Shanxi Airlines has a 31.38% Interest ( 47,073 thousand), and Yunnan Shilin Airlines has the rest of 0.67% interest ( 1,000 thousand). In according with the validation report (Kun Ya Hui Yan Zi No. [2005] 1-105), the process of the increased share capital has been completed on 18 November 2005. Yunnan Xiangpeng is still in organization period until the end of 2005.

C In February and August 2005, the Company transferred its 20% interest in Beijing Tianchen Exhibition Co., Ltd. and Beijing Hengshi Real Estate Development Co., Ltd. to Xian Minsheng Real Estate Co. Ltd at the price 1,200 thousand and 5,800 thousand respectively.

(3). Long-term equity investment with equity method breakdown:

Item	Initial Amount	Addition	Accrued Investment income	Accrued Increase/ Decrease	Ending amount
Hainan Haihang Aircraft Maintenance Co., Ltd	50,000	-19,517	-1,708	-21,225	28,775
Hainan Haihang Airlines Aviation Import & Export Co., Ltd.	3,000	0	6,498	6,498	9,498
Lucky International Travel Services Co., Ltd.	22,000	0	-3,581	-3,581	18,419
Beijing Yanjing Hotel Co., Ltd.	11,269	62,119	-13,624	48,495	59,764
Beijing Vision Advertising Co., Ltd.	3,000	0	-114	-114	2,886
Xinda International Transportation Agency Co., Ltd.	3,312	0	-851	-851	2,461
Beijing Hengshi Real Estate Development Co., Ltd.	5,800	-5,800	0	-5,800	0
Beijing Tianchen Exhibition Co., Ltd.	1,038	-1,038	0	-1,038	0
Shenzhen Aviation Hotel	5,082	0	-2,508	-2,508	2,574
Chongqing Changjiang International Leasing Co., Ltd.	40,545	0	-1,505	-1,505	39,040
Xinhua Airlines United Transportation Services Co., Ltd.	2,750	0	-1,966	-1,966	784
Yunnan Shilin Airlines Company Limited	8,000	0	0	0	8,000
Hainan Airlines Group Finance Company Limited	100,000	0	1,561	1,561	101,561

Yunnan Xiangpeng Airlines Co., Ltd.	47,073	0	0	0	47,073
Total	<u>302,869</u>	<u>35,764</u>	<u>-17,798</u>	<u>17,966</u>	<u>320,835</u>

(4) Consolidation differences

Items	Initial Amount	31 December 2004	Addition	Amortization	31 December 2005
Xinhua Airlines	68,109	45,145	0	6,772	38,373
Chang'an Airlines	9,878	6,747	0	988	5,759
Shanxi Airlines	<u>99,033</u>	<u>77,576</u>	<u>0</u>	<u>9,903</u>	<u>67,673</u>
Total	<u>177,020</u>	<u>129,468</u>	<u>0</u>	<u>17,663</u>	<u>111,805</u>

## 8. Fixed Assets

### (1) Cost, Accumulated depreciation

	Plant & Building	Aircraft & Engines owned	Aircraft & Engines held under finance lease	Leasehold improvement	Vehicles	Other Equipments	High-price rotatable spares	Total
Cost								
31 December 2004	1,841,189	9,336,778	5,241,315	210,572	193,371	313,568	2,135,688	19,272,481
Additions	268,791	4,851,231	181,274	1,381	23,809	43,552	207,361	5,577,399
Including CIP transferred in	241,367	4,466,475		398		21,881		4,730,081
Disposals	<u>6,949</u>		<u>182,424</u>		<u>8,320</u>	<u>16,508</u>		<u>214,201</u>
31 December 2005	<u>2,103,031</u>	<u>14,188,009</u>	<u>5,240,165</u>	<u>211,953</u>	<u>208,860</u>	<u>340,612</u>	<u>2,343,049</u>	<u>24,635,679</u>
Accumulated depreciation:								
31 December 2004	179,692	1,356,469	1,492,557	156,797	86,729	116,460	812,274	4,200,978
Additions	48,878	538,886	270,732	20,343	17,895	33,091	165,670	1,095,495
Disposals	<u>1,452</u>		<u>36,932</u>		<u>3,258</u>	<u>8,915</u>		<u>50,557</u>
31 December 2005	<u>227,118</u>	<u>1,895,355</u>	<u>1,726,357</u>	<u>177,140</u>	<u>101,366</u>	<u>140,636</u>	<u>977,944</u>	<u>5,245,916</u>
<b>Net book value:</b>								
31 December 2004	<u>1,661,497</u>	<u>7,980,309</u>	<u>3,748,758</u>	<u>53,775</u>	<u>106,642</u>	<u>197,108</u>	<u>1,323,414</u>	<u>15,071,503</u>
31 December 2005	<u>1,875,913</u>	<u>12,292,654</u>	<u>3,513,808</u>	<u>34,813</u>	<u>107,494</u>	<u>199,976</u>	<u>1,365,105</u>	<u>19,389,763</u>

- A. Increases in plant & building in amount of 268,790 thousand are mainly transferred from construction in progress including Xianyang Travel Training College, Catering Building, Xinhua Airport, Tianzhu 3<sup>rd</sup> Stage, Beijing International Airport.
- B. Increase in owned aircraft & engines in amount of 4,851,231 thousand is mainly due to the transferred in five B737-800 aircrafts, six A319 and three aircraft simulators from construction in progress.
- C. Pursuant to the agreement signed by the Company, the Liquidation Team of Xinjiang Finance leasing Co., Ltd., and Wulumuqi Hongshan Branch, China Construction Bank in October 2005,

The Company agreed to undertake all the debts of Xinjiang Finance Leasing Co., Ltd due to Wulumuqi Hongshan Branch, China Construction Bank and Xinjiang Finance leasing transferred its leased Dash-8 airlines to the Company. The agreement reached to the decrease of the cost of aircrafts and engines of the Group in amount of 182,424 thousand, and accumulated depreciation in amount of 3,258 thousand.

Increase in aircrafts held under finance lease is due to the 2 Dornier Aircrafts finance lease signed with Hainan BiaoZhun Leasing Co., Ltd.

The high-price rotatable spares have increased 207,361 thousand, since the number and type of aircraft quickly increases.

- D. Up to 31 December 2005, Fix assets of the Company have been pledged as security for loans of the Group include: plant and buildings (cost: 1,144,915 thousand, net value: 1,031,069 thousand; aircrafts and engines (cost: 7,818,155 thousand, net value: 6,854,792 thousand, including five Donier standby engines (cost: 74,550 thousand, net value: 62,866 thousand).
- E. Up to the balance sheet date, included in the net book value of buildings is a total of 238,213 thousand for which property certificates have not been obtained, the application of property certificates for these buildings is still in process. According to Wan Yi Zi No.2 [2006] and No.5[2006] verified by Hainan Wanli Legal Firm, the Company will get the property certificates for these buildings.

## (2) Provision for Impairment

Items	31 December 2004	Additions	Disposals	31 December 2005
Plant and Buildings	1,389	8,000	1,052	8,337
High-price rotatable spares	16,378	0	0	16,378
Furniture & Office Equipment	130	0	0	130
Machinery Equipment	400	0	0	400
Others	14	0	0	14
<b>Total</b>	<b>18,311</b>	<b>8,000</b>	<b>1,052</b>	<b>25,259</b>

The Group accounted provision for impairment of buildings in excess of net accounting amount and recoverable amount which is equal to 8,000 thousand in Year 2005.

The Group disposed part of impaired fixed assets during year 2005, which reached to the decrease of total provision for impairment with amount of 1,052 thousand.

## 9. Construction in Progress

### (1). Construction in Progress includes:

<u>Items</u>	<b>31 December 2005</b>	<b>31 December 2004</b>
Prepayment for aircraft & Engine	784,815	1,544,169
Construction Projects	339,830	834,437
<b>Total</b>	<b>1,124,645</b>	<b>2,378,606</b>
Provision for impairment	6,862	500

Net book value	1,117,783	2,378,106
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(2). Prepayment for aircraft and engines Breakdown

Items	31 December 2004	Additions	Transferred to FA	31 December 2005
4 B737-800 aircrafts signed in 2004	924,679	1,559,555	2,050,800	433,434
5 Dornier aircrafts signed in 2005	20,723	0	0	20,723
1 A319 signed in 2004	598,767	1,688,042	2,060,318	226,491
8 B787 aircrafts signed in 2005	0	104,167	0	104,167
Others	0	149	149	0
<b>Total</b>	<b>1,544,169</b>	<b>3,351,913</b>	<b>4,111,267</b>	<b>784,815</b>

(3). Construction Projects Breakdown

Name	31 December 2004	Addition	Transferred to Fix Assets	Other Disposals	31 December 2005	Source of Fund	Stage of completion	Remarks
GENESYS software	0	1,470	0	0	1,470	Owned	In progress	
PROS income management system	2,342	495	0	0	2,837	Owned	In progress	
Basement in Beijing International Airport	4,748	12,178	16,926	0	0		finished	
Catering Building	39,887	29,772	69,320	339	0		finished	
Kehang Mansion	301,430	0	0	0	301,430	Owned	In progress	
Sanya Travel Training School	451,292	21,721	470,287	0	2,726	Bank loans	In progress	
Tianzhu 3 <sup>rd</sup> Stage	7,877	45,702	53,579	0	0		finished	
Xiguan Airport	500	0	0	0	500	Owned	Suspend	
Others	26,361	13,208	8,702	0	30,867	Owned	In progress	
<b>Total</b>	<b>834,437</b>	<b>124,546</b>	<b>618,814</b>	<b>339</b>	<b>339,830</b>			

- A. Sanya Travel Training School is jointly constructed project by the Company and Sanya municipal government. This project includes acquisition of 3 aircraft simulators with amount of 355,208 thousand and building classrooms and dormitories. The planned completion schedule was during the end of 2004. Up to the balance sheet date, this project has almost been completed.
- B. Beijing Kehang Mansion is jointly invested by the Company and Beijing Kehang Investment Company limited. The total budget is 451,760 thousand and the planned completion schedule is on 31 December 2006.
- C. Increase in construction in progress includes capitalized interest and exchange loss or gain in amount of 62,387 thousand at the capitalization rate as follow: 5.91% for A319, 5.73% for B737-800.

(4) Provision of Impairment

<b>Item</b>	<b>31 December 2004</b>	<b>Additions</b>	<b>Disposals</b>	<b>31 December 2005</b>
Xiguan Airport	500	0	0	500
3 Dornier 328 signed in 2003	0	6,362	0	
<b>Total</b>	<b>500</b>	<b>6,362</b>	<b>0</b>	<b>6,862</b>

10. Intangible Assets

<b>Items</b>	<b>Land Use Right</b>
Acquisition method	Purchase
Cost	16,081
31 December 2004	14,674
Additions	0
Amortization	402
Other disposal	
Accumulated amortization	1,809
31 December 2005	14,272
Remaining years	35

11. Long-term deferred expenses

<b>Items</b>	<b>31 December 2004</b>	<b>Additions</b>	<b>Amortization</b>	<b>Other disposals</b>	<b>31 December 2004</b>	<b>Initial Amount</b>	<b>Remaining Years</b>	<b>Accumulated Amortization</b>
Supervision for Reforming Aircraft	46,744	0	18,449		28,295	208,048	1-5	179,753
Initial acquisition of Pilots & training Fee	289,787	96,574	72,332		314,029	518,492	1-7	204,463
Rents of Tianzhu Basis	18,830	0	1,093		17,737	26,587	23	8,850
Using charge for Tianjin Aircraft Parking Area	8,694	0	381		8,313	9,760	21	1,447
Others	46,850	565	9,672		37,743	146,621	1-6	108,878
<b>Total</b>	<b>410,905</b>	<b>97,139</b>	<b>101,927</b>		<b>406,117</b>	<b>909,508</b>		<b>503,391</b>

12. Other long-term assets

Deferred losses and gains under sale and leaseback transactions breakdown:

<b>Lessor</b>	<b>31 December 2004</b>	<b>Addition</b>	<b>Amortization</b>	<b>Other Disposals</b>	<b>31 December 2005</b>	<b>Initial Amount</b>	<b>Remaining Years</b>	<b>Accumulated Amortization</b>
Sumisho Aircraft Asset Management B.V	45,232	0	8,218	0	37,014	65,744	4.5	28,730
Mc. Aviation Financial Services (Europe) B.V	45,457	0	8,157	0	37,300	65,264	4.5	27,964

Jiangsu Leasing Co., Ltd.	-1,447	0	-81	0	-1,366	-1,616	17	-250
Chongqing Changjiang International Leasing Co., Ltd.	43,047	0	6,510	0	36,537	53,616	0.5-7.5	17,079
Far East International Leasing Co., Ltd.	33,243	0	3,961	0	29,282	39,844	7.5	10,562
Shenzhen Leasing Co., Ltd.	213,820	0	11,091	0	202,729	235,055	2-17	32,326
<b>Total</b>	<b>379,352</b>	<b>0</b>	<b>37,856</b>	<b>0</b>	<b>341,496</b>	<b>457,907</b>		<b>116,411</b>

Other long-term assets refer to deferred losses and gains under sale and leaseback transaction, which represents the difference between the selling price of the aircrafts and engines under sale and leaseback transactions and their carrying amount. Deferred losses or gains arisen from operating leases are amortized evenly over the lease period. Deferred losses or gains arisen from finance leases are amortized evenly over the estimated useful lives.

### 13. Short-term Loans

Item		<b>31 December 2005</b>	<b>31 December 2004</b>	<b>Annual Interest Rate</b>
Bank loans				
Including:	Unsecured loans	530,000	100,000	5.05%
	Mortgaged loans	442,000	400,000	5.86%
	Guaranteed loans	3,233,000	2,359,049	5.022%-5.58%
	Hypothecation loans	506,779	422,500	4.72%-5.58%
Loans from other financial institutions				
Including:	Unsecured loans	112,609	26,735	5.59%
	Guaranteed loans	<u>30,000</u>	<u>0</u>	8.3%
<b>Total</b>		<b><u>4,854,388</u></b>	<b><u>3,308,284</u></b>	

The pledges of 362,000 thousand mortgaged loans include: the plants and buildings of the Company, Haihan Xinglong Spa and Golf Co., Ltd., and Hainan Xinguo Hotel. 80,000 thousand mortgaged loans have been pledged by the buildings of Chang'an Airlines. At the same time, Haikou Meilan International Airport Co., Ltd. and Shanxi Yingze Aviation Hotel Co., Ltd provide security for the mortgaged loans.

Haikou Meilan Airport Co., Ltd. and Hainan Airlines Group Co., Ltd. guaranteed for the bank loans of the Company as amount to 2,172,000 thousand. The Company guaranteed for the bank loans of the subsidiaries as amount to 731,000 thousand. Xinhua Airlines guaranteed for the bank loans as amount to 300,000 thousand and guaranteed for the bank loans of Xinhua Airport as amount to 30,000 thousand.

Hypothecation loans as total amount to 136,000 thousand have been impawned by the

Company's 332, 560 thousand shares in Xinhua Airlines, HNA Group's 130 million shares in Yangzijiang has been impawned for hypothecation loans as amount to 160,000 thousand and the rest of loans have been impawned by the Company's fixed deposit 210,779 thousand.

The balance of loans from other financial institutions on 31 December 2005 include the loan borrowed from Hainan American Co., Ltd. as amount to 5,015 thousand, from Hainan Airlines Group Finance Co., Ltd. as amount to 107,594 thousand and from Shanghai International Investment Co., Ltd. as amount to 30,000 thousand guaranteed by HNA Group.

#### 14. Notes Payable

<b>Item</b>	<b>31 December 2005</b>	<b>31 December 2004</b>
Bank Acceptance	116,000	371,672
Commercial Acceptance	701,433	270,765
Total	<u>817,433</u>	<u>642,437</u>

There is no payable due to shareholders holding over 5% (including 5%) interest of the Company.

#### 15. Payable

##### (1) Accounts Payable

The balance of accounts payable is 1,533,233 thousand on 31 December 2005. (2004: 967,919 thousand) mainly includes payables of aviation material, fuel oil fee, take off expenses and payables of selling tickets for other airline companies.

Account payable due to shareholders holding over 5% (including 5%) interest of the Company include Hainan Airlines Group Co., Ltd. as amount to 92,003 thousand.

##### (2) Other Payables

The balance of other payable is 361,824 thousand in the end of year 2005 (634,746 thousand for 2004). The main reason for decrease in year 2005 is due to the decrease of payables of Hainan Jiahui Investment Co., Ltd. in amount of 187,000 thousand.

The other payable due to shareholders holding over 5% (including 5%) interest of the Company is the payables due to Hainan Airlines Group Co., Ltd. as amount of 14,306 thousand.

#### 16. Dividend Payable

<b>Items</b>	<b>31 December 2005</b>	<b>31 December 2004</b>	<b>Remarks</b>
Legal person shares	21,011	21,013	Normal arrears to pay
Others	5,878	5,878	Normal arrears to pay
Total	<u>26,889</u>	<u>26,891</u>	

17. Taxes Payable

<b>Item</b>	<b>31 December 2005</b>	<b>31 December 2004</b>
Value-added Tax	288,226	210,649
Business tax	27,695	16,881
City construction tax	2,988	1,200
Income tax	-1,766	-2,081
Customs duty	-21,841	40,888
Others	1,632	6,749
Total	<u>296,934</u>	<u>274,286</u>

For details of the tax rate of the Group goes to Note V: Taxation Items.

18. Other statutory payable

<b>Item</b>	<b>31 December 2005</b>	<b>31 December 2004</b>
Civil aviation infrastructure Fund	140,052	69,949
Education surcharge	2,947	2,906
Airport Construction Fee	<u>170,909</u>	<u>72,463</u>
Others	<u>0</u>	<u>0</u>
Total	<u>313,908</u>	<u>145,318</u>

Increase in other statutory payable as amount to 168,590 thousand compared with 31 December 2004, the main reason is the increase of civil aviation infrastructure fund and withhold airport construction fee. The balance as at 31 December 2005 is mainly represented the civil aviation infrastructure fund.

According to circular Cai Zong No.[2004]51 *the Answer of reform the collection of civil aviation construction fee* approved by the Ministry of Finance (“MOF”) and the Civil Aviation Administration of China, the carrier withholds airport construction fee from passengers for the Civil Aviation Administration of China (“CAAC”) and hand in to CAAC per month effected 1 September 2004, The balance of airport construction fee is mainly the payables of the fee.

19. Accrued Expenses

<b>Items</b>	<b>31 December 2005</b>	<b>31 December 2004</b>
Fuel expenses	271,399	362,469
Take-off expenses	391,530	358,559
Catering expenses	20,525	45,439
Loan interest	47,051	31,408
Aircraft & engine maintenance costs	282,159	34,737

Fee of computer reservation	66,284	40,943
Promotion expenses	10,000	10,870
Aircraft insurance premium	61,318	39,955
Others	16,471	4,542
<b>Total</b>	<b>1,166,737</b>	<b>928,922</b>

## 20. Sales in Advance of Carriage

The balance of sales in advance of carriage represents the amount of sold but unused tickets in amount of 477,141 thousand on 31 December 2005.

## 21. Current Portion of Long-term Liabilities

Item	31 December 2005	31 December 2004
Current portion of long-term loans (a)	1,529,199	1,521,720
Current portion of long-term payable (b)	589,171	589,423
<b>Total</b>	<b>2,118,370</b>	<b>2,111,143</b>
Plus: Unrecognized finance leasing expenses	63,386	78,396
<b>Current Portion of Long-term Liabilities</b>	<b>2,054,984</b>	<b>2,032,747</b>

### (a) Current portion of long-term loans

Item	31 December 2005	31 December 2004
Bank Loans		
Including:		
Unsecured loans	269,968	180,000
Mortgaged loans	425,178	341,336
Guaranteed loans	450,000	242,415
Hypothecation loans	384,053	575,076
Subtotal	1,529,199	1,338,827
Loans from other financial institutions		
Including:		
Unsecured loans	0	182,893
Subtotal	0	182,893
<b>Total</b>	<b>1,529,199</b>	<b>1,521,720</b>

Unsecured loans are the loans from financial institution for the acquisition of aircrafts.

Mortgaged loans are pledged by the owned aircraft as security.

Meilan Airport and HNA Group guaranteed for loans of the Group as amount to 450,000 thousand.

Hypothecation loans as total amount to 102,211 thousand have been impawned by the Company's interest in its subsidiaries and Hainan Meilan International Airport Co., Ltd. 160,000 thousand has been impawned by the Group's BPS benefit right and the rest of 121,842 thousand has been impawned by HNA Group's share in Meilan Airport.

(b) Current portion of long-term payables

Current portion of long-term payables of the Company is payables due within one year for aircraft and engines under finance lease.

Lessor	Period	Initial Amount	Interest Payable	31 December 2005
Raytheon	11.5	82,880	0	6,480
Shenzhen Finance & Leasing Co. Ltd	5-10	885,860	40,069	128,399
Sino-America Aviation	6	24,309	0	6,295
Pacific American Corporation	11.5	1,437,975	0	185,349
Jiangsu Leasing Co., Ltd.	3	37,111	0	8,963
Chongqing Changjiang International Leasing Co., Ltd.	2-3	231,105	412	83,364
Structured Trade Finance Group	11-13	1,176,864	11-13 years	77,686
Far East International Leasing Co., Ltd.	2-4.5	290,000	8,445	62,777
Hainan Biaozhun Leasing Co., Ltd.	6	145,264	7,261	29,858
Total		<u>4,311,368</u>	<u>63,386</u>	<u>589,171</u>

22. Long-term Loans

		31 December 2005	31 December 2004
Bank loans			
Including:	Unsecured loans	1,272,079	114,436
	Mortgaged loans	2,516,790	7,224,681
	Guaranteed loans	2,443,667	1,994,350
	Hypothecation loans	7,089,738	954,662
	Subtotal	<u>13,322,274</u>	<u>10,288,129</u>
Loans from other financial institutions			
Including:	Unsecured loans	<u>3,967</u>	<u>1,226,465</u>
	Subtotal	<u>3,967</u>	<u>1,226,465</u>
Total		<u>13,326,241</u>	<u>11,514,594</u>

90,000 thousand mortgaged loans have been pledged by the Group's buildings, the rest of them have pledged by the Group's owned aircrafts.

Meilan Airport and Hainan Airlines Group guaranteed for the guaranteed loans of the Group as amount to 2,443,667 thousand.

320,000 thousand hypothecation loans have been impawned by the Group's BSP benefit right,

884,361 thousand have been impawned by HNA Group's share in Meilan Airport, 2,302,224 impawned by the Group's aircraft acquisition contracts, and 3,583,153 thousand has been impawned by the Company's interest in its subsidiaries and Meilan Airport, and also pledged by HNA Group, HNA Hotel (Group), and Haian Qixing Industry Investment's interest in their subsidiaries, the owned Dornier aircrafts, and the Group's property right, the land use right of Hainan Xinglong Spa and Entertainment Co., Ltd.

## 23. Long-term Payables

(1) Long-term payables by remaining due years breakdown:

Items	31 December 2005	31 December 2004
Minimum Lease Payments		
Including: The second year	395,755	463,709
The third year	283,694	402,083
Following years	1,263,467	1,572,256
Total	1,942,916	2,438,048
Plus: Unrecognized finance leasing expenses	176,043	257,790
Long-term Payables	1,766,873	2,180,258

Long-term payables represent payments for finance leasing aircraft and engines. The long-term payable due within one year has been reclassified as current portion of long-term liabilities.

(2) Long-term payables by clients breakdown

Lessor	Remaining Years	Initial Amount	Interest Payable	31 December 2005	Type
Raytheon	11.5	82,880	0	46,636	Finance leasing aircraft
Shenzhen Finance & Leasing Co. Ltd	5-10	885,860	153,384	648,614	Finance leasing aircraft & engines
Sino-America Aviation	11.5	1,437,975	0	959,772	Finance leasing aircraft
Jiangsu Leasing Co., Ltd.	3	37,111	0	8,963	Finance leasing aircraft & engines
Structured Trade Finance Group	11-13	1,176,864	1,440	36,683	Finance leasing aircraft
Far East International Leasing Co., Ltd.	2-4.5	290,000	7,280	116,940	Finance leasing aircraft
Hainan Biao Zhun Leasing Co., Ltd.	6	145,264	13,939	125,308	Finance leasing aircraft
Total		4,055,954	176,043	1,942,916	

## 24. Specific Payables

The balance of specific payment for the year ended 31 December 2005 is 20,000 thousand, which is a financial allocation appropriated by the Shanxi Development and Planning Committee to Chang'an Airlines for the project of Xianyang Aircraft Parking Area pursuant to its circular Shan Ji Tou Zi No.[2001]1239.

## 25. Other Long-term Liabilities

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The balance of other long-term liabilities is 143,113 thousand as of 31 December 2005 which is the VAT payables and customs duty for the imported aircraft in 2006 and later.

26. Minority Interests

<b>Subsidiary Company</b>	<b>Owners Equity as at 31 December 2005</b>	<b>Percentage</b>	<b>Amount</b>
China Xinhua Airlines Co., Ltd.	1,520,761	40%	608,304
Changan Airlines Co., Ltd.	279,656	26.49%	74,081
Shanxi Airlines Co., Ltd.	257,127	6.25%	16,077
Deer Jet Co., Ltd.	119,631	5%	5,982
Hainan Airlines VIP Flight Services Co., Ltd.	-29,902	49%	-14,652
Hainan Haihang Zhongmian Duty Free Co., Ltd.	1,573	30%	472
Beijing Xinhua Air Catering Co., Ltd.	113,819	49%	55,771
Shanxi Chang'an Hainan Aviation Star Hotel Co., Ltd.	23,126	20%	4,625
<b>Total</b>			<b>750,660</b>

27. Share Capital

Par share value is 1.00, the Share capital breakdown:

<b>Item</b>	<b>31 December 2004</b>	<b>Increase /Decrease</b>	<b>31 December 2005</b>
(1) Unlisted shares			
(a) Promoter shares	134,837	0	134,837
Including: State shares	17,289	0	17,289
(b) Domestic legal person shares	38,735	0	38,735
(c) Foreign legal person shares	0	0	0
Subtotal	173,572	0	173,572
(2) Listed shares			
(a) Domestic investment shares-A shares	371,958	0	371,958
(b) Foreign investment shares-B shares	184,723	0	184,723
Subtotal	556,681	0	556,681
<b>Total</b>	<b>730,253</b>	<b>0</b>	<b>730,253</b>

28. Capital Reserve

<b>Items</b>	<b>31 December 2004</b>	<b>Increase</b>	<b>Decrease</b>	<b>31 December 2005</b>
Share premium	965,745		0	965,745
Donated aviation materials	11,056	0	0	11,056
Share premium from Associated Company	61,605	0	0	61,605
Related party transactions difference	18,091	0	0	18,091
Provision for equity investment	2,232	155	0	2,387
Others	0	1,500,000	0	1,500,000
<b>Total</b>	<b>1,058,729</b>	<b>1,500,155</b>	<b>0</b>	<b>2,558,884</b>

In accordance with the approval of China Regulatory Securities Commission by its circular Zheng Jian Gong Si Zi No.[2005]50 Notice of Hainan Airlines issuing directional shares, Hainan Airlines can issue no more than 2,800 million personal legal shares. Pursuant to the personal legal share agreement signed between the Company and Xinhua Airlines Holding Co., Ltd (“Xinhua Airlines Holding”) dated 24 October 2005, the Company issued 750 million personal legal shares to Xinhua Airlines Holding for a consideration of 1,500 million, which has been verified by Asian Pacific Zhonghui CPA firm. The change of business license and legal documents will be completed until the total 2,800 million issuing share completes. The amount of 1,500 million has been temporarily credited to “capital reserve—others”. The usage of the RMB1,500,000,000 is restricted by the resolutions of the 11th Session of the 4th Board Meeting of the Company and the 1st Temporary Board Meeting of 2005 of the Company as follows:

1. to purchase the minority interests;
2. to repay bank loans;
3. to purchase/acquire aircraft for the expansion of the fleet of the Company; and
4. as working capital of the Company.

#### 29. Surplus Reserve

Items	31 December 2004	Increase	Decrease	31 December 2005
Statutory surplus reserve	115,003	0	0	115,003
Statutory Employee Welfare Fund	54,095	0	0	54,095
Total	<u>169,098</u>	<u>0</u>	<u>0</u>	<u>169,098</u>

#### 30. Retained Earning

Item	31 December 2005	31 December 2004
Retained profit at the Beginning of the Year	-514,191	-604,840
Add: Current profit	-215,818	90,649
Less: Provision for statutory surplus reserve	0	0
Provision for general surplus reserve	0	0
Provision for statutory welfare reserve	0	0
Dividends being transferred to share capital	0	0
Dividends for Common Shares	0	0
Ending balance	<u>-730,009</u>	<u>-514,191</u>

#### 31. Revenue from principal operations

Items	2005	2004
Passenger revenue	9,125,754	7,707,738
Cargo and Excessive weight of luggage revenue	312,126	261,998
Charter flight revenue	623,588	404,710
Others	<u>0</u>	<u>36,093</u>
Total	<u>10,061,468</u>	<u>8,410,539</u>

32. Turnover Tax and Surcharge

<b>Items</b>	<b>2005</b>	<b>2004</b>
Business tax	301,591	251,907
City construction tax	9,070	14,579
Education surcharge	4,388	6,103
Regulating Fund for Price Fluctuation	402	615
Total	<u>315,451</u>	<u>273,204</u>

33. Income from other operations

<b>Items</b>	<b>2005</b>	<b>2004</b>
Ticket refund charges	32,157	27,218
Agent handling fees	4,048	2,929
Cargo Service Fee	1,317	21,375
Cargo Income	23,792	19,504
Aircraft Ad. Income	18,930	0
Catering Income	8,074	0
Maintenance Income	3,052	0
Sale Income from Free duty Goods	268	0
Others	6,077	5,905
Total	<u>97,715</u>	<u>76,931</u>

34. Financial Expenses

<b>Items</b>	<b>2005</b>	<b>2004</b>
Interest expenses	929,915	766,081
Less: Interest income	17,823	10,779
Exchange loss	0	0
Less: Exchange gain	152,522	10,111
Others	59,382	49,300
Total	<u>818,952</u>	<u>794,491</u>

35. Investment Income

1. Items		<b>2005</b>	<b>2004</b>
Hainan Haihang Airlines Aviation Import & Export Co.,	A	1,385	2,471
Hainan Haihang Aircraft Maintenance Co.	A	-91	-86
Lucky International Travel Services Limited	A	-1,276	-1,472
Shenzhen Aviation Hotel	A	365	441
Chongqing Changjiang International Leasing Co., Ltd.	A	162	
Beijing Yanjing Hotel Co., Ltd.	A	502	-670
Hainan Airlines Group Finance Co., Ltd.	A	3,361	
Haikou Meilan Airport Co., Ltd	B	0	-2,052

China Aviation Information System Co., Ltd.	B	395	5,472
Hainan Meilan Airport Co., Ltd	B	835	756
Hainan Aviation Kaiya Co., Ltd.	B	168	205
Hainan Airlines Catering Co., Ltd.	B	0	8,363
Hainan Airlines Group Co., Ltd.	C	540	0
Amortization of Equity Investment Difference	D	-23,324	-21,544
Including: China Xinhua Airlines Co., Ltd.		-6,772	-6,772
Changan Airlines Co., Ltd.		-988	-988
Shanxi Airlines Co., Ltd.		-9,903	-9,903
Chongqing Changjiang Leasing Co., Ltd.		-865	-490
Beijing Yanjing Hotel Co., Ltd.		-3,391	-3,391
Hainan Airlines Group Finance Co., Ltd.		-1,780	-1,780
Provision for Impairment		0	-8,000
Others		1,518	-1,039
Total		<u>-15,835</u>	<u>-16,667</u>

- A Investment income is accounted for by using equity method.
- B Received earning is accounted for by using cost method.
- C It is the interest income of trusting income, which has been lent to HNA Group by Xinhua Airport Co., Ltd.
- D It is the amortization of equity investment difference of the Company's interest in its subsidiaries and the Group's interest in associates.

Investment income mentioned above will be received without restriction.

### 36. Subsidiary Income

Item		2005	2004
Turnover tax refund	A	1,000	13,167
Subsidy for improvement in technology	B	42,811	0
Subsidy for flight	C	<u>5,600</u>	<u>400</u>
Total		<u>49,411</u>	<u>13,567</u>

The turnover tax refund is the financial refund 1,000 thousand from Wulumuqi Bureau of Finance to the Company's Wulumuqi Branch.

Subsidies for improvement in technology include: Subsidy in amount of 11,730 thousand from the Company's parent company—HNA Group; Subsidy in amount of 4,792 thousand to Sanya Branch from Sanya Bureau of Finance for year 2004; Special subsidy in amount of 9,031 thousand to Xinhua Airlines from Tianjin Bureau of Finance; Financial subsidy in amount of 17,258 to the Company from Tianzhu Government, Shunyi City, Beijing for year 2004 and 2005.

The subsidy for flight includes the subsidy in amount of in amount of 2,240 thousand to the Company's Parent company from hainan Bureau of Finance for year 2004, and the financial subsidy in amount of 3,360 thousand for international flights in 2004.

37. Non-operating Income and non-operating expenses

(1) Non-operating Income

<b>Items</b>	<b>2005</b>	<b>2004</b>
Net gain from disposal of fixed assets	2,069	1,015
Penalty income	496	334
Missing number punishment income	1,610	179
Penalty income	34,840	
Income from transferred out pilots	516	513
Others	<u>39,531</u>	<u>2,041</u>
Total	<u>2,069</u>	<u>1,015</u>

(2) Non-operating expenses

<b>Items</b>	<b>2005</b>	<b>2004</b>
Net loss from disposal of fixed assets	3,708	9,497
Provision for impairment of fixed assets	8,000	5,168
Provision for impairment of CIP	6,362	0
Donation	0	7
Penalty for breaking contracts	4,000	0
Others	<u>179</u>	<u>967</u>
Total	<u>22,249</u>	<u>15,639</u>

4,000 thousand is the penalty interest for the delayed paying for the acquired aircraft in year 2005.

38. Other cash received relating to operating activities

<b>Items</b>	<b>2005</b>	<b>Remarks</b>
Current accounts	10,990,182	Current accounts with other comp Rental Income, Penalty income an refund of guaranteed deposit
Others	<u>49,637</u>	
Total	<u>11,039,819</u>	

39. Other cash paid relating to operating activities

<b>Items</b>	<b>2005</b>	<b>Remarks</b>
rental	751,137	Rental payment for operating lea
Others	<u>11,766,692</u>	Administrative expenses
Total	<u>12,517,829</u>	

40. Other cash paid relating to investing activities

<b>Item</b>	<b>2005</b>	<b>Remarks</b>
Renting & Security Deposit	<u>1,313,443</u>	The renting and expense for aircrafts, engines and materials under finance lease
Total	<u>1,313,443</u>	

## VII. Significant notes to the Company's financial statements

### (1). Long-term equity investment

Item	31 December 2005	31 December 2004
Investment in Subsidiaries	1,573,584	1,584,464
Investment in Associated Companies	70,201	69,842
Others	420,382	420,382
Total	<u>2,064,167</u>	<u>2,074,688</u>
Less: Provision for Impairment	8,610	8,610
Net value	<u><u>2,055,557</u></u>	<u><u>2,066,078</u></u>

### (2). Long-term equity investment Breakdown

Company	31 Decemb 2005	31 December 2004	Share-holding Percentage
<b>Subsidiaries</b>			
Hainan Golden-Deer Aviation Sales Co., Ltd.	113,649	113,649	95.00%
China Xinhua Airlines Co., Ltd	950,830	956,021	60.00%
Chang'an Airlines Co., Ltd	211,334	216,487	73.51%
Shanxi Airlines Co., Ltd	296,670	297,297	89.06%
Hinan Haihang Zhongmian Duty Free Co., Ltd	1,101	1,010	70.00%
Subtotal	<u>1,573,584</u>	<u>1,584,464</u>	
<b>Associates</b>			
Hainan Haihang Aircraft Maintenance Co. Ltd	28,775	28,865	48.00%
Hainan Haihang Airlines Aviation Import & Export Co., Ltd.	9,498	8,113	30.00%
Chongqing Changjiang International Leasing Co., Ltd.	19,114	19,407	20.00%
Lucky Internantional Travel Services Limited	9,204	9,847	22.00%
Yunnan Shilin Airlines Company Limited	3,610	3,610	54.70%
Subtotal	<u>70,201</u>	<u>69,842</u>	
<b>Other Equity Investment</b>			
Hainan Airlines Hotel (Group) Co., Ltd.	58,161	58,161	19.00%
Hainan Air Tourism Developing Co., Ltd	3,274	3,274	3.30%
Hainan Meilan Airport Company Limited	6,906	6,906	2.20%
Hainan Xinguo Hotel Limited	15,000	15,000	15.00%
China Airline Infor Network Co., Ltd.	17,000	17,000	1.93%
Hainan Development Bank	5,000	5,000	0.30%
Yangtze River Express Co., Ltd.	10,000	10,000	2.00%
Haikou Meilan Airport Co., Ltd.	304,765	304,765	16.48%
Others	276	276	
Subtotal	<u>420,382</u>	<u>420,382</u>	
Total	<u><u>2,064,167</u></u>	<u><u>2,074,688</u></u>	

3) Long-term equity investment with equity method Breakdown

Item	Original	Additions	Accumulated	Accumulated	31 December 2005
	Amount		income	changes	
Hainan Golden-Deer Aviation Sales Co., Ltd.	8,000	0	105,649	105,649	113,649
China Xinhua Airlines Co., Ltd	927,571	161,177	-137,919	23,258	950,829
Changan Airlines Co., Ltd	553,575	0	-342,241	-342,241	211,334
Shanxi Airlines Co., Ltd	275,097	0	21,573	21,573	296,670
Hinan Haihang Zhongmian Duty Free Co., Ltd	1,050	0	51	51	1,101
Hainan Haihang Aircraft Maintenance Co. Ltd	50,000	-19,517	-1,708	-21,225	28,775
Yunnan Shilin Airlines Company Limited	3,610	0	0	0	3,610
Hainan Haihang Airlines Aviation Import & Export Co., Ltd.	3,000	0	6,498	6,498	9,498
Chongqing Changjiang International Leasing Co., Ltd.	19,505	0	-391	-391	19,114
Lucky International Travel Services Limited	11,000	0	-1,795	-1,795	9,205
<b>Total</b>	<u>1,852,408</u>	<u>141,660</u>	<u>-350,283</u>	<u>-208,623</u>	<u>1,643,785</u>

2、 Investment income:

Item		2005	2004
China Xinhua Airlines Co., Ltd	A	1,582	12,477
Changan Airlines Co., Ltd	A	-4,170	-103,800
Shanxi Airlines Co., Ltd	A	9,126	37,715
Hainan Haihang Airlines Aviation Import & Export Co., Ltd.	A	1,385	2,471
Lucky International Travel Services Limited	A	-642	-736
Chongqing Changjiang International Leasing Co., Ltd.	A	-293	-98
Hainan Haihang Aircraft Maintenance Co. Ltd	A	-91	-86
Hinan Haihang Zhongmian Duty Free Co., Ltd	A	91	-40
Haikou Meilan Airport Co., Ltd	B	0	-2,052
Aviation Information System Company	B	0	3,249
Hainan Meilan Airport Co., Ltd.	B	835	756
Hainan Aviation Kaiya Co., Ltd.	B	0	39
Hainan Airlines Catering Co., Ltd.	B	0	10,421
Amortization of Equity Investment Difference Including: China Xinhua Airlines Co., Ltd.	C	-17,663	-17,663
Changan Airlines Co., Ltd.		-988	-988
Shanxi Airlines Co., Ltd.		-9,903	-9,903
Provision for Impairment		0	-3,610
<b>Total</b>		<u>-9,840</u>	<u>-60,957</u>

- 
- A Investment income from subsidiaries and associates is accounted for by using equity method.
- B Received earning is accounted for by using cost method.
- C Balance is the amortized equity investment difference in this year.
- D Balance is provision for impairment of 100% investment in Yunnan Shilin Airlines Company Limited.

## VIII. Related Party Relationship and Transactions

### (1). Related parties with control relationship

Company Name	Registered Address	Scope of Business	Relationship	Business Character /Style	Legal representative
Hainan Airlines Group Co. Ltd.	Haikou	Air transportation, investment and management of airport; Investment and development of real estate; Import and export of airplane and aviation materials.	Shareholder	Limited Company	Feng Chen
Hainan Golden-Deer Aviation Sales Co., Ltd.	Haikou	Provision of transportation and chartered flight agency services.	Subsidiary	Limited Company	Feng Chen
Hainan Airlines VIP Flight Service Co. Ltd.	Haikou	Chartered flights agency.	Subsidiary	Joint Venture	Feng Chen
China Xinhua Airlines Co., Ltd	Beijing	approved international and domestic air passenger and cargo transportation.	Subsidiary	Limited Company	Jiaxu Liu
Chang'an Airlines Co., Ltd	Xi'an	Air passenger and cargo transportation in Shanxi province and its surrounding provinces.	Subsidiary	Limited Company	Yining She
Shanxi Chang'an Hainan Aviation Star Hotel Co., Ltd.	Xi'an	Hotel and catering, commodity, costume sales, typing and other office services.	Subsidiary	Limited Company	Yongqing Ma
Shanxi Airlines Co., Ltd	Taiyuan	Air passenger and cargo branch line transportation in Shanxi province and its surrounding provinces.	Subsidiary	Limited Company	Jianmin Qin
Beijing Xinhua Air Catering Co., Ltd.	Beijing	Production and sale of pastry, food and beverage.	Subsidiary	Limited Company	Zhongying Zhao
Hinan Haihang Zhongmian Duty Free Co., Ltd	Haikou	Sale of duty free items and present of travel	Subsidiary	Limited Company	Zhongying Zhao

(2). Registered Capital, Stock Held and their Movement of Related Parties with Control Relationship

Company	B. Registered Capital		Share-held Percentage	
	2005	2004	2005	2004
	Hainan Airlines Group Co. Ltd.	500,000	500,000	11.9%
Hainan Golden-Deer Aviation Sales Co., Ltd.	8,000	8,000	95%	95%
Hainan Airlines VIP Flight Service Co., Ltd.	USD 1,020	USD 1,020	51%	51%
Xinhua Airlines Co., Ltd.	1,830,000	1,830,000	60%	60%
Changan Airlines Co., Ltd.	754,390	754,390	73.51%	73.51%
Shanxi Airlines Co., Ltd.	320,000	320,000	92.51%	92.51%
Hinan Haihang Zhongmian Duty Free Co., Ltd. *2	1,500	1,500	70%	70%
Beijing Xinhua Air Catering Co., Ltd.	120,000	29,990	51%	51%
Shanxi Chang'an Hainan Aviation Star Hotel Co., Ltd.	25,000	25,000	80%	80%

(3). Pricing Policy for related party transactions

Market price is used for all significant related party transactions.

(4). Related parties without control relationship: (Only included significant transactions of related parties)

Company	Relationship
Beijing Yanjing Hotel Company Limited	Associated Company
Hainan Airline Catering Holding Co., Ltd.	Under Common Control
HNA Group Finance Co., Ltd.	Associated Company
Hainan Airlines Hotel (Group) Company Limited	Under Common Control
Haikou Meilan International Airport Company Limited	Associated Company
Hainan Haihang Airlines Aviation Import & Export Company Limited	Associated Company
Hainan Haihang Airport Group Company Limited	Under Common Control
Hainan Airlines Catering Company Limited	Under Common Control
Hainan Jiahui Investment Company Limited	Under Common Control
Hainan Meilan Airport Company Limited	Under Common Control
Haikou High-Tech Venture Capital Company Limited	Under Common Control
Hainan Meiya Industry Co., Ltd.	Subsidiy of associated Company
Hainan Aviation Import & Export Trade Company Limited	Under Common Director
Deer Jet Company Limited	Under Common Control
Sanya Phoenix International Airport Company Limited	Under Common Control
Yangtze River Real Estate Group	Associated Company
Yangtze River Express Company Limited	Associated Company

Yangtze River Investment Holding Company Limited	Under Common Control
Chongqing Changjiang International Leasing Company Limited	Associated Company
Hainan Yangpu Huanmei Company Limited	Under Common Control
Lucky International Travel Services Limited	Associated Company
Xi'an Minsheng Real Estate Co., Ltd.	Under Common Control
Beijing Kehang Investment Co., Ltd	Under Common Control
Shenhua Group Co., Ltd.	Shareholder of Subsidiary

(5). Significant transactions with related parties.

(a) Current capital due to or due from related parties

Company	Relationship with the Group	Related parties provided capital to the Company	Providing capital to related parties
HNA Group	Shareholder	590,729	417,888
Haikou Meilan International Airport Co., Ltd.	Under Common Control	395,355	291,059
Beijing Yanjing Hotel	Associated Company	0	10,471
Beijing Kehang Investment Co., Ltd.	Under Common Control	50,000	0
Hainan Jiahui Investment Co., Ltd.	Under Common Control	2,112,500	1,959,126
Hainan Yangpu Industrial Co., Ltd.	Under Common Control	343,925	333,680
Hainan Haihang Construction Development Co., Ltd.	Under Common Control	2,409	2,739
Kangleyuan Hotel	Under Common Control	0	79,990
Yangzi River Investment Holding Co., Ltd.	Under Common Control	490,774	476,170
Yangzi River Real Estate Group Co., Ltd.	Under Common Control	71,250	9,208
Hainan Hainang Imp. & Exp. Co., Ltd.	Associated Company	1,221,682	1,171,077
Total		<u>5,278,624</u>	<u>4,751,408</u>

(b) Other Transactions

Companies	Relationship	Nature of transaction	2005	2004	Remarks
HNA Group	Shareholder	Trusting lending	54,366	34,000	
HNA Catering Co., Ltd.	Under Common Control	Catering Payment	34,719	18,379	
HNA Catering Holding Co., Ltd.	Under Common Control	Prepayment for acquired share	61,200	40,000	A
Haikou Meilan International Airport Co., Ltd.	Under Common Control	Taking-off and landing services charges	27,137	37,158	
Jeer Jet Co., Ltd.	Under Common Control	Advance money of airport rents	175,603	0	B
Hainan Haihang Aviation Imp. & Exp. Co., Ltd.	Associated Company	Aviation materials agency fees	17,799	15,429	
Hainan Meilan Airport Co., Ltd.	Under Common Control	Taking-off and landing serves charges	86,054	80,876	
Yangzijiang Express Co., Ltd.	Associated Company	Advance money for airports rents	117,951	0	C

Chongqing International Renting Co., Ltd.	Associated Company	Renting aircrafts and engines	84,359	100,386	
Hainan Hotel Holding Group Co.,Ltd.	Under Common Control	Advance money for projects	8,870	0	
Hainan Meiya Industrial Co., Ltd.	Subsidiary of associates	Payment for aircrafts oil fees	309,771	249,408	
Sanya Phoenix International Airport Co., Ltd.	Under Common Control	Taking-off and landing service charges	18,396	10,758	
Hainan aviation training Co., Ltd.	Under Common Control	Advance money for aircraft models	16,685	0	
HNA Group Finance Co., Ltd.	Associated Company	Deposits	13,887,540	4,673,667	D
HNA Group Finance Co., Ltd.	Associated Company	Withdrawn	12,408,955	3,389,839	D
Xi'an Minsheng Real Estate Co.,Ltd.	Under Common Control	Transferring investment	7,000	0	E
Yangzi River Investment Holding Co., Ltd.	Under Common Control	Sales of aircrafts and aviation materials	0	11,327	
Yangzi River Real Estate Group Co., Ltd.	Under Common Control	Transferring investment	0	22,500	
HNA Airport Group Co., Ltd.	Under Common Control	Transferring investment	0	201,600	
Key Management of the Group	Key management	Payment emolument	3,008	3,008	F

- A. Pursuant to the share transferred agreement signed between Xinhua Airlines and Hainan Hainan Catering Holding Co., Ltd., Xinhua Airlines transferred its interest in Xinhua Airport to Hainan Haihang Catering Holding Co., Ltd. at a transaction price of 61,200 thousand. Xinhua Airlines has received the prepayment for transferred share up to the end of this financial period.
- B. Pursuant to the pilots transferred agreement signed between the Company and Jeer Jet Co., Ltd. in December 2005, 23 pilots have been transferred to Jeer Jet at a transaction price of 19,650 thousand. The Company signed a pilot lease agreement with Jeer Jet, and the Company will pay for 18,477 thousand for renting pilots from Jeer Jet for year 2005.
- C. Pursuant to the pilots transferred agreement signed between the Company and Yangzi River Express in December 2005, 26 pilots have been transferred to Yangzi River Express at a transaction price of 22,700 thousand. The Company signed a pilot lease agreement with Yangzi River Express, and the Company will pay for 10,764 thousand for renting pilots for year 2005.
- D. Pursuant to the finance service agreement signed between the Company and HNA Group Finance Co., Ltd in 2004, HNA Group Finance provided general bank services to the Company and loaned money to the Company on the issued interest rate by PBOC. The above mentioned amount is the accumulated transaction in year 2005.
- E. Xinhua Airlines transferred its 20% interest in Beijing Tianchen Exhibition Projects Co., Ltd. and Beijing Hengshi Real Estate Development Co., Ltd. to Xi'an Minsheng Real Estate Co., Ltd. at a transaction price of 1,200 thousand and 5,800 thousand.

F. The above amount is the emolument paid to the key management by the Group. The key management includes: directors, member of supervisory committee, CEO, Present, Vice Present, CFO, and secretary of Board of Directors.

(b) Guarantee of related parties

Detail information that the Company guaranteed for related parties please refer to note IX.2

(c) Related party balance

Items	Company	31 December 2005	31 December 2004
Cash in bank & on hand	Hainan Airlines Group Finance Company Limited	2,762,413	1,283,828
Account receivable	Yangtze River Express Company Limited	18,867	17,769
	HNA Group	397	9,000
	Haikou Meilan Airport Co., Ltd.	9,000	0
	Deer Jet Company Limited	67,161	0
	Subtotal	<u>95,425</u>	<u>26,769</u>
Advance to Suppliers	Hainan Jiahui Investment Company Limited	0	174,898
	Hainan Haihang Airlines Aviation Import & Export Co., Ltd.	3,272	99,442
	Hainan Yangpu Huanmei Company Limited	0	39,683
	Haikou Meilan Airport Co. Ltd	0	15,815
	Hainan Airlines Catering Co., Ltd.	0	5,217
	Others	2,125	532
	Subtotal	<u>5,397</u>	<u>335,587</u>
Other Receivable	Hainan Jiahui Investment Company Limited	348,024	326,500
	Hainan Yangpu Huanmei Company Limited	333,680	294,120
	Haikou Meilan Airport Co. Ltd	0	181,144
	Hainan Airlines Group Co. Ltd	12,893	99,659
	Yangtze River Express Company Limited	108,275	70,263
	Yangtze Real Estate Group Company Limited	141,708	39,116
	Deer Jet Company Limited	88,966	3,034
	Hainan Airlines Hotel (Group) Company Limited	8,870	0
	Hainan Aviation Import & Export Trade Company Limited	24,673	21,560

	Haikou High-Tech Venture Capital Company Limited	20,879	20,444
	Shenzhen Aviation Hotel	79,989	91
	HNA Group Training Center	6,385	21,284
	Senhua Group Co., Ltd.	5,000	10,000
	ShanXi Aviation Industry Co., Ltd.	117	56,073
	Others	24,265	13,876
	Subtotal	<u>1,203,724</u>	<u>1,157,164</u>
Accounts Payable			
	Hainan Meilan Airport Company Limited		
	Haikou Meilan Airport Company Limited	74,336	98,973
	HNA Group	38,575	89,223
	Yangzi River Express Co., Ltd.	92,003	67,933
	Hainan Meiya Industry Co., Ltd.	53,989	54,284
	Hainan Aviation Catering Co., Ltd.	36,668	27,628
	Deer Jet Co., Ltd.	21,989	26,015
	Hainan Aviation Import & Export Trade Company Limited	30,294	9,916
	Beijing Kehang Investment Company limited	24,375	49,046
	Sanya Phoenix International Airport Co.,	52,500	0
	Hainan Aviation Catering Co., Ltd.	16,638	4,541
	Lucky travel agency Co., Ltd.	<u>61,200</u>	<u>0</u>
	Others	<u>8,568</u>	<u>0</u>
	Subtotal	<u>526,863</u>	<u>433,868</u>
Other Payables			
	Hainan Jiahui Investment Company Limited	0	273,000
	Beijing Yanjing Hotel Company Limited	32,013	42,003
	Deer Jet Company Limited	31,782	30,504
	Hainan Aviation Import & Export Trade Company Limited	6,328	0
	Lucky International Travel Services Limited	20,818	21,627
	Hainan Airlines Group Co. Ltd	14,306	18,387
	Hainan Meilan Airport Company Limited	772	2,588
	Haikou Meilan Airport Company Limited	0	33,000
	Hainan Yangpu Huanmei Company Limited	10,000	123
	Sanya Phoenix International Airport Co., Ltd.	6,438	0
	Yangzi River Real Estate Group	<u>11,700</u>	<u>0</u>
	Other	<u>6,447</u>	<u>4,922</u>
	Total	<u>140,604</u>	<u>426,154</u>
Notes Payable			

	Hainan Haihang Aviation Import & Export Trade Company Limited	100,000	0
	Yangzi River Investment Holding Co., Ltd.	16,000	0
	Subtotal	<u>116,000</u>	<u>0</u>
Short-term Loan			
	Hainan Airlines Group Finance Company Limited	0	21,720
Current Portion of Long-term Liabilities			
	Chongqing Changjiang International Leasing Company Limited	82,952	60,913
Long-term Payables			
	Chongqing Changjiang International Leasing Company Limited	0	17,128
Trusting Lend			
	HNA Group	30,000	0

## IX. Contingency

### 1 Litigations

Shanxi Airlines Company Limited, the subsidiary of the Company, has been involved in a lawsuit relate to the political loans as amount to 54,000 thousand. According to the opinion of government and the financial institution, this case will be settled by auctioning mortgaged assets, transferring debt into share capital, and Shanxi Airlines would not suffer significant contingent loss from this litigation. The solution and amount related to this case are still pending at year ended 2005.

### 2 Guarantee

Up to 31 December 2005, the Group provided guarantee for the loans of the companies controlled by HNA Group in amount of 505,350 thousand, the Company provided guarantee for its subsidiaries' loan in amount of 731,000 thousand, and for its subsidiaries' banking acceptance in amount of 35,000 thousands.

## X. Commitments

### 1 Capital commitments

As at 31 December 2005, the total amount of capital expenditure for but not recognized in the consolidated financial statements is 13,418,670 thousand: the committed expenditure for acquisition of aircraft is 11,715,050 thousand, including 1,719,908 thousand needed to be paid in year 2006; the committed expenditure for construct-in-progress is 1,703,620 thousand, including 1,020,220 thousand expected to be paid in year 2006.

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## 2 Rents payable under operating leases

As at 31 December 2005, the rents payable under operating leases are as follows:

Item	31 December 2005	31 December 2004
Within one year	600,907	673,599
The second year	533,571	540,986
The third year	489,406	481,511
Over three years	1,298,739	1,533,046
Total	<u>2,922,623</u>	<u>3,229,142</u>

## XI. Subsequent events after the balance sheet date

Pursuant to the decision of the temporary general meeting of shareholders on 24 January 2006, the Company will issue no more than 800 million short-term enterprise bonds to inter-bank bonds market with 365 days time limit. The issue of application is in process.

Pursuant to the debt reorganization agreement with over 50 associated companies, including Hainan Jiahui Investment Co., Ltd., Jeer Jet, Hainan Haihang Aviation Imp. & Exp., and Yangzi River Express dated in January 2006, all the parties agreed to reorganize the Group's accounts receivable and payable: the total amount of deducted accounts receivable is 647,967 thousand, and the total amount of deducted accounts payable is 600,722 thousand, and the remaining amount of 47,245 has been recognized as the accounts receivable due from Hainan Jiahui Investment Co., Ltd.

The Group has received amount of 723,680 thousand due from Hainan Jiahui Investment Co., Ltd. and Hainan Yangpu Huanmei Industrial Co., Ltd. in April 2006.

## XII. Extraordinary gain and loss

In accordance with the requirements of *Questions and answers on the preparation of information disclosures of companies issuing public shares No. 1 – Extraordinary gain and loss* (revised 2004) issued by China Securities Regulatory Commission, the extraordinary gain and loss of the Group are set out below:

Item	Amount
1. Disposal gains or losses in long-term investment, fixed assets, CIR, intangible assets , and other long-term assets	32,639
2. tax refundable or exemption with official approval	0
3. various type of government subsidies	38,895
4. interest income of lent money to non-financial enterprises	0
5. gains or losses in short-term investment,	0
6. income of consigned investment	165
7. non-operating income or payment after deducting all type of provision for impairment based on the applied accounting policies	-1,384
8. provision for impairment caused by unexpected events	0
9. recoverable impairment of prior years	973
10. debt reorganization gains or losses	0
11. transferred assets gains or losses	0
12. gains or losses of exceeding fair value part of unfair transactions	0
13. the influence of changed accounting policies	0
14. other non-operating profit or loss items	<u>0</u>

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**Total**

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71,288

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The above extraordinary gain and loss includes the amount of subsidiaries of the Company according to the share of the Company.

### **XIII. Other Matters**

According to the relevant regulations issued by the MOF and CAAC: PRC airlines companies were required to pay civil aviation infrastructure levies equal to 10% of domestic traffic revenues before 1 January 1998; the rate was 8% for domestic traffic revenues between 1 January 1998 and 31 December 2003; the rate was 5% for domestic traffic revenues and 2% for international traffic revenues between 1 January 1999 and 3 April 2003. All the PRC airlines were exempted to pay civil aviation infrastructure levies between 1 May 2003 and 31 December 2003 because of SARS influence. From 1 April 2004, the Company started to account for civil aviation infrastructure levies pursuant to the notice of the collection of civil aviation infrastructure levies payable (Cai Zong [2004] No.38) issued by the Ministry of Finance, and detail rules of the collection of civil aviation infrastructure levies payable (Civil Aviation Gui Cai Fa [2004] No.94) issued by the Civil Aviation Administration of China. As at 31 March 2004, the Company had total levies exposure of 950,534 thousand.

In November 1994, the Hainan Provincial Government applied Qiong Fu Han [1994] No.77 to the MOF for exemption of the payment of the levies or treating the levies due by the Company as infrastructure investment granted by CAAC to the Company. As at the date of issuance of these consolidated financial statements, such application has still not yet been approved by the MOF. A circular Qiong Cai Shui Han No.[1996]132 was issued by the Hainan Provincial Finance and Tax Bureau on 18 October 1996. Pursuant to the circular, Finance and Tax Bureau agreed to assist in relation to the application for exemption of payment of levies with the MOF and CAAC and has undertaken to resolve the matter through other means if the application is rejected. According to another circular Qiong Fu Han No.[1999] 83 issued on 24 August 1999, the Hainan Provincial Government has undertaken to resolve the payment of levies, if any, through other means.

Pursuant to the legal opinion issued by independent legal counsel, above-mentioned undertakings of the Hainan Provincial Government are effective. Accordingly, no provision for payment of such levies has been made in these consolidated financial statements.

### **Supplementary**

In accordance with the requirements of *Questions and answers on the preparation of information disclosures of companies issuing public shares No. 9 – Net assets profit ratio and earning per share* issued by China Regulatory Securities Committee, net assets profit ratio and earning per share of the Company in year 2005 are set out below:

<b>Profit earned during the year 2005</b>	<b>Net assets profit ratio (%)</b>		<b>Earning per share ( Yuan / share)</b>	
	<b>Overall Diluted</b>	<b>Average weighted</b>	<b>Overall Diluted</b>	<b>Average weighted</b>
Gross profit on sales	57%	97%	2.10	2.10
Operating profit	-10%	-17%	-0.37	-0.37
Net profit	-8%	-14%	-0.30	-0.30
Net profit after deduction extraordinary profit/loss	-11%	-18%	-0.39	-0.39

As at 31 December 2005

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## **XII. Documents for Reference**

The complete set of documents is available at the office of the Company for the reference of the China Securities Regulatory Committee, Shanghai Stock Exchange, Hainan Provincial Securities Administration Office as well as relevant authorities and shareholders:

- 1.** The accounting statement bearing signatures and stamps of the legal representative, chief financial officer and chief of the accounting institution.
- 2.** The original copy of the auditing report bearing the stamp of the accounting firm and signature & stamp of the certified accountant.
- 3.** The original copies of documents and notices published on Shanghai Securities News, China Securities News, Securities Times and Hong Kong's Wen Wei Po in the report period.

Hainan Airlines Company Limited

Chairman: Chen Feng

Date: April 29, 2006