AviChina

AviChina Industry & Technology Company Limited

中國航空科技工業股份有限公司

(A joint stock limited company incorporated in the People's Republic of China with limited liability)

(Stock Code: 2357)

Annual Report 2008

Contents

AviChina Industry & Technology Company Limited (the "Company") is a joint stock limited company promoted by AVIC II as a main promoter and was incorporated on 30th April 2003 in compliance with the Company Law of the PRC. The Company's H Shares have been listed on the Stock Exchange since 30th October 2003. The stock code of the Company is "2357". The principal shareholders of the Company's domestic shares are AVIC, China Hua Rong Asset Management Corporation, China Cinda Asset Management Corporation and China Orient Asset Management Corporation, and the substantial shareholder of the Company's H shares is European Aeronautics Defence and Space Company (the "EADS").

The Company mostly operates through its subsidiaries. The Company and its subsidiaries (the "Group") are mainly engaged in:

- the development, manufacture, sales and upgrade of aviation products such as helicopters, trainers, general-purpose aircraft and regional jets for domestic and overseas customers;
- the co-development and manufacture of helicopters with foreign helicopter manufacturers; and
- the development, manufacture and sales of mini-sized vehicles, economy sedans and automobile engines.

PRINCIPAL PRODUCTS OF THE GROUP:

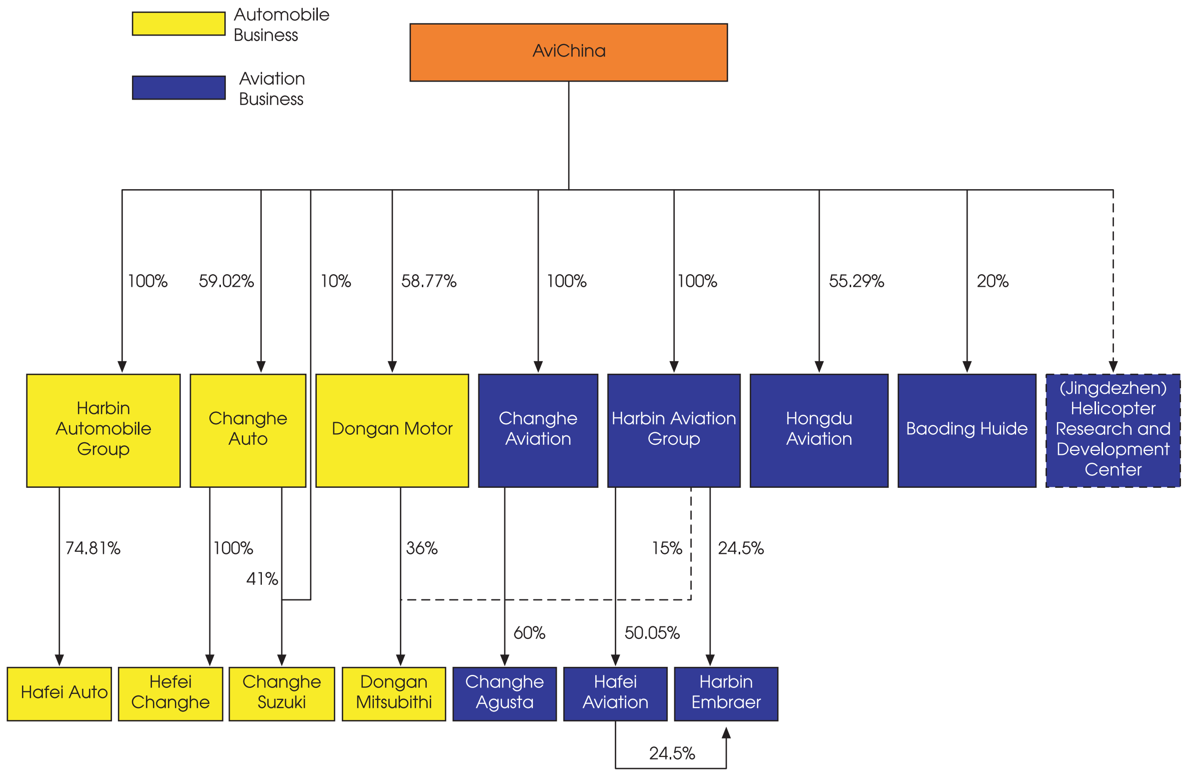
Aviation Products:

The Z-8, Z-9, Z-11 and HC-I20 series helicopters; K-8 series and CJ-6 trainers; Y-12 series multi-purpose aeroplanes and the N-5 series agricultural aeroplanes; EC-120 helicopters jointly produced by the Group and Eurocopter; CA109 helicopters jointly produced by the Group and Agusta; and ERJ-145 series regional jets jointly produced by the Group and Embraer-Empresa Brasileira de Aeronautica S.A. ("Embraer").

Automobile Products:

Hafei series and Changhe series mini-sized vehicles; low-emission economy sedans such as Lobo, Beidouxing, Saima and Ideal; sedans such as Saibao and Liana; and Dongan series auto engines (under 1.3 L); 4G1 and 4G9 series auto engines (from 1.3 L to 2.0 L) manufactured by the joint venture of the Group and Mitsubishi; K14B engines manufactured by the joint venture of the Group and Suzuki.

BUSINESS STRUCTURE OF THE GROUP (AS AT THE DATE OF THIS REPORT)



CONSOLIDATED PROFIT AND LOSS

(Prepared under International Financial Reporting Standards)
(RMB million, other than basic and diluted loss per Share)

	For the year ended 31st December		
	2008	2007	Changes
Turnover	**16,385**	16,541	(0.94%)
Loss before taxation	**(722)**	(797)	(9.41%)
Net loss attributable to the equity holders of the Company	**(1,157)**	(1,026)	12.77%
Gross profit margin	**9.56%**	10.64%	N/A
Basic and diluted loss per share for loss attributable to the equity holders of the Company (RMB)	**(0.249)**	(0.221)	12.67%

CONSOLIDATED ASSETS AND LIABILITIES

(Prepared under International Financial Reporting Standards)
(RMB million)

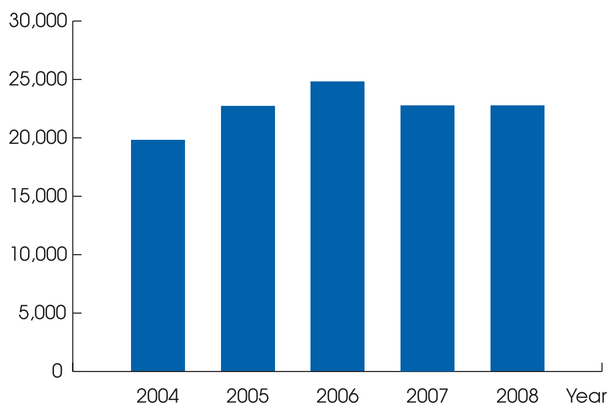
	As at 31st December		
	2008	2007	Changes
Total assets	**22,445**	22,778	(1.46%)
Total liabilities	**16,871**	16,120	4.66%
Minority interests	**3,241**	3,170	2.24%
Owner's equity (excluding minority interests)	**2,333**	3,488	(33.11%)

The Group's financial information in the recent five years starting from 1st January 2004 is summarized as follows:
(Prepared under International Financial Reporting Standards)
(RMB million, other than basic and diluted (loss)/earnings per Share)

	As at 31st December/For the year ended 31st December				
	2008	2007	2006	2005	2004
Total assets	**22,445**	22,778	24,811	22,712	19,816
Total liabilities	**16,871**	16,120	16,689	14,002	11,778
Minority interests	**3,241**	3,170	3,793	3,496	2,942
Owner's equity (excluding minority interests)	**2,333**	3,488	4,329	5,214	5,096
Turnover	**16,385**	16,541	17,111	14,266	12,877
(Loss)/profit before taxation	**(722)**	(797)	(473)	240	224
Net (loss)/profit attributable to the equity holders of the Company	**(1,157)**	(1,026)	(331)	118	71
Gross profit margin	**9.56%**	10.64%	11.14%	13.11%	14.98%
Basic and diluted (loss)/earnings per share for (loss)/profit attributable to the equity holders of the Company(RMB)	(0.249)	(0.221)	(0.071)	0.025	0.015

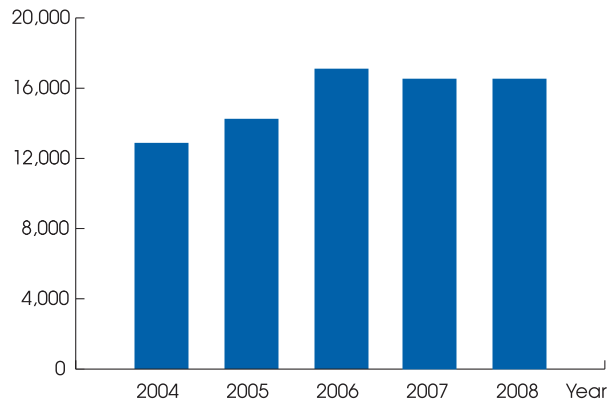
TOTAL ASSETS

(RMB million)



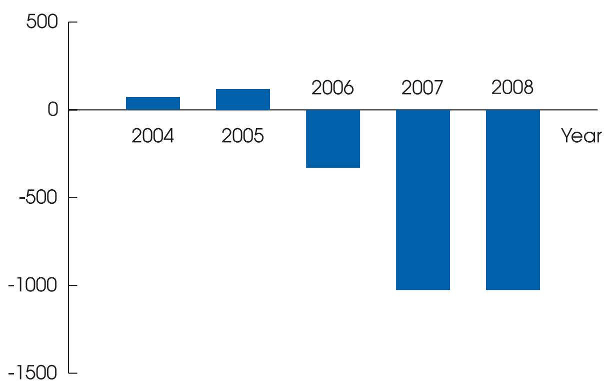
TURNOVER

(RMB million)



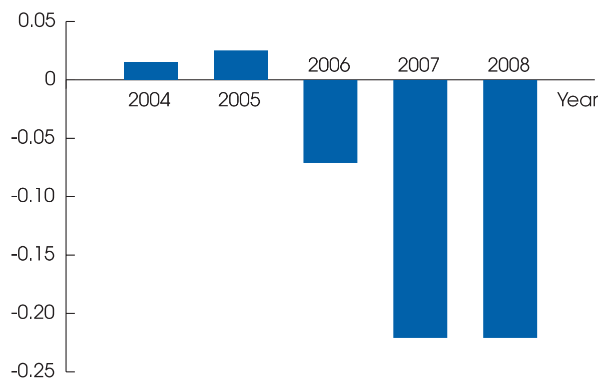
NET PROFIT/(LOSS) ATTRIBUTABLE TO THE EQUITY HOLDERS OF THE COMPANY

(RMB million)



BASIC AND DILUTED EARNINGS/(LOSS) PER SHARE FOR PROFIT/(LOSS) ATTRIBUTABLE TO THE EQUITY HOLDERS OF THE COMPANY

(RMB)



To all shareholders,

I hereby, on behalf of the Board of AviChina Industry & Technology Company Limited, would like to present the annual results of AviChina for the year ended 31st December 2008.

ANNUAL RESULTS

For the year ended 31st December 2008, the Group recorded a turnover of RMB16,385 million, close to the turnover of 2007, and the net loss attributable to the equity holders of the Company amounted to RMB1,157 million, representing an increase of 12.77% as compared with that of 2007.

BUSINESS REVIEW

In 2008, the Group's aviation products recorded a sales revenue of RMB4,596 million, representing a decrease of 13.72% from that of 2007 and accounting for 28.05% in the total turnover of the Group, descending from 32.21% of 2007. Despite the decrease in sales revenue, the gross margin of the Group's aviation products increased by 2.79 percentage points over that of 2007 to 15.62%.

Mr. Lin Zuoming, Chairman

In 2008, both output and sales volume of vehicle products in PRC ceased its high-speed growth, the growth rate in economic benefits from automobile industry slowed down evidently.

The sales volume of the Group's entire vehicle products for 2008 was 297,000 units, representing an increase of 1.81% as compared with that of 2007. Auto engines sold to parties outside the Group amounted to 329,800, representing an increase of 16.12% as compared with that of 2007.

To resolve the impact to the Group arising from loss of the automobile business, the Group commenced the disposal of the automobile business of Changhe Auto since June 2008, and is actively examining other issues relating to reorganization of other automobile business.

In 2008, the structure of the PRC aviation industry had changed tremendously. Considering the developing trend of aviation industry in the new era, the state government decided to restructure the system of the PRC aviation industry so as to speed up its development. Former AVIC I and AVIC II had been reorganized and merged to form AVIC, which was registered and established on 6th November 2008. Upon reorganization, AVIC becomes the controlling shareholder of AviChina. I, myself, was honored to be appointed as the Chairman of AviChina on 16th October 2008. This merger and reorganization reinforced the scale of aviation industry, optimized allocation of resources and eliminated internal competition among enterprises within the industry so as to speed up the development of the PRC aviation industry. In addition, the PRC government decided to invest in the development of large aircraft programs, and established Commercial Aircraft Corporation of China (CACC) to engage in research and development of large passenger aircraft and new regional aircraft ARJ21. AVIC, the controlling shareholder of the Company, has invested RMB5 billion and becomes a major shareholder of CACC. These measures imply a new era of the PRC aviation industry. The snow storm which occurred in early 2008 in southern China and the earthquake affecting Wenchuan in Sichuan Province which occurred in May 2008 exposed deficiencies in the PRC's air rescue operations. As a result, the PRC government and citizens increasingly value the importance of the aviation industry to the nation and impose new demands on the ability of the aviation industry to supply equipment. This has provided further opportunities to the development of aviation industry.

The Group's aviation products had played important roles in some significant missions. Z-8 series helicopters participated in rescue, transporting rescue resources and transferring survivors and wounded people after the earthquake disaster, fully demonstrating the key roles played by helicopters in emergency, rescue and national economical construction. CA109 helicopter manufactured by Changhe Agusta was employed as police helicopter by Beijing Municipal Public Security Bureau to provide security services during Beijing Olympic Games, which took charges of air surveillance, commanding and coordinating with ground departments so as to fulfill missions together. The test flight of 03 prototype of L15 advanced trainer was completed. The sale of civilian aircraft made new progress, and the research and development of civilian aircraft had also been strengthened. Agricultural aircraft N-5B completed "first flight of two aircraft". Research and development of Y-12F aircraft processed swiftly. International cooperation made remarkable achievements. Localization of parts and components of ERJ145 proceeded steadily. Certain programs cooperated with Airbus and other partners progressed smoothly. The Group contributed USD30 million to invest in Harbin Hafei Airbus Composite Manufacturing Centre Company Limited. Sub-contract production grew steadily. Changhe Aviation and USA Boeing Company entered into a sub-contract agreement for production of parts and components of 767-300BCF aircraft.

OUTLOOK

In 2009, AviChina will dispel all hesitations and exert all strength to strike upward in the depressing environment. It will take active measures to push forward the reorganization of automobile business, make full use of market resources to expand its aviation business, grasp opportunities arising from the reorganization and merger of the PRC aviation industry and integrate into international aviation industry chain through cooperation with foreign partners.

AviChina will negotiate with its strong controlling shareholder AVIC on reorganization of other aviation enterprises so as to become an overseas financing platform of AVIC. AVIC has a registered capital of RMB64 billion, holds a completed aviation industry chain comprising research and development, manufacturing, marketing and services, employs art-of-the-edge technologies and top human resources in the PRC, and controls 21 listed companies in the PRC and overseas. In 2008, AVIC recorded a revenue of RMB166 billion in total. The business strategy of AVIC can be summarised as "two integrations, three creations, five development objectives and a goal towards one trillion". "Two integrations" means integration into the international aviation market and integration into the regional economic circle. "Three creations" means developing a new core competency of the Group based on the creation of brand value, the creation of a business model and the creation of an integrated network. "Five development objectives" involve promoting reform towards marketization, reorganization towards specialization, capitalized operation, international expansion and industrialization. "A goal towards one trillion" means striving to attain a production value of RMB1 trillion by 2017. After the reorganization of the PRC aviation industry, AVIC became the controlling shareholder of AviChina, which will provide stronger support and further expansion opportunities for the development of AviChina. As for AviChina itself, it will reinforce its foundation, continue to improve its system of management and supervision, enhance management and standardize operations so as to maximize efficiency.

ACKNOWLEDGEMENT

Finally, I hereby, on behalf of the Board, would like to extend my earnest gratitude to our customers, partners and shareholders for your constant confidence on and supports to AviChina. I, myself, also would like to take this opportunity to express my appreciation to all our employees for their hard work and contributions last year. I will work with my employees together to face challenges hand in hand. Based on its solid business foundation, unique competitive advantage and clear strategies on development, AviChina will aggressively push forward its aviation business and manage to be the most valuable operator in aviation industry of the PRC.

Lin Zuoming
Chairman
Beijing, 9th April 2009

The following discussion should be read in conjunction with the Group's consolidated financial statements and notes thereto set out in this annual report and other sections.

SUMMARY

For the year ended 31st December 2008, the Group recorded a turnover of RMB16,385 million, close to the turnover of RMB16,541 million in 2007. Among which, the turnover derived from the aviation business decreased by 13.72% from that of 2007, as affected by the declined revenue from aviation parts and components; and the turnover derived from automobile products presented a growth of 5.13% over that of 2007, as the sales volume of automobile products increased in 2008. As the entire vehicle business, which accounted for a significant part in the whole business of the Group, suffered a continuous loss, the Group commenced the disposal of its automobile business in June 2008 which has not been completed yet as at 31st December 2008. As a result, the share of loss by the equity holders of the Company amounted to RMB1,157 million in 2008, representing an increased loss as compared to that of 2007.

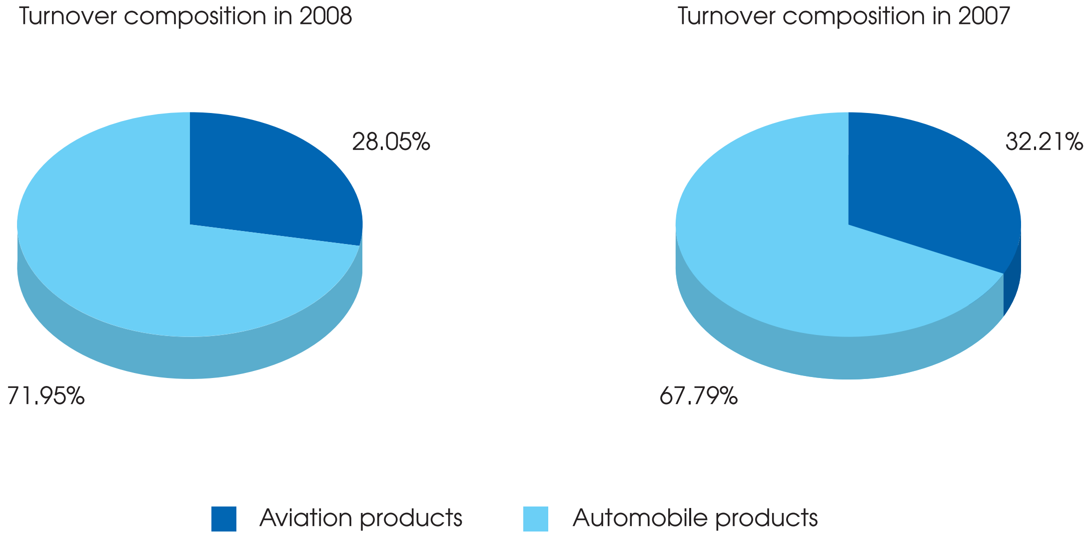
Mr. Tan Ruisong, President

The following table shows the comparison between the years ended 31st December 2008 and 2007:

CONSOLIDATED OPERATING RESULTS

	Year ended 31st December		
RMB million	**2008**	2007	Changes
Turnover	**16,385**	16,541	(0.94%)
Of which: automobile segment	**11,789**	11,214	5.13%
aviation segment	**4,596**	5,327	(13.72%)
Cost of sales	**(14,819)**	(14,781)	0.26%
Of which: automobile segment	**(10,941)**	(10,137)	7.93%
aviation segment	**(3,878)**	(4,644)	(16.49%)
Other income and gains	**128**	213	(39.91%)
Selling and distribution expenses	**(872)**	(981)	(11.11%)
General and administrative expenses and other operating expenses	**(1,216)**	(1,516)	(19.79%)
Operating loss	**(394)**	(524)	(24.81%)
Finance costs, net	**(368)**	(329)	11.85%
Share of results of associates	**40**	57	(29.82%)
Loss before taxation	**(722)**	(797)	(9.41%)
Taxation	**(189)**	(51)	270.59%
Minority interests	**(246)**	(178)	38.20%
The loss attributable to the equity holders of the Company	**(1,157)**	(1,026)	12.77%

1 Composition of turnover



The Group's turnover for 2008 was RMB16,385 million, which is close to the turnover in 2007.

The turnover of the Group's aviation products in 2008 was RMB4,596 million, representing a decrease of 13.72% as compared to that in 2007.The turnover of the Group's aviation segment accounted for 28.05% of the total turnover of the Group, representing a decrease of 4.16 percentage points from 2007 when it had been 32.21%.

The turnover of the Group's automobile products in 2008 was RMB11,789 million, representing an increase of 5.13% as compared to that in 2007. The turnover of the Group's automobile segment accounted for 71.95% of the total turnover of the Group, representing an increase of 4.16 percentage points from 2007 when it had been 67.79%.

The Group operates mainly in the mainland China where a majority of the turnover is generated.

2 Selling and distribution expenses

The Group's selling and distribution expenses for 2008 amounted to RMB872 million, representing a decrease of RMB109 million, or a reduction of 11.11% as compared with that in 2007. The decrease was mainly attributable to a decrease in transportation expenses and after-sales services expenses of automobile products caused by the enhanced expenses control during the year.

3 General and administrative expenses and other operating expenses

The Group's general and administrative expenses and other operating expenses for 2008 amounted to RMB1,216 million, representing a decrease of RMB300 million, or a 19.79% decrease as compared with that in 2007. The main reason is that the Group strengthened inventory control for the year resulting in the decrease in the provision for inventory impairment allowances.

4 **Operating loss**

The Group suffered an operating loss of RMB394 million for 2008, representing a decreased loss of RMB130 million as compared to the operating loss of RMB524 million in 2007. The main reason is that the Group strengthened the cost control of aviation products resulting in the increase of the gross profit of aviation products on a year-on-year basis and took active measures to reduce the expenses of automobile products causing the decrease in operating loss of automobile products compared with that in last year.

5 **Finance costs, net**

The Group's net finance costs in 2008 amounted to RMB368 million, representing an increase of RMB39 million over that of 2007 which was RMB329 million. This was mainly attributable to an increase in bank borrowings. Details are set out in note 9 to the financial statement.

6 **Income tax expense**

The Group's income tax for 2008 was RMB189 million, representing an increase of RMB138 million over that of 2007 which was RMB51 million. Details are set out in note 10 to the financial statements.

7 **Minority interests**

The profit attributable to the Group's minority interests for 2008 was RMB246 million, representing an increase of RMB68 million as compared to that of 2007. Certain non wholly-owned subsidiaries of the Group recorded profits steadily.

GUARANTEED AND SECURED LOANS

As at 31st December 2008, the Group's total borrowings amounted to RMB6,573 million, of which RMB201 million was secured by properties and buildings, with a net book value of RMB507million.

Guaranteed borrowings amounted to RMB4,775 million, of which RMB2,774 million was cross guaranteed amongst the subsidiaries of the Group, RMB239 million was guaranteed by other related parties and RMB 1,762 million was guaranteed by AVIC and its subsidiaries.

EXCHANGE RISKS

The Group mainly operates in the PRC with most of the transactions settled in Renminbi. The Group's assets and liabilities, and transactions arising from its operations subject to foreign exchange risk are primarily associated with United States Dollar, Euro, Hong Kong Dollar and Japanese Yen.

Due to its operational needs, the Group had taken out loans denominated in Euro, United States Dollar and Japanese Yen. In addition, the Company has some deposits in Hong Kong Dollar, being part of the proceeds raised from the initial public offering in October 2003. The directors are of the opinion that the exchange risks to the Group are low and will not have any material adverse impact on the Group's financial results. Details are set out in note 41(a)(i) to the financial statements.

CONTINGENT LIABILITIES AND GUARANTEES

As at 31st December 2008, the Group had not provided any guarantees in favor of any third party nor were there any significant contingent liabilities.

CASH FLOW AND FINANCIAL RESOURCES

1 Liquidity and capital resources

As at 31st December 2008, the Group's net cash and cash equivalents amounted to RMB2,324 million which was mainly derived from the followings:

- cash and bank deposits at the beginning of the year;
- funds generated from its operations; and
- new bank borrowings.

The Group's cash flow for each of the year 2008 and 2007 were as follows:

Unit: RMB million (except percentage)

Main items of cash flow	**2008**	2007	Change (amount)	Change (percentage)
Net cash flows generated from operating activities	**564**	97	467	481.44%
Net cash flows used in investing activities	**(1,100)**	(556)	(544)	97.84%
Net cash flows generated from/(used in) financing activities	**407**	(244)	651	(266.80%)
Net decreasein cash and cash equivalents	**(129)**	(703)	574	(81.65%)

2 Operating activities

Net cash flows generated from operating activities for the year amounted to RMB564 million, representing an increase of RMB467 million over that of 2007. Details are set out in note 37(a) to the financial statements.

3 Investing activities

Net cash flows used in investing activities for the year amounted to RMB1,100 million, representing an increase of RMB544 million from that of 2007, which was mainly attributable to an increase in term deposits with an initial term of over three months as compared to that of 2007.

4 Financing activities

Net cash flows generated from financing activities for the year was an inflow of RMB407 million, while the financing activities in 2007 generated a net outflow of RMB244 million. The increase was mainly attributable to an increase of RMB498 million in total borrowings as at the end of 2008 when compared to that of 2007.

As at 31st December 2008, the Group's total borrowings amounted to RMB6,573 million, of which the current borrowings, current portion of long-term borrowings and non-current portion of long-term borrowings amounted to RMB4,911 million, RMB728 million and RMB934 million, respectively.

The Group's long-term borrowings are repayable as follows:

Maturity	RMB million
Within one year	728
In the second year	370
In the third to fifth year	269
After the fifth year	295
Total	1,662

As at 31st December 2008, the Group's bank borrowings amounted to RMB5,993 million with an average interest rate of 6.13% per annum, representing 91.18% of the total borrowings. Other borrowings amounted to RMB580 million with an average interest rate of 3.24%, accounting for 8.82% of the total borrowings.

As at 31st December 2008, the Group's borrowings denominated in foreign currencies amounted to RMB287 million, representing 4.37% of the total borrowings, of which borrowings denominated in United States Dollar, Euro and Japanese Yens amounted to USD20 million, Euro5 million and Yen1,308 million respectively.

GEARING RATIO

As at 31st December 2008, the Group's gearing ratio was 29.28% (31st December 2007: 26.67%), which was arrived at by dividing the total borrowings by total assets as at 31st December 2008.

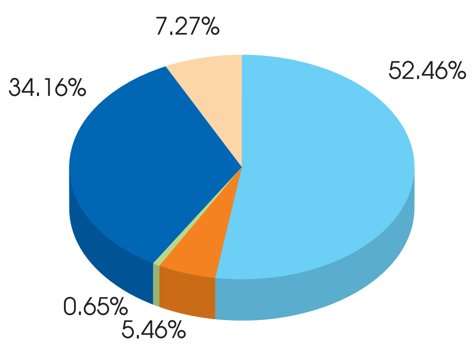
SEGMENT INFORMATION

The Group's principal operations comprise two segments, namely the aviation segment and the automobile segment.

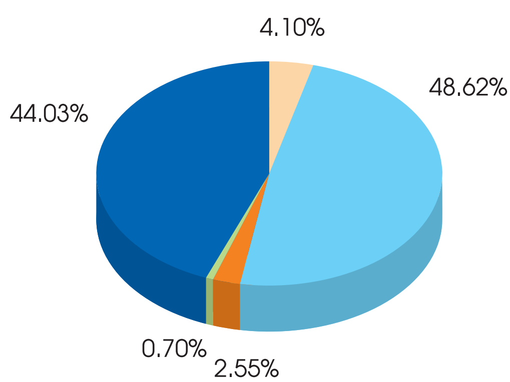
AVIATION SEGMENT

Sales Revenue

Sales Revenue of Aviation Segment in 2008



Sales Revenue of Aviation Segment in 2007



Helicopters | Trainers | General-purpose aircraft | Aviation parts and components | Others

The Group's sales revenue derived from aviation products for 2008 was RMB4,596 million, representing a decrease of RMB731 million, or a 13.72% decrease from that of 2007. The decrease was mainly attributable to a decrease in revenue from aviation parts and components as compared to that in 2007. According to customers' requirements in 2008, some aviation parts were de-equipped, which caused the decrease in revenue from aviation parts and components.

Cost of Sales

Cost of sales of the Group's aviation products for 2008 was RMB3,878 million, representing a decrease of RMB766 million(in percentage terms, 16.49%) as compared to that in 2007. The rate of decrease in cost of sales was greater than the rate of decrease of 13.72% in sales revenue. This reflected strengthened cost control for aviation products.

Gross Margin

Gross margin of the Group's aviation products for 2008 was 15.62%, representing an increase of 2.79 percentage points as compared to that in 2007. In 2008, the Group undertook several measures to improve its gross margin, such as adjusting the products structure and cost control, through which the gross margin of the Group's helicopters, trainers and general-purpose aircraft and the profitability of the overall aviation products were all improved.

Review and Outlook

In 2008, as affected by the global financial crisis and the earthquake disaster occurred in China, there were significant changes in the economic environment in China, leading to a downturn of economic growth and stepping to an economic adjustment period. Under the challenging external economic environment, the Group continued to strengthen the efforts in expanding the markets for its aviation products. Through the participation in the 7th Session of the China International Aviation & Aerospace Exhibition held in 2008, the reputation of the Group's aviation products has been further enhanced.

During the reporting period, the Group sold 117 helicopters in total, which was three units less than that of 2007. Z-9 helicopters and CA109 helicopters successfully completed a number of aerial photography missions and other missions during the Beijing Olympic Games, demonstrating its safety and reliability. Z-9 helicopters and Z-8 helicopters also successfully fulfilled emergency rescue missions during the earthquake disaster. In addition, the research and development of a new helicopter model progressed smoothly, which had entered into test and manufacturing phase.

In 2008, the Group reached agreements with China National Aero-Technology Import & Export Corporation ("CATIC") on sale of 18 units of K-8 trainers, which were expected to be delivered in 2009 and 2010. Meanwhile, two units of K-8 trainers to be exported to Pakistan had been delivered to the flight testing station and the Group had also successfully delivered the first batch comprising eight units K-8 trainers pursuant to contracts. At the same time, four units of K-8 trainers were successfully delivered and exported to Ghana, which was the first entry of K-8 trainers to the West African market. Currently, several African countries have imported K-8 trainers. The first flight of the 03 prototype of L15 advanced trainer, which was primarily researched and manufactured by the Group, had completed successfully.

During the reporting year, sales of the Group's civilian aircraft had made new progress, and the research and development of civilian aircraft had also been strengthened. N-5B fulfilled "first flights of two aircraft". The development and research of the Group's Y-12F aircraft processed swiftly. Hafei Aviation had signed framework agreements with CATIC for the sale of twenty units of Y-12F aircraft. Two units of Y-12IV aircraft were formally delivered to Fiji National Aviation Company which was the first time export of this model. Another Y-12IV ocean surveillance aircraft ordered by the State Oceanic Administration of the PRC were also delivered. Eight units of N-5A aircraft had been delivered to the Ministry of Agriculture of the PRC. The Group anticipated that the international market of N-5A could be further expanded and could satisfy the demand of large-area agricultural and forestry industry in the northeast and western regions of the PRC. The market prospect for N-5A aircraft is therefore very positive.

During the reporting period, pursuant to strategies for development of the aviation business, the Group had been continuously strengthening its co-operation with international partners and expanding its subcontracting business on parts and components production. The Group's international cooperation had made remarkable achievements. The localization of parts and components of ERJ145 proceeded steadily. Certain cooperative programs with Airbus and other partners had also progressed smoothly. The cooperation of Changhe Aviation with Agusta, an Italian company, and the sub-contracting manufacture of aviation parts and components for USA Boeing Company had also made achievements respectively. In addition, Hafei Aviation formally signed a sub-contracting agreement on the supply of aviation parts and components to USA Honeywell and Britain GKN. The Company, Harbin Aircraft Group, Airbus China Limited, Hafei Aviation and Harbin Development Zone Heli Infrastructure Development Co., Ltd. had also signed a joint venture agreement, pursuant to which the parties will establish a joint venture in the PRC to manufacture composite parts and components of Airbus A350XWB and Airbus A320 series. The Group will invest a total of USD30 million to the joint venture.

As national economy of the PRC grows rapidly, it is anticipated that the demands for helicopters and general-purpose aircraft will also increase progressively. Helicopters played a prominent role in rescuing Wenchuan earthquake survivors, and are irreplaceable in economy develoment and emergencies treatment. These imply a tremendous and wide market for helicopters in the future. Amid the current financial crisis, the development of general-purpose aviation will drive the development of the whole industry chain, play a crucial role "to propel domestic demands and stimulate consumption" for the macro-economy; and provide more opportunities to the aviation industry of the PRC. In respect of the global market, as the pace of internationalization of the global aviation industry has been speeded up, competition among aviation manufacturers is escalating and the capability of the PRC aviation industry is rising rapidly. All these factors create a desirable developing environment and favorable opportunities for the PRC aviation manufacturers to collaborate with international partners. In 2008, the Group made remarkable progress in exploring markets for its aviation products, although the profitability of its aviation business still needs to be improved. In 2009, the Group will adopt the following strategies to improve its aviation business:

1. Grasp the opportunities brought about by the reorganization of the PRC's aviation industry. Increase its capital and enlarge the proportion taken by the aviation business segment within the Group;

2. Negotiate with the strong controlling shareholder to inject or acquire aviation business assets to improve the profitability of the Group;

3. Take active measures to explore markets for the Group's products and expand international cooperation through domestic and overseas markets and resources so as to become a part of the global aviation manufacturing system;

4. Further enhance quality management, improve quality assurance system, continue to implement lean production and put emphasis on cost control measures;

5. Adopt the idea of human capitalization, enhance human resources, provide more trainings to employees, strengthen the training and management on employees and train up an excellent team for aviation industry; and

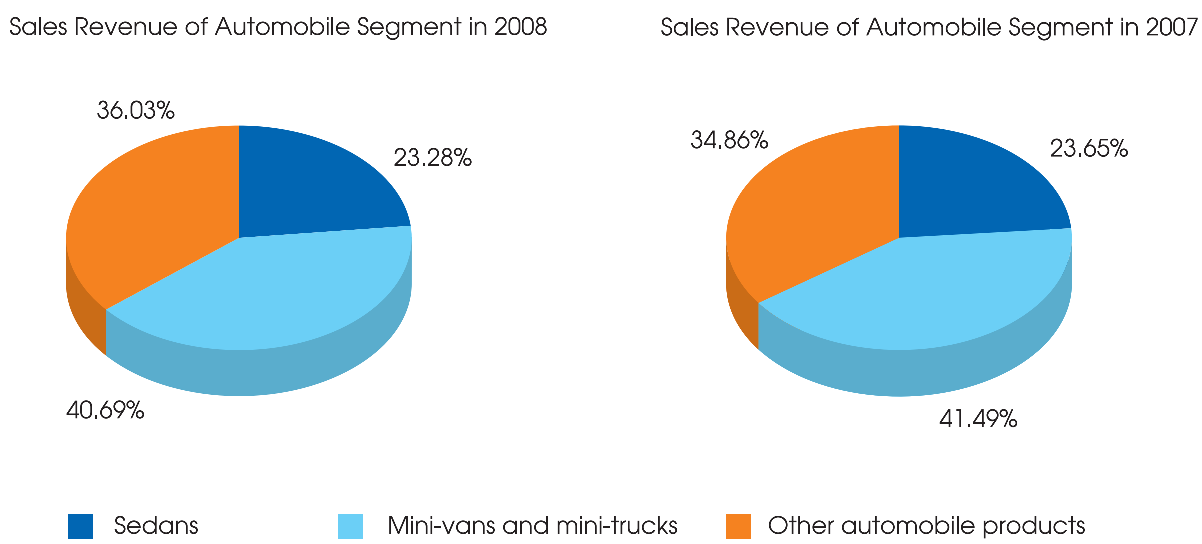
6. Continuously improve administration and supervision system and accelerate the growth in management efficiency.

Orders for Aviation Products

As at the date of this report, the Group has received orders for 123 helicopters, 164 trainers, 39 general aeroplanes and 36 regional aeroplanes. The Group is endeavoring to get more orders for its aviation products.

AUTOMOBILE SEGMENT

Sales Revenue



The Group's turnover of automobile products for 2008 amounted to RMB11,789 million, representing an increase of RMB575 million from that of 2007. This is mainly due to the increase in the turnover of the mini-vans and trucks and engines. Included in the 2008 turnover was a sales volume of the vehicle-manufacturing business which was RMB7,541 million, representing an increase of RMB236 million, or a 3.23% as compared to that of 2007. This presents a return to an increasing trend. Sales of automobile engine products and auto parts and components to parties outside the Group amounted to RMB4,248 million, representing an increase of 8.67% compared to that of 2007.

Cost of Sales

Cost of sales of the Group's automobile products for 2008 amounted to RMB10,941 million, representing an increase of RMB804 million or 7.93% from that of 2007. The main reasons for that include the increase in price of the raw materials and the depreciation of production lines due to the inability of sales volume of certain products to reach the designed capacity level.

Gross Margin

Gross margin of the Group's automobile products for 2008 was 7.19%, representing a decrease of approximately 2.41 percentage points as compared to that in 2007. The drop of the gross margin of the automobile products was caused by the increase in the price of the raw materials and the depreciation of production lines due to the inability of sales volume of certain products to reach the designed capacity level.

Review and Outlook

In 2008, due to the great changes arose in the overseas and domestic economic situation, the PRC automobile industry ceased its rapid growth, which had continued for a number of years and presented an evident slowdown. According to the statistics published by China Automobile Industry Association, a total of approximately 9,345,100 and 9,380,500 vehicles were produced and sold, respectively in the PRC in 2008, representing an increase of 5.21% and 6.70%, respectively as compared to that of 2007, respectively. As compared with the of last year, the rise dropped by 16.81 and 15.14 percentage points, respectively.

In 2008, despite the depression of the macro-economy, the sales volume of the vehicles and engines all achieved a growth through the efforts made by the Group. The Group sold 296,965 vehicles in 2008, representing an increase of 1.8% as compared to that of 2007. Among which the sales volume of mini-vans and trucks (excluding exporting) was 164,519 units, increasing 5.73% over that in 2007; and the sales volume of sedans was 101,808, representing an increase of 6.45% as compared to that in 2007. The number of auto engines sold to third parties outside the Group was 329,771 units, representing an increase of 16.12% as compared to that of 2007.

In 2008, the growth rate in sales volume of sedan "Beidouxing", mini-van "Furuida" and automobile engines of Dongan Mitsubishi, were all higher than the average level of the industry. The sales volume of "Beidouxing" , "Furuida" and Dongan Mitsubishi, amount to 51,512 units, 29,121 units and 319,010 units respectively, representing an increase of 22.82%, 67.43% and 19.28% respectively over those of 2007.

In 2008, the Group continued to restructure its automobile products. The development of new models of HF9 and HF10 had been completed and both models are ready for production. The development on Hafei Lobo Fuel-Saving π model equipped with AMT gearbox had been completed. The structural design and CAE analysis on Hafei electric vehicle model were also finished. In respect of engines products, the first phase of development of engine model DA468QB had been completed and the related performance development tests had also been conducted. The Group also completed the development on 4G15MIVEC engines and launched the development of new models and gearboxes. K14B was awarded as the "Top ten engines in 2008".

In 2009 the Group will adopt the following strategies to improve its automobile business.

1. Focus on the improvement of operation efficiency and profitability. With emphasis on decreasing loss, the Group will continue to put forward the cost controlling work;

2. Strengthen marketing strategies and brand building through the expansion to the second tier and the third tier sales service network building and refine the after-sale system;

3. Actively drive forward adjustments in products structure, such as the upgrading of "Beidouxing" and "Lobo" models, extending the development on "Furuida" model, introducing auto gearbox and actively conducting the research on new fuel automobile;

4. Further promote self-owned development and the cooperation between the domestic and overseas manufacturers in order to better integrate with the mainstream automobile industry and improve the brand image and market competitiveness; and

5. Consider the reorganization of the remaining of the automobile business of the Group, based on the reorganization of Changhe Auto.

USE OF PROCEEDS

According to the plan for use of proceeds, the proceeds used up to 31st December 2008 amounted to RMB 955 million in total, out of which RMB700 million was used for the research and development of new vehicle models and new automobile engines; RMB255 million was used for the research and development of new advanced trainers and helicopters; and the remaining balance was deposited with banks in the PRC as short term deposits which would also be used by the Company as planned.

EMPLOYEES

As of 31st December 2008, the Group had 27,801 employees. The Group has provided appropriate emoluments, benefits and training to its employees.

Employees breakdown by functions

	Number of employees	Percentage to total employees (%)
Vehicles and engines	16,609	59.74%
Aviation	11,170	40.18%
Other activities	22	0.08%
Total	27,801	100%

For the year ended 31st December 2008, total staff costs of RMB1,090 million were incurred by the Group in connection with its employees, representing an increase of RMB145 million as compared to RMB945 million in 2007.

REMUNERATION OF EMPLOYEES

The Group's remuneration scheme is determined based on fair and reasonable principles which are similar to those available in the market. Remuneration of employees comprises basic salary, contribution to a housing fund, and contributions to pension plans. The Group will also, in its discretion, pay year-end bonus to employees according to their respective performance.

TRAINING FOR EMPLOYEES

The Group expects a high level of knowledge and skill in respect of the automobile manufacturing industry and the aviation manufacturing industry from its employees. Therefore, implementation of comprehensive employee training is the key to the Group's continuous development. Accordingly, the Group will continuously review its existing employee training scheme in order to provide comprehensive and systematic training to its employees.

In 2008, the Group provided more special training courses, seminars and field survey on strategic management, human resources management, and financial management. Training relating to all kinds of professional skills and management techniques are also provided to all professional departments of the Group's headquarters and the business departments of its subsidiaries. On-the-job training covering corporate culture, management concept and management standardization are also provided to new employees.

The Group also provides overseas training to the management officers and technicians through co-operation with international partners. The employees, through training, are able to continuously acquire new knowledge to improve their capabilities. This will in turn enhance the Group's competitiveness in the ever-changing market.

During the year of 2008, there were substantial changes to the composition of the Board and the Supervisory Committee. Details of the directors and supervisors are set out as follows:

Executive Directors

Lin Zuoming (appointed on 16th October 2008)
Zhang Hongbiao (resigned on 16th October 2008)
Tan Ruisong
Wu Xiandong

Non-executive Directors

Gu Huizhong (appointed on 16th October 2008)
Xu Zhanbin (appointed on 16th October 2008)
Geng Ruguang (appointed on 16th October 2008)
Zhang Xinguo (appointed on 16th October 2008)
Li Fangyong (appointed on 16th October 2008)
Wang Yong
Maurice Savart
Liang Zhenhe (resigned on 16th October 2008)
Song Jingang (resigned on 16th October 2008)
Tian Min (resigned on 16th October 2008)
Wang Bin (resigned on 16th October 2008)
Chen Huaiqiu (resigned on 16th October 2008)

Independent Non-executive Directors

Guo Chongqing
Li Xianzong
Lau Chung Man, Louis

Supervisors representing the shareholders

Hu Wenming (appointed on 16th October 2008)
Bai Ping
Yu Yan
Wang Yuming (appointed on 16th October 2008)
Wang Shouxin (resigned on 16th October 2008)
Li Deqing (resigned on 16th October 2008)

Supervisors representing the employees

Tang Jianguo
Li Yuhai (appointed on 25 August 2008)
Gao Jianshe (appointed on 25 August 2008)
Li Shentian (resigned on 25 August 2008)
Han Xiaoyang (resigned on 25 August 2008)

Independent supervisors

Zheng Li
Xie Zhihua

DIRECTORS

Executive Directors

Mr. Lin Zuoming （林左鳴）*(Chairman of Development and Strategy Committee)*

51, chairman of the Board of Directors. He is a doctorate degree holder and researcher. Mr. Lin is also the general manager of AVIC. He graduated from Nanjing University of Aeronautics and Astronautics in 1982 majoring in engine design; and received his Ph.D. degree in administrative engineering from Beijing University of Aeronautics and Astronautics in 2006. Mr. Lin commenced his career in July 1982, and used to be a staff and deputy director of Human Resource Division, deputy director of Engineering and Technology Division, deputy director-general of Technical Research Institute, deputy chief engineer, vice general manager, general manager and chairman of the board of Chengdu Engine Co., Ltd.; general manager of Shenyang Liming Aero-Engine (Group) Corporation Ltd. since October 1998; vice general manager of AVIC I and chairman and general manager of Shenyang Liming Aero-Engine (Group) Corporation Ltd. in July 2001; and general manager of AVIC I since May 2006. Mr. Lin also serves as vice chairman of the board of Commercial Aircraft Corporation of China, Ltd., chairman of the board of AVIC I Commercial Aircraft Co., Ltd., chairman of the board of AVIC I Investment Co., Ltd. and chairman of the board of AVIC I Consultant Co., Ltd.. Mr. Lin has been appointed as the chairman of the Board and executive director since October 2008.

Mr. Tan Ruisong（譚瑞松）*(Chairman of the Remuneration Committee)*

47, vice chairman of the Board and president of the Company. He is a researcher level senior engineer. Mr. Tan also serves as the vice general manager of AVIC. He graduated from Beijing University of Aeronautics and Astronautics in 1983 with a bachelor degree majoring in manufacture and design of engines, and received his master degree in shipping and ocean engineering and Ph.D. degree in management science and engineering from Harbin Engineering University in 2002 and 2006, respectively. Mr. Tan commenced his career in aviation in July 1983, and used to be a technician, technical supervisor and workshop supervisor of National Dongan Machinery Factory. He had been the deputy chief engineer and deputy general manager of Harbin Dongan Engine Company, the general manager of Harbin Dongan Auto Engine Co., Ltd., member and vice chairman of the board and the general manager of Harbin Dongan Engine (Group) Co., Ltd., and the chairman of the board of Harbin Aviation Industry (Group) Co., Ltd, vice general manager of AVIC II. Mr. Tan has been appointed as a director of the Company since June 2005, the vice chairman of the Board and executive director since June 2006 and as the vice chairman of the Board, executive director and president of the Company since October 2008.

Mr. Wu Xiandong（吳獻東）

44, executive director and a researcher. Mr. Wu also serves as the vice general manager of AVIC. He graduated from Beijing University of Aeronautics and Astronautics majoring in electro-mechanical control in manufacturing engineering and received his Ph.D. degree from the Moscow Aircraft Institute of Russia majoring in production organization in the aviation industry. He has been engaged in the aviation field since July 1987, joined former AVIC in 1996, and joined AVIC II in 1999. He used to be an assistant engineer in Harbin Dongan Engine Manufacturing Company, the general manager of Harbin Aviation Elec-Mec Company, the director of assets and enterprises management department of AVIC II and an assistant to the general manager of AVIC II and a vice general manager of AVIC II. Mr. Wu has been appointed as the vice chairman of the Board and the president of the Company from April 2003 to October 2008 and as the executive director of the Company since October 2008.

Non-executive Directors

Mr. Gu Huizhong（顧惠忠）*(member of Audit Committee)*

51, a master degree holder and researcher level senior accountant. Mr. Gu is also a vice general manager and the chief accountant of AVIC. He graduated from Zhengzhou Aviation Industry Management Institute in 1981 majoring in financial management, and received his master degree from Beijing University of Aeronautics and Astronautics in 2000 majoring in international finance. Mr. Gu commenced his career in aviation industry in July 1981, and used to be a staff, deputy director and director of Financial Departments of The Third Mechanical and Industrial Department, Aviation Industry Ministry and Aviation and Space Industry Ministry; director of International Affairs Financial Division of Financial Department of former AVIC since June 1993; general manager of Zhongzhen Accounting Consultative Corporation since August 1994; vice manager of Financial Department of former AVIC since November 1995; deputy director-general of Financial Department of State Commission of Science, Technology and Industry for National Defence since July 1998; vice general manager of AVIC I since June 1999; and hold a concurrent post as chief accountant of AVIC I since February 2005. Mr. Gu also serves as a member of board and general manager of AVIC I Investment Co., Ltd. and chairman of the board of AVIC I Investment Co., Ltd. and CATIC International Holdings Limited since December 2008. Mr. Gu has been appointed as a non-executive director of the Company since October 2008.

Mr. Xu Zhanbin（徐占斌）

44, a bachelor degree holder and researcher. Mr. Xu is also a vice general manager of AVIC. He graduated from Shenyang Institute of Aeronautical Engineering with a bachelor in 1985 majoring in manufacture engineer of air vehicle. Mr. Xu commenced his career in aviation industry in July 1985, and used to be a technician, regional manager, deputy director and director of Harbin Aircraft Group Co., Ltd.; vice general manager and director-general of Aircraft Sale Department of Harbin Aircraft Group Co., Ltd. since December 1998; a member of the board, vice general manager and administrative deputy director-general of Aviation Business Department of Harbin Aircraft Group and a member of the board and administrative vice general manager of Hafei Aviation Industry Co., Ltd. since March 2000; deputy chief engineer of AVIC II since December 2000 and vice general manager of AVIC II since November 2001. Mr. Xu has been appointed as a non-executive director of the Company since October 2008.

Mr. Geng Ruguang（耿汝光）*(member of Development and Strategy Committee)*

52, EMBA and researcher. Mr. Geng is also a vice general manager of AVIC. He graduated from Beijing University of Aeronautics and Astronautics with a bachelor degree in 1982 majoring in air vehicle design and completed the EMBA of France HEC International Business School in 2008. Mr. Geng commenced his career in aviation industry in 1982, and used to be an aircraft designer, assistant engineer, engineer, deputy director, director and deputy director-general of aviation departments of Aviation Industry Ministry, Aviation and Space Industry Ministry and former AVIC; deputy director-general of Aviation Products Department of AVIC I since July 1999; general manager assistant of AVIC I since July 2001; and vice general manager of AVIC I since July 2003. Mr. Geng also serves as chairman of the board of AVIC Aircraft Corporation Limited., Xi'an Aircraft Industry (Group) Corporation Ltd. and a member of board of AVIC I Investment Co., Ltd.. Mr. Geng has been appointed as a non-executive director of the Company since October 2008.

Mr. Zhang Xinguo（張新國）

49, a doctorate degree holder major in engineering, doctorate degree holder majoring in management, researcher and supervisor of Ph.D. students. Mr. Zhang is also a vice general manager, Chief Information Officer of AVIC and the director of China Aeronautical Establishment. He graduated from Northwestern Polytechnical University with a bachelor degree in 1982 majoring in general dynamics. During the period from 1990 to 1991, Mr. Zhang was receiving advanced training in University of Salford in the United Kingdom as a visiting student sponsored by government's scholarship. He received his Ph.D. degree from Beijing University of Aeronautics and Astronautics in 1995 majoring in air vehicle control, guidance and emulation and received his another Ph.D. degree from Administration College of Xi'an Jiaotong University in 2008 majoring in enterprise management. Mr. Zhang commenced his career in aviation industry in 1982, and used to be a system engineer, vice director and director of Flight Control Research Department of Xi'an Flight Automatic Control Research Institute; deputy director-general, chief engineer and director-general of Xi'an Flight Automatic Control Research Institute since June 1996; and vice general manager of AVIC I since August 2006. Mr. Zhang also serves as chairman of the board of AVIC I Aviation Electron Co., Ltd.; a member of board of AVIC I Investment Co., Ltd.. Mr. Zhang has been appointed as a non-executive director of the Company since October 2008.

Mr. Li Fangyong（李方勇）

46, a bachelor degree holder and researcher. Mr. Li is also a vice general manager of AVIC. He graduated from Beijing University of Aeronautics and Astronautics with a bachelor degree in 1985 majoring in air vehicle manufacture. Mr. Li commenced his career in aviation industry in 1985, and used to be a technician and head of Techniques Sector and deputy director-general of Engineering Department of Shenyang Aircraft Corporation; vice general manager, vice chairman of the board, general manager and chairman of the board of Shenyang Aircraft Corporation since July 1999; and vice general manager of AVIC I since September 2007. Mr. Li has been appointed as a non-executive director of the Company since October 2008.

Mr. Wang Yong（王勇）

52, a senior economist. He was appointed as the deputy general manager of China Hua Rong Asset Management Corporation Changchun Office in April 2000. He has been appointed as the deputy general manager of China Hua Rong Asset Management Corporation Harbin Office since December 2001. He graduated from Harbin Normal University in 1997 with a bachelor degree majoring in economics management. Mr. Wang commenced his career in the People's Bank of China, Lanxi County branch in 1977. He had been the manager of the credit and loan department and a vice president of Industrial and Commercial Bank of China, Suihua branch, the department head of credit and loan department of Industrial and Commercial Bank of China, Heilongjiang branch, the president of Industrial and Commercial Bank of China, Qiqihar branch. At present, Mr. Wang serves as a vice chairman of China First Heavy Industries (Group) Co., Ltd., a vice chairman of the board of Harbin Turbine Co., Ltd.. and a vice chairman of the board of Harbin Huaer Chemical Industry Co., Ltd. Mr. Wang has been appointed as a non-executive director of the Company since June 2005.

Mr. Maurice Savart *(Member of Development and Strategy Committee)*

50, Chairman of Airbus Asia Advisory Council. Mr. Maurice commenced his career in science and technology for national defence in 1982 when he worked at the Training and Cooperation Department of the Ministry of Defence of France. He used to be the area sales manager (Asia) of the Thomson-CSF/Aerospace Group, the business development director (Asia Pacific), vice president (North Asia) of the Lagardere Group, the managing director (North Asia) of Aerospatiale Lagardere International and the senior vice president of EADS in charge of business in north Asia. He has been the Chairman of Airbus Asia Advisory Council from late 2007. Mr. Maurice graduated from the School of Engineering of Ecole Nationale Supérieure de Physique in France in 1980 and received his master degree in Science from the University of California in the USA in 1981 and a MBA degree from the School of Business Administration of Institut Supérieure des Affaires in France in 1982. Mr. Savart has been appointed as a non-executive director of the Company since June 2004.

Independent Non-executive Directors

Mr. Guo Chongqing（郭重慶）*(Member of Audit Committee and Remuneration Committee)*

76, an academician of the Chinese Academy of Engineering and a professor of Tongji University, a professor of Shanghai Jiao Tong University, the consulting dean of the Mechanical Engineering Institute and Economics and Management Institute, the head of management and science department of the National Committee of Natural Science Funds and a member of the specialist committee of Chinese Association of Machine Building. He graduated from Harbin Polytechnical University in 1957 majoring in machinery manufacturing and was an assistant professor in the university. He had been the chief designer of a number of major national construction projects, and was awarded the "Chinese Master of Engineering Design". Mr. Guo has been appointed as an independent non-executive director of the Company since May 2003.

Mr. Li Xianzong（李現宗）*(Chairman of Audit Committee and member of Remuneration Committee)*

52, a professor and supervisor for master degree students. He graduated from Zhengzhou Institute of Aeronautical Industry Management in 1982. He then graduated from Tianjin Finance and Economics Academy in 1996 with a master degree majoring in accounting. Mr. Li was the deputy chairman and subsequently the chairman of the Accounting Department of Zhengzhou Institute of Aeronautical Industry Management. He is the deputy dean of Zhengzhou Institute of Aeronautical Industry Management. Mr. Li was an independent non-executive director of Guizhou Guihang Automobile Parts Joint Stock Company Limited. Mr. Li is also a member of the Association of Accounting in the PRC, non-practicing member of the Chinese Institute of Certified Public Accountants in the PRC, an asset appraiser, member of the Institute of International Internal Auditors, and a member of the third Council of the Chief Accountants' Association in the PRC. Mr. Li has been appointed as an independent non-executive director of the Company since December 2004.

Mr. Lau Chung Man, Louis（劉仲文）*(Member of Audit Committee and Remuneration Committee)*

50, executive director and CFO of Sing Tao News Corporation ("Sing Tao", a company listed on the main board of the Stock Exchange). Mr. Lau joined Sing Tao on 23rd May 2005. Mr. Lau is a Chartered Accountant and has been granted the Master of Business and Administration in Victoria University of Wellington, New Zealand. Mr. Lau is also a member of New Zealand Institute of Chartered Accountants (NZICA) and an associate member of Hong Kong Institute of Certified Public Accountants (HKICPA). He has experience in corporate management, accounting and finance. Before he joined the Sing Tao, he had been an executive director of China Everbright Ltd. (a company listed on the main board of the Stock Exchange) since 1st September 2002. Mr. Lau has been appointed as an independent non-executive director of the Company since August 2006.

Supervisors

Mr. Hu Wenming（胡問鳴）

51, a doctorate degree holder and researcher. Mr. Hu is also a vice general manager of AVIC. He graduated from Nanjing University of Aeronautics and Astronautics with a bachelor degree in 1982 majoring in computer mathematics, and received his doctorate degree from Nanjing University of Aeronautics and Astronautics in 2005 majoring in management science and engineering. Mr. Hu commenced his career in aviation industry in 1982, and used to be a teacher, deputy director of training center, general manager assistant, vice general manager of Suzhou Changfeng Mechanism Factory; chairman of the board and general manager of Suzhou Changfeng Co., Ltd, since February 1999; director-general of Airborne Equipment Department of AVIC 1 since July 2001; and vice general manager of AVIC I since March 2002. Mr. Hu also serves as a member of the board of AVIC I Investment Co., Ltd.. Mr. Hu has been appointed as a supervisor of the Company and as the chairman of the Supervisory Committee since October 2008.

Mr. Tang Jianguo (湯建國)

57, a researcher. Mr. Tang is also a vice general manager of AVIC. He graduated from Beijing University of Aeronautics and Astronautics majoring in metallic materials and welding engineering. He commenced his career in the aviation industry in December 1971 and used to serve at Factory No.550 under the Ministry of Aviation Industry, Beijing University of Aeronautics and Astronautics, former AVIC, vice director and the director of the human resources department and director of development and research department of AVIC II, director of human resources department and chief director of China Aviation Economy Establishment and vice general manager of AVIC II. He is the chief director of China Aviation Industry and Technology Research Institute, a research fellow of China Engineering Academy, a research fellow of Beijing University of Aeronautics and Astronautics Advanced Education Study Centre, a research fellow of China Labour Scientific Institute and councillor and vice chairman of the remuneration committee of China Labour's Society. Mr. Tang has been appointed as a supervisor of the Company since April 2003 and as the chairman of the Supervisory Committee from August 2006 to October 2008.

Mr. Li Yuhai (李玉海)

50, and is a doctorate degree holder and researcher. Mr. Li is also a vice general manager of AVIC. He graduated from Northwestern Polytechnical University in 1982 with a bachelor degree majoring in structural intensity of air vehicle, and received his Ph.D. degree in engineering dynamics from Beijing University of Aeronautics and Astronautics in 2001. Mr. Li commenced his career in aviation industry in 1982, and used to be a designer, deputy team head, deputy director, director of Intensity Division of Shenyang Aircraft Research Institute; deputy director-general and director-general of Shenyang Aircraft Research Institute since June 1997; director-general of Aviation Products Department of AVIC I since March 2003; and vice general manager of AVIC I since August 2006. Mr. Li also serves as a member of board of AVIC I Investment Co., Ltd. as well as a visiting professor and supervisor for Ph.D. degree students in Beijing University of Aeronautics and Astronautics. Mr. Li has been appointed as a supervisor of the Company since August 2008.

Mr. Gao Jianshe (高建設)

45, a master degree holder and class one senior economist. Mr. Gao is also a vice general manager of AVIC. He graduated from Xiamen University with a bachelor in 1985 majoring in philosophy, and completed courses for master degree candidates majoring in educational economy and administration conducted by Beijing University of Aeronautics and Astronautics in 2001. Mr. Gao commenced his career in aviation industry in 1985, and used to be a staff, senior staff, deputy director, director of Enterprise Cadre Division of Human Resource and Labor Department of Aviation Industry Ministry, Aviation and Space Industry Ministry and former AVIC; deputy director-general and director-general of Human Resource Department of AVIC I since July 1999; and vice general manager of AVIC I since August 2006. Mr. Gao also serves as chairman of supervisory committees of AVIC I Consultant Co., Ltd. and AVIC I Investment Co., Ltd.. Mr. Gao has been appointed as a supervisor of the Company since August 2008.

Ms. Bai Ping（白萍）

54, a class one senior accountant and a certified public accountant. Ms. Bai is also the deputy chief accountant and director-general of financial management department of AVIC. She graduated from Zhengzhou Aviation Industry Management Institute majoring in financial management. She also took the business administration diploma course in the faculty of economics, management and human resources training center in Beijing University of Aeronautics and Astronautics and an MBA course sponsored by the University of California, USA. She commenced her career in aviation industry in 1970 and served as a staff in the management office of electronic component division of Shaanxi Xingping Qinling Company, an auditor of the audit department of the Ministry of Aero-Space Industry, a deputy director and the director of the audit office under the finance department of former AVIC, and the director-general of the finance and audit department and deputy chief accountant of AVIC II. Ms. Bai has been appointed as a supervisor of the Company since April 2003.

Mr. Yu Yan（于岩）

47, a senior economist. Mr. Yu also serves as an assistant manager of the assets management department of China Orient Asset Management Corporation, Harbin Office responsible for assets and stock management. From 1989, he worked in the Bank of China, Heilongjiang branch's finance research institute, trust and investment corporation and corporate department engaged in research, investment management, investment fund and credit and loan operations. He joined China Orient Asset Management Corporation Harbin Office since 2000. Mr. Yu has been appointed as a supervisor of the Company since April 2003.

Mr. Wang Yuming（王玉明）

38, a bachelor degree holder and an economist. Mr. Wang is also the vice general manager of the Assets Preservation Department of China Construction Bank Corporation, Heilongjiang branch. He graduated from Lanzhou University with a bachelor degree in 1993 majoring in administrative management. He commenced his career in China Construction Bank Corporation, Heilongjiang branch in July 1993, and used to be a staff, deputy director and director of Human Resource Division and the president of China Construction Bank Corporation, Harbin Nangang branch since May 2002. Mr. Wang has been appointed as a supervisor of the Company since October 2008.

Independent Supervisors

Ms. Zheng Li（鄭力）

73, a senior economist, Certified Public Accountant and an international Certified Internal Auditor. She graduated from Moscow Finance and Economics Institute in January 1959. She then worked in the former State Development and Planning Commission and held the position of deputy division head, division head and deputy department head of the general department of national economy of the State Development and Planning Commission; she was a full-time committee member of the State Development and Planning Commission; the deputy auditors-general of the Auditing Administration, a special inspector of the State Council and member of the supervisory board of China Development Bank and the chairman of China Internal Audit Committee. She was a deputy to the 9th China People's Political Consultative Committee, member of the executive board of the 5th, 6th and 7th All-China Women's Federation and was awarded the National "Eighth of March" Red Flag Bearer. Ms. Zheng has been appointed as an independent supervisor of the Company since September 2003.

Mr. Xie Zhihua（謝志華）

49, a professor and a vice chancellor at the Beijing Business University, a Ph.D. degree holder, a certified public accountant, a vice chairman of China Commerce and Economy Academy, a vice chairman of China Commerce and Accounting Academy, a standing director of China Audit Academy, a director of China Accounting Academy, a director of China Financial Academy, a director of China Cost Academy and a vice chairman of the Guidance Committee of Industrial and Commercial Subjects of Education Ministry. He also serves as visiting professor in over twenty universities and institutes, such as the Science and Research Institute under the Financial Ministry. He is a special research fellow at the Chinese Study Centre of University of Cardiff. He is awarded ministry-level young specialist in management and special subsidy by the State Council as a specialist. Mr. Xie has been appointed as an independent supervisor of the Company since May 2003.

Senior Management

Mr. Li Hui（李慧）

53, a vice president of the Company. He is also a researcher level senior engineer and holds a post-graduate degree. He graduated from Beijing University of Aeronautics and Astronautics majoring in computer programme system design and economics and management. He commenced his career in the aviation industry in September 1978 and used to be a technician at the electrical equipment division of the ancillary machine department of the Third Ministry of the Machine-Building Industry and general office secretary, an assistant engineer at the Third Ministry of the Machine-Building Industry, secretary and engineer at general office of the Ministry of the Aviation Industry, a deputy director and the director of the trading division of China Aviation Industry Science and Technology Corporation, a deputy general manager of China Aviation Industry Science and Technology Corporation, a deputy director, the general deputy director and the director of the general office of AVIC II, and the director of China Aviation Industry Economy Technology Research Centre and the director of development and research department. Mr. Li has been appointed as the vice president of the Company since April 2003.

Mr. Li Yao（李耀）

44, a vice president and the chief financial officer of the Company and a senior accountant. He is also a director of Hafei Aviation. He graduated from Zhengzhou Aviation Industry Management Institute majoring in finance and accounting, Beijing University of Aeronautics and Astronautics majoring in corporate management and industrial economics and Tsinghua University majoring in EMBA. He commenced his career in the aviation industry in July 1986 and served as a staff official in the finance department of the Ministry of Aviation Industry and the Ministry of Aero-Space Industry, a deputy director of the enterprise division of the finance department of former AVIC and a deputy director of the finance and audit department of AVIC II. Mr. Li has been appointed as the vice president of the Company since April 2003.

Mr. Liu Tao（劉濤）

55, a vice president and a class one senior economist. Mr. Liu graduated from Hafei Industry Institute majoring in enterprise administration. He commenced his career in the aviation industry in August 1969 and used to be the chief supervisor of workshop and vice director of the production department of Harbin Aircraft Manufacturing Co., Ltd., a deputy general manager and the general manager of Hafei Auto Co., Ltd., a deputy general manager and a member of the board of Harbin Aircraft Industry (Group) Co., Ltd., a deputy general manager and a member of the board of Harbin Aviation Industry (Group) Co., Ltd. and the chairman of Hafei Automobile Industry Group Co., Ltd.. Mr. Liu has been appointed as the vice president of the Company since August 2007.

Board Secretary

Mr. Yan Lingxi（閆靈喜）

39, a senior engineer. He is also a director of Hongdu Aviation, a director of Dongan Motor and a supervisor of Hafei Aviation. He graduated from the Beijing University of Aeronautics and Astronautics with a bachelor degree in engineering (majoring in management information system) in 1991 and with a master degree in management in 1999. He commenced his career in the aviation industry in July 1991 and worked in the reform bureau of the Ministry of Aero-Space Industry, the corporate management office of Nanjing Jincheng Machinery Factory, the corporate management department and the asset and business management department of former AVIC. He was appointed as a deputy division director and a division director of the corporate assets management department of AVIC II, and is also the director in the security and legal department of the Company. Mr. Yan has been appointed as the Board Secretary of the Company since April 2003.

Company Secretary

Mr. Ip Kun Wan, Kiril（葉冠寰）

48, also a managing director of China Everbright Investments Management Limited, a wholly owned subsidiary of China Everbright Limited (a company listed on the Stock Exchange). Mr. Ip was the company secretary and legal counsel of China Everbright Limited. He started his career as marine engineer and subsequently changed his career to become a solicitor of the High Court of Hong Kong. Mr. Ip graduated from the University of Hong Kong with a bachelor degree in mechanical engineering and from the University of Sydney with a master degree in transport management. Mr. Ip has been appointed as the Company Secretary of the Company since September 2003.

The Board presents its annual report of the directors together with the audited financial statements of the Group for the year ended 31st December 2008.

BUSINESS OF THE GROUP

The Group is principally engaged in the research, development, manufacture and sale of civil aviation products and automobiles.

RESULTS AND DIVIDEND

The results of the Group for 2008 are set out in the Consolidated Income Statement on page 52 of the Annual Report.

The Board recommended no distribution of final dividend for the year ended 31st December 2008.

SHARE CAPITAL

In 2008, there were no changes in the share capital of the Company.

The Company's capital structure as at 31st December 2008 was as follows:

Class of shares	Number of shares as at 31st December 2008	Percentage of total number of shares in issue as at 31st December 2008 (%)
Domestic shares	2,963,808,000	63.83
Overseas listed foreign invested shares (H shares)	1,679,800,500	36.17
Total	4,643,608,500	100

FIVE-YEAR FINANCIAL HIGHLIGHTS

A summary of the results, assets and liabilities of the Group for the last five financial years is set out on pages 5 to 6 of this annual report.

SHAREHOLDINGS OF SUBSTANTIAL SHAREHOLDERS

As at 31st December 2008, pursuant to the register kept under Section 336 of the Securities and Futures Ordinance (the "SFO"), shareholders holding more than 5% equity interests in the Company and associated corporations were as follows:

Name of Shareholders	Class of shares	Number of shares	Percentage of shareholdings in the same class of shares	Percentage of shareholdings out of share capital in issue	Nature of shares held
AVIC	Domestic shares	2,835,305,636	95.66%	61.06%	Long position
EADS	H shares	232,180,425	13.82%	5.00%	Long position
The Hamon Investment Group Pte Limited	H shares	200,768,000 (Note 1)	11.95%	4.32%	Long position
The Bank of New York Mellon Corporation	H shares	101,412,000 (Note 2)	6.04%	2.18%	Long position

Notes:

1. These H shares were held directly by various controlled corporations of The Hamon Investment Group Pte Limited, of which 57,064,000 H shares were held by Hamon Asset Management Limited, 110,090,000 H shares were held by Hamon U.S. Investment Advisors Limited and 33,614,000 H shares were held by Hamon Investment Management Limited.

2. These H shares were held directly by The Dreyfus Corporation, a corporation controlled by The Bank of New York Mellon Corporation.

Save as disclosed above, as at 31st December 2008, the Company had not been notified of any interests and short positions in 5% or more than 5% of shares and underlying shares of the Company which had been recorded in the register kept under section 336 of the SFO.

PURCHASE, SALE AND REDEMPTION OF SHARES

Neither the Company nor any of its subsidiaries had purchased, sold or redeemed any of the Company's shares for the year ended 31st December 2008.

PRE-EMPTIVE RIGHTS

There are no provisions in respect of pre-emptive rights under the Articles of Association and the laws of the PRC.

DESIGNATED DEPOSITS AND OVERDUE FIXED DEPOSITS

As at 31st December 2008, there was no designated deposit or overdue fixed deposit placed by the Group that could not be collected by the Group upon maturity.

FIXED ASSETS

Details of fixed assets of the Company are set out in note 15 to the financial statements.

RESERVES

Details of movement in reserves of the Group for the year ended 31st December 2008 are set out in the Consolidated Statement of Changes in Equity and note 36 to the financial statements.

DISTRIBUTABLE RETAINED EARNINGS

As at 31st December 2008, the Company had no distributable retained earnings.

MAJOR CUSTOMERS AND SUPPLIERS

During the reporting period, the Group's total purchases from the five largest suppliers accounted for 10.69% of the Group's total purchases, of which purchases from the largest supplier accounted for approximately 3.35% of the Group's total purchases. The Group's sales to the five largest customers accounted for 38.99% of the Group's total sales, of which, sales to the largest customer accounted for 11.93% of the Group's total sales.

Purchases of aviation segment from the five largest suppliers accounted for 46.50% of the total purchases in the Group's aviation segment, of which, purchases from the largest supplier accounted for 17.78% of the total purchases in the Group's aviation segment. Sales in the aviation segment to the five largest customers accounted for 93.08% of the total sales in the Group's aviation segment, of which, sales to the largest customer accounted for 42.53% of the total sales in the Group's aviation segment.

Purchases of automobile segment from the five largest suppliers accounted for 8.20% of the total purchases in the Group's automobile segment, of which, purchases from the largest supplier accounted for 2.31% of the total purchases in the Group's automobile segment. Sales in the automobile segment to the five largest customers accounted for 31.33% of the total sales in the Group's automobile segment, of which, sales to the largest customer accounted for 14.59% of the total sales in the Group's automobile segment.

During the reporting period, save for the connected transactions with AVIC Group, as disclosed in the section of Connected Transactions in the Annual Report, none of the directors, their associates or any shareholder holding more than 5% in the share capital of the Company has any interest in the above major suppliers and customers.

SUBSIDIARIES, ASSOCIATES AND A JOINTLY CONTROLLED ENTITY

Details of subsidiaries, associates and a jointly controlled entity of the Company are set out in note 43 to the financial statements.

DIRECTORS

Details of the directors of the Company during the financial year ended 31st December 2008 are set out in page 21 of this annual report.

MATERIAL ACQUISITIONS AND DISPOSAL OF SUBSIDIARIES AND ASSOCIATED COMPANIES DURING THE REPORTING YEAR

On 9th October 2008, Changhe Auto, a non wholly-owned subsidiary of the Company, and AVIC Organizing Unit entered into the Acquisition Agreement. Details of the transaction can be referred to in page 38 of this annual report.

CONNECTED TRANSACTIONS

Continuing Connected Transactions

During the year ended 31st December 2008, the Group engaged in several continuing connected transactions with AVIC II Group (AVIC II and its subsidiaries, together referring to as AVIC II Group, is a connected person of the Company as AVIC II is the controlling shareholder of the Company), joint venture partners (who are connected persons of the Company as they hold at least 10% interests in the subsidiaries of the Company) and non-wholly owned subsidiaries of the Company (who are connected persons of the Company as AVIC II or its associates hold 10% or more interests in them).

As AVIC II, a controlling shareholder holding 61.06% interests in the Company, merged with AVIC I to establish AVIC on 6th November 2008, the Company announced on 9th November 2008 that the controlling shareholder changed to AVIC and that all the contracts signed with AVIC II remained effective during the term of the agreements. The proposed annual caps in 2008 had not been adjusted. The Company has considered the impact of the establishment of AVIC on the continuing connected transactions in 2008 in reporting the statistics of the continuing connected transactions in the 2008 annual report.

Set out below are the details of the approved continuing connected transactions of the Company for the year ended 31st December 2008:

1. On 26th August 2005, the Company entered into a supplemental agreement with AVIC II to renew the terms of the product and ancillary services mutual supply agreement ("Mutual Supply Agreement") for a further term of three years expiring on 31st December 2008, whereby the AVIC II Group has agreed to provide certain products and services to the Group and the Group has agreed to provide certain products and services to AVIC II Group.

2. On 26th August 2005, the Company entered into a supplemental agreement with AVIC II to renew the terms of the comprehensive services agreement ("Comprehensive Services Agreement") for a further term of three years expiring on 31st December 2008, whereby AVIC II Group has agreed to provide certain social welfare and logistics services to the Group.

3. On 2nd October 2003, the Company entered into a land use rights leasing agreement ("Land Use Rights Leasing Agreement") with AVIC II whereby the AVIC II Group has agreed to lease to the Group 48 pieces of land, with an aggregate area of approximately 2.9 million square metres at the annual rent of approximately RMB37.6 million. The land is used by the Group as workshops, warehouses, an administrative office and ancillary facilities. The term of the lease is 20 years.

4. On 26th August 2005, the Company entered into a supplementary agreement to the properties leasing agreement ("Properties Leasing Agreement") with AVIC II whereby the AVIC II Group has agreed to lease to the Group certain properties with an aggregate gross floor area of approximately 111,000 square metres ("Rented Properties") at an annual rent of approximately RMB24 million. Similarly, the Group has agreed to lease to the AVIC II Group certain properties with an aggregate gross floor area of approximately 36,000 square meters ("Leased Properties") at an annual rent of approximately RMB1.1 million. The Rented Properties are built on leased lands and used by the Group as workshops, warehouses and ancillary facilities. The Leased Properties are used by the AVIC II Group as workshops, warehouses and ancillary facilities.

5. On 26th August 2005, the Company entered into a supplementary agreement with AVIC II to renew the terms of the technology cooperation framework agreement ("Technology Cooperation Agreement") for a further term of three years expiring on 31st December 2008, whereby the AVIC II Group has agreed to transfer or grant a licence to the Group to use certain existing technologies required for the Group's business in connection with the production of aviation products and automobiles. The agreement has also provided for future co-operation between the AVIC II Group and the Group in respect of development of new technology.

6. On 30th June 1999, Dongan Mitsubishi entered into a technology transfer agreement ("Mitsubishi Technology Transfer Agreement") with Mitsubishi, a connected person by virtue of it being a substantial shareholder of Dongan Mitsubishi, whereby Mitsubishi has agreed to grant to Dongan Mitsubishi a licence to use the industrial properties rights, patent and technology documents relating to engines, gearboxes and the respective assemblies, parts and components.

7. As part of the joint venture establishment agreement of Dongan Mitsubishi dated 16th June 1998, the CKD spare parts supply agreement between Dongan Mitsubishi and Mitsubishi ("Mitsubishi CKD Agreement") states that Dongan Mitsubishi agrees to purchase CKD spare parts and components from Mitsubishi.

8. On 26th August 2005, the Company and its subsidiaries entered into a supplementary agreement to renew the term of the internal connected transaction agreement ("Internal CT Agreement") for a further term of three years expiring on 31st December 2008, which set out the general principles of the transactions between the Company (or its wholly-owned subsidiaries) and the non-wholly owned subsidiaries of the Company and transactions between the non-wholly owned subsidiaries of the Company. Dongan Mitsubishi and Hafei Auto are the two parties engaging in transactions according to the Internal CT Agreement.

9. On 2nd June 2005, the Group entered into the Agusta Agreement with Agusta, a connected person by virtue of it being a substantial shareholder of Changhe Agusta (a joint venture established by the Group and Agusta, whereby Agusta agrees to provide to Changhe Agusta parts and components for manufacturing helicopters and assistance in manufacturing, assembling and selling helicopters.

10. On 24th December 2003, 21st March 2005 and 24th December 2003, Changhe Suzuki entered into three licence agreements ("Suzuki Licence Agreements") with Suzuki, a connected person by virtue of it being a substantial shareholder of Changhe Suzuki, namely Liana Licence Agreement, New Series Automobile Licence Agreement and K Series Engine Licence Agreement, whereby Suzuki agrees to grant Changhe Suzuki licence to use Suzuki's technologies in manufacturing, assembling and selling Lianas, new series, K series engines, gear boxes and relevant parts and components and to use relevant patents, brands and technologies, provide technical assistance, and supply relevant parts and components.

11. On 8th August 2005, Hafei Auto entered into the Mitsubishi Joint Development Agreement with Mitsubishi, whereby Mitsubishi agrees to provide assistance to Hafei Auto in developing automobile products with Mitsubishi's technologies and grant Hafei Auto licence to use certain Mitsubishi's automobile technologies, information and patents.

12. On 8th August 2005, Hafei Auto entered into the Mitsubishi Hafei CKD Agreement with Mitsubishi, whereby Hafei Auto agrees to purchase CKD spares and parts from Mitsubishi so as to use Mitsubishi's technologies in manufacturing automobiles.

Details of the above continuing connected transactions can be referred to in the announcement and circular of the Company dated 30th September 2005 and 2nd November 2005, respectively.

Set out below are the annual caps for the continuing connected transaction as compared with the actual transaction amounts incurred by the Group in 2008. For the year ended 31st December 2008, the continuing connected transactions of the Company were calculated on a consolidated basis as follows:

Agreements	Consolidated consideration for the year ended 31st December 2008 (RMB million)	Annual Caps in 2008 (RMB million)
1 **Mutual Supply Agreement**		
(a) Annual expenditures of the Group	2,956	4,000
(b) Annual revenues of the Group	3,502	8,500
2 **Comprehensive Services Agreement**		
Annual expenditures of the Group	100	220
3 **Land Use Rights Leasing Agreement**		
Annual expenditures of the Group	24	38
Properties Leasing Agreement		
(a) Annual expenditures of the Group	10	24
(b) Annual revenues of the Group	1	1.1
4 **Technology Co-operation Agreement**		
(a) Annual expenditures of the Group	22	40
(b) Annual revenues of the Group	—	27
5 **Mitsubishi Technology Transfer Agreement**		
Annual expenditures of the Group	91	150
Mitsubishi CKD Agreement		
Annual expenditures of the Group	138	450
6 **Internal CT Agreement**		
(i) Annual expenditures of Dongan Mitsubishi and Hafei Auto	1,429	3,800
(ii) Annual revenues of Dongan Mitsubishi and Hafei Auto	126	600
(iii) Annual guarantees provided by subsidiaries of the Group to Hafei Auto	1,244	2,000
7 **Agusta Agreement**		
Annual expenditures of the Group	29	117
8 **Liana Licence Agreement, New Model Technology Transfer Agreement and K Series Licence Agreement**		
Annual expenditures of the Group	27	2,121
9 **Mitsubishi Joint Development Agreement**		
Annual expenditures of the Group	9	53
Mitsubishi Hafei Parts and Components Contract		
Annual expenditures of the Group	—	135

The Board (including independent non-executive directors) has reviewed the above continuing connected transactions and confirmed that they had been entered into under the following conditions:

(a) The transactions were entered into in the ordinary and usual course of business of the Group;

(b) The transactions were entered into: i) on normal commercial terms; or ii) in accordance with the relevant agreements governing such transactions, on terms that are fair and reasonable and in the interests of the shareholders of the Company as a whole; and iii) where there is no appropriate comparison for the purposes of determining whether the above (i) or (ii) is satisfied, on terms that are no less favourable to the Company than terms available to or from (as appropriate) independent third parties; and

(c) The aggregate amounts of the transactions have not exceeded the respective caps as set out above.

The Company's auditor has reviewed the relevant transactions, and have confirmed in a letter to the Directors stating that:

(a) The transactions have received the approval of the Board;

(b) The transactions have been entered into in accordance with the pricing policies as stated in the relevant agreements, or if no such policies or agreements are available, on terms no less favourable than those available from/to (as appropriate) independent third parties;

(c) The transactions have been entered into in accordance with the terms of the respective agreements and documents governing the transactions, or if no such agreements or documents are available, on terms no less favorable than those available from/to (as appropriate) independent third parties; and

(d) The aggregate amounts of the transactions have not exceeded the respective annual caps as set out above.

ONE-OFF CONNECTED TRANSACTIONS

1. On 29th December 2007, each of the Company and Hongdu Group entered into Subscription Agreement I and Subscription Agreement II with Hongdu Aviation. Pursuant to the agreements, each of the Company and Hongdu Group undertakes to subscribe new shares in the share capital of Hongdu Aviation for a total consideration of approximately RMB250 million and RMB350 million, respectively. As AVIC II holds an aggregate of approximately 56.32% (including 55.29% interest held by the Company) of the issued share capital of Hongdu Aviation, and AVIC II is a controlling shareholder of the Company holding 61.06% equity interest in the Company, and Hongdu Group is a wholly-owned subsidiary of AVIC II, pursuant to Chapter 14A of the Listing Rules, AVIC II is a connected person of the Company and Hongdu Group is an associate of AVIC II. Therefore, the subscription of new Hongdu shares by AVIC II through Hongdu Group constituted a connected transaction of the Company. Details of the transactions have been disclosed in the announcements of the Company dated 9th January 2008 and 22nd February 2008, the circular of the Company dated 25th February 2008 and the 2007 annual report of the Company. The transactions did not go through eventually because certain conditions under the agreements were not satisfied.

2. On 26th March 2008, Hongdu Aviation, a non wholly-owned subsidiary of the Company, AVIC II and its associates, China Huarong Asset Management Corporation, an independent third party and AviChina Undercarriage Limited Liability Company entered into an agreement for the injection by Hongdu Aviation of RMB100,000,000 as capital into AviChina Undercarriage Limited Liability Company. AVIC II is the controlling shareholder of the Company, holding 61.06% equity interest in the Company. As AVIC II is a substantial shareholder of AviChina Undercarriage Limited Liability Company, the proposed injection of capital by Hongdu Aviation into AviChina Undercarriage Limited Liability Company therefore constituted a connected transaction of the Company under Chapter 14A of the Listing Rules. Details of the transactions have been disclosed in an announcement published by the Company on 27 March 2008.

3. On 26th March 2008, Hongdu Aviation, a non wholly-owned subsidiary of the Company, Hongdu Group and Jiangxi Changjiang General Aviation Company Limited entered into an agreement for the injection by Hongdu Aviation of RMB 49,960,000 as capital into Jiangxi Changjiang General Aviation Company Limited. Hongdu Group is an associate of AVIC II, a connected person of the Company, by virtue of its being a wholly-owned subsidiary of AVIC II. As Hongdu Group is a substantial shareholder of Jiangxi Changjiang General Aviation Company Limited, the proposed capital injection by Hongdu Aviation into Jiangxi Changjiang General Aviation Company Limited therefore constituted a connected transaction of the Company under Chapter 14A of the Listing Rules. The Company has published an announcement to disclose the details of the above transactions on 27 March 2008.

4. On 9th October 2008, Changhe Auto, a non wholly-owned subsidiary of the Company, and AVIC Organizing Unit entered into the Acquisition Agreement. Pursuant to the Acquisition Agreement, Changhe Auto conditionally agreed to purchase and AVIC Organizing Unit on behalf of AVIC I and AVIC II (and AVIC, upon its establishment after completion of the proposed merger and reorganization of AVIC I and AVIC II) conditionally agreed to sell the aviation assets to Changhe Auto. Such aviation assets included Shanghai Aviation Electric Co., Ltd. and Lanzhou Wanli Aviation Electrical Co., Ltd., which were wholly-owned by AVIC with a total net asset value of RMB793,177,100. Changhe Auto agreed to transfer all of its automobile assets (including liabilities) valued at RMB406,618,700 to AVIC and issued not more than 74,625,174 new Changhe Shares to AVIC at an issue price of not less than RMB5.18 per share with a total value of not lower than RMB386,558,400. Details of the transactions have been disclosed in the announcement and circular of the Company dated 13th October 2008 and 3rd November 2008, respectively.

SIGNIFICANT EVENT DURING THE REPORTING YEAR

On 6th November 2008, AVIC was officially established after the merger and reorganization of AVIC II and AVIC I. AVIC became the controlling shareholder of the Company holding 61.06% equity interest of the Company.

CORPORATE GOVERNANCE

Details of corporate governance practices adopted by the Company are set out in the section of "Corporate Governance Report" of the Annual Report.

PUBLIC FLOAT

Based on the information that is publicly available to the Company and to the knowledge of the Board, throughout the year ended 31 December 2008 and up to the date of this report, the Company maintained a sufficient public float of more than 25% of the Company's issued shares as required under the Listing Rules.

AUDITORS

The financial statements for the year have been audited by PricewaterhouseCoopers. In the forthcoming annual general meeting, a resolution for the re-appointment of PricewaterhouseCoopers and PricewaterhouseCoopers Zhong Tian CPAs Limited Company as the international and domestic auditors of the Company for the financial year of 2009 will be proposed. In the past three years, the auditors of the Company remained unchanged.

CHANGES OF DIRECTORS, SUPERVISORS AND SENIOR MANAGEMENT

At an extraordinary general meeting and the board meeting of the Company held on 16th October 2008, Mr. Lin Zuoming was appointed as the chairman of the Board of the Company. Mr. Tan Ruisong was appointed as the president of the Company and continued to be the vice chairman and executive director. Mr. Wu Xiandong ceased to be the vice-chairman of the Board and president of the Company but continued to be the executive director.

Mr. Zhang Hongbiao resigned as the executive director and chairman of the Board. Mr. Liang Zhenhe, Mr. Tianmin, Mr. Song Jingang, Mr. Chen Huaiqiu and Mr. Wang Bin resigned as the non-executive directors. Mr. Lin Zuoming was appointed as the executive director of the Company. Mr. Gu Huizhong, Mr. Xu Zhanbin, Mr. Geng Ruguang, Mr. Zhang Xinguo and Mr. Li Fangyong were appointed as the non-executive directors of the Company.

Mr. Wang Shouxin, Mr. Li Shentian, Mr.Han Xiaoyang and Mr. Li Deqing resigned as the supervisors of the Company due to reallocation of work. Mr. Hu Wenming and Mr. Wang Yuming were appointed as the supervisors representing the shareholders of the Company. Mr. Gao Jianshe and Mr. Li Yuhai were appointed as the supervisors representing the employees of the Company.

SERVICE CONTRACTS OF DIRECTORS AND SUPERVISORS

Each of the Directors (except the independent non-executive directors) and Supervisors has entered into a service contract with the Company. None of the Directors and Supervisors has entered into service contracts which are not terminable by the Company within one year without payment of compensation (other than statutory compensation).

DIRECTORS' AND SUPERVISORS' INTERESTS IN CONTRACTS

During the reporting year, none of the Directors or Supervisors had any material interest, directly or indirectly, in any contract of significance to which the Company or its subsidiaries was a party.

THE INTERESTS OF DIRECTORS, SUPERVISORS AND CHIEF EXECUTIVE IN THE SECURITIES OF THE COMPANY

As at 31st December 2008, none of the Directors, Supervisors and Chief Executive of the Company had interests or held short positions in the shares of the Company and/or shares, relevant shares and/or securities of its associated corporations (within the meaning of Part XV of the SFO), which are required to be recorded and kept in the register pursuant to section 352 of the SFO and be notified to the Company and the Stock Exchange pursuant to Part XV, Part 7 and Part 8 of the SFO.

REMUNERATION OF DIRECTORS, SUPERVISORS AND SENIOR MANAGEMENT

Details of remuneration of the existing Directors, Supervisors and senior management are set out in note 14 to the financial statements.

RIGHTS OF DIRECTORS AND SUPERVISORS TO ACQUIRE SHARES OR DEBENTURES

As at 31st December 2008, none of the Directors or Supervisors was entitled to acquire shares or debentures of the Company or its associated corporation (within the meaning of the SFO).

MANAGEMENT CONTRACTS

No contracts concerning the management and administration of the whole or any substantial part of the business of the Company were entered into or existed during the year of 2008.

To all shareholders:

During the year of 2008, the Supervisory Committee strictly complied with the PRC Company Law, the Articles of Association and Procedural Rules for Meetings of Supervisory Committee and duly adhered to the principles of honesty and integrity in performing the supervisory duties and exercising the rights conferred on it by the Articles of Association, and also in good faith safeguarded the shareholders' interests in a diligent, pragmatic and serious manner.

The Supervisory Committee convened three meetings in 2008, at which 10 resolutions were considered and approved. The Supervisory Committee fulfilled its tasks on reviewing the 2007 Annual Report, 2008 Interim Report, plans on distribution of profits for 2007 and the first six months of 2008 respectively, budgets for 2008 of the Company and the resolutions on changes of the supervisors and appointment of the chairman of the Supervisory Committee. The Supervisory Committee had also attended the Board meetings and the general meetings held in 2008 to monitor the validity of procedures undertaken leading to the convening of and decisions made during the board meetings and general meetings. Through convening supervisory committee meetings and attending board meetings and general meetings, the Supervisory Committee performed its duties of supervising the major operating activities of the Group, as well as the performance of directors and senior management officers in discharging their duties and provided advice to the Board.

The Supervisory Committee has reviewed the Report of the Board which the Board submitted to the general meeting, and considered that the report has fairly reflected the current position of the Company. In 2008, the Board and the senior management of the Company had duly exercised various powers conferred by the shareholders pursuant to the laws, performed various obligations, and used their best endeavors to make important contributions to the development of the Company.

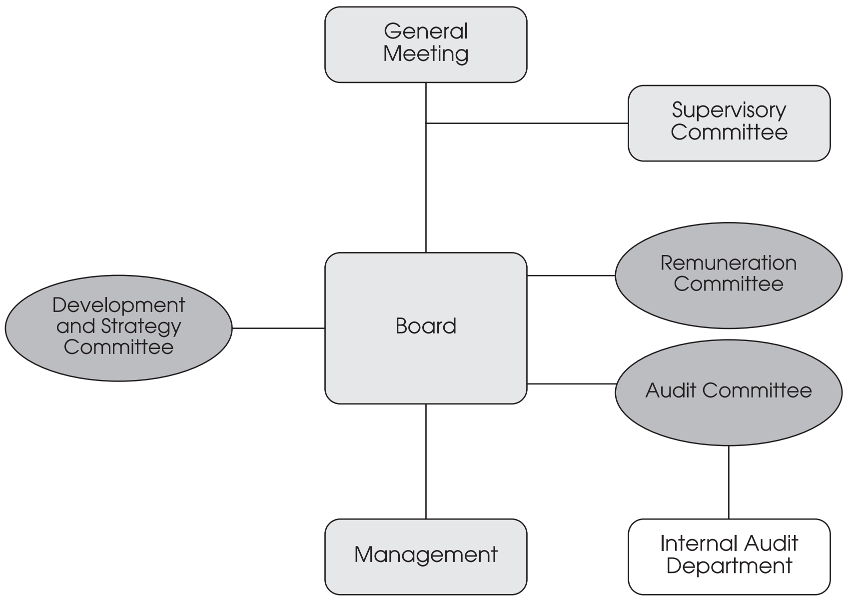
The Supervisory Committee has also reviewed the financial statements as audited by PricewaterhouseCoopers, and considered that the statements had fairly reflected the financial position and operating results of the Company. The Company's financial statements are prepared accurately with clear records and complete information.

The Supervisory Committee is fully confident in the prospect of the Company. In 2009, the Supervisory Committee will continue to strictly perform its duties in accordance with the Articles of Association and the relevant requirements to safeguard shareholders' interests.

Hu Wenming
Chairman of the Supervisory Committee
Beijing, the PRC, 9th April 2009

The Company strictly complies with various applicable laws, rules and regulations as well as the Articles of Association to standardize its operation. In 2008, under the framework guidance of the Articles of Association, Procedural Rules for General Meetings, Procedural Rules for Board Meetings, Procedural Rules for Meetings of Supervisory Committee, Working Guidelines for the Management, Working Guidelines for the Audit Committee, Terms of Reference of the Remuneration Committee and Rules on Information Disclosure, the Company continuously enhanced its corporate governance standard through the co-ordination of general meetings, the Board and the relevant special committees of the Board, the Supervisory Committee and the management.

Governance structure of the Company is set out as follow:



CODE ON CORPORATE GOVERNANCE PRACTICES

The Board reviewed the corporate governance practices adopted by the Company and is of the view that the Company had complied with the principles and code provisions set out in the Code on Corporate Governance Practices (the "Code") in Appendix 14 to the Listing Rules during the reporting year.

THE BOARD

The Board is responsible for the leadership and supervision of the Company. The Board assumes the role to promote the business of the Company through directing and supervising the affairs of the Company.

DIRECTORS

The Board comprises thirteen Directors, including three executive Directors, namely, Mr. Lin Zuoming (Chairman), Mr. Tan Ruisong and Mr. Wu Xiandong, seven non-executive directors, namely, Mr. Gu Huizhong, Mr. Xu Zhanbin, Mr. Geng Ruguang, Mr. Zhang Xinguo, Mr. Li Fangyong, Mr. Wang Yong and Mr. Maurice Savart and three independent non-executive directors, namely, Mr. Guo Chongqing, Mr. Li Xianzong and Mr. Lau Chung Man, Louis. The Directors have contributed their comprehensive knowledge, skills and experience for the effective management of the Group. With extensive professional knowledge and experience, the independent non-executive directors have assumed the supervisory and balancing roles in order to protect the interests of shareholders of the Company and the Company as a whole. The Board believes that the independent non-executive directors are capable of making judgments independently and comply with the guidelines on the independence of independent non-executive directors as set out in Rule 3.13 of the Listing Rules. In addition, the Company had received a written confirmation from each independent non-executive director on their independency, based on which the Company considers that the independent non-executive directors are independent.

The Company adopts the formal procedures in the appointment of new directors. The Company has not established any nomination committee. During 2008, the Board met once with all directors present except a non-executive director, Mr. Maurice Savart to consider referrals from the shareholders and nominate new directors for approval by the Shareholders of the Company pursuant to certain standards. These standards include relevant professional knowledge and industry experience, personal ethics, integrity and skills of directors, as well as their time commitment to the affairs of the Company.

Each director (including non-executive director) holds office for a period of three years, and is eligible for re-election upon the expiration of the term of office. A list of directors, their respective profiles and roles in the Board and special committees of the Board are set out in pages 22 to 26 of the Annual Report. Relevant information will also be published on the website of the Company. There are no relationship (including financial, business, family or other material or relevant relationships) among members of the Board.

The Company has arranged for appropriate insurance coverage in respect of any legal actions which may be instituted against its directors and senior management in relation to their services.

RESPONSIBILITIES OF THE BOARD

The Board manages and supervises the Group on behalf of the shareholders of the Company. Each director is deemed to act in the best interest of the Company with prudence and honesty.

The Board regularly reviews the Group's overall strategy, its business targets and operational results. The Board exercises its power to formulate the objectives and strategies of the Group, and to monitor operational and financial performance of the Group.

The Board will ensure the completeness of the financial information and the effectiveness of internal control and risk management procedures of the Group. The Board is also responsible for preparing the financial statements of the Group. All Group policies, material transactions or transactions leading to conflicts of interest are decided by the Board. On the other hand, the chief executive officer is responsible for attaining the business targets of the Company and managing the daily operations. Duties reserved to the Board and those delegated to management are clearly set out in the Procedural Rules for Board Meetings and Working Guidelines for the Management. The Board regularly reviews the duties and powers delegated to the chief executive officer to ensure such arrangements are appropriate.

CHAIRMAN AND CHIEF EXECUTIVE OFFICER

The roles of the chairman and the chief executive officer have been clearly segregated to ensure a balance of power and authority. The current chairman of the Company, Mr. Lin Zuoming, is responsible for leading the Board to ensure the effective operation of the Board. The chief executive officer, Mr. Tan Ruisong, is responsible for business operations of the Company. The roles and duties of the chief executive officer are clearly set out in the Working Guidelines for the Management.

BOARD MEETINGS

The Board has four scheduled meetings every year in April, June, August and December respectively. Matters to be considered at these regular board meetings are put into writing. Further, additional board meetings are held as and when required, and reasonable notices are sent to the Directors before the convening of such meetings.

The company secretaries assist the chairman in preparing the agenda for each board meeting and consider the matters proposed by other directors for inclusion in the agenda. The agenda and relevant materials are usually delivered to the directors at least three days before the relevant board meeting date. The chairman should ensure that all directors are properly briefed on issues to be discussed at the board meeting and provided with relevant documents which contain analysis and background information.

The management has provided the directors and committee members with adequate and sufficient information on a timely basis. This will ensure that the directors and committee members are well-informed of the Company's latest development so that they may discharge their duties effectively. Every director has received comprehensive induction training upon his appointment. Directors are encouraged to constantly update their skills, knowledge and understanding of the business of the Group through the induction training, regular attendance to board meetings and committee meetings, and meetings with key personnel of the head office and various departments of the Group.

All directors have access to the services of the company secretaries. The board secretaries are responsible for ensuring that board procedures are followed and advising the Board accordingly. The company secretaries regularly update the Reference Guide for Directors and Supervisors to ensure that the Board and Supervisors are well-informed of the latest information on corporate governance and supervision as well as the development of the Group. Directors, the audit committee and the remuneration committee may seek independent professional advice at the Company's expenses in discharging their duties.

Directors are encouraged to discuss issues of the Group openly and frankly at board meetings and every executive director is available for inquires raised by non-executive directors. Independent non-executive directors may convene meetings amongst themselves if necessary to discuss issues related to the Group. Board minutes as well as any materials related to the board meetings are kept by the company secretaries and made available for inspection by any member of the Board.

The Board has established an audit committee and a remuneration committee to ensure good corporate governance. Duties of these committees are set out in accordance with the principles of the Code. In addition, the Company has combined Aviation Business Development & Strategy Committee and Automobile Business Development & Strategy Committee to form Development & Strategy Committee to formulate long-term development strategies and to decide on substantial investments. Each committee reports directly to the Board. Minutes of committee meetings are kept by the Board Secretary. In 2008, the Company convened no meeting of the Remuneration Committee and Development & Strategy Committee.

Five meetings were held by the Board during 2008. The chief executive officer and vice presidents, including the chief financial officer, attended these meetings to brief the Board and reply to issues relating to resolutions discussed at those meetings. The attendance of every director (including the circumstance of appointing another director on his behalf) in the board meetings and the audit committee meetings in 2008 is set out below:

	Times of presence/Times of meetings should present	
Directors	**The Board**	**Audit Committee**
Executive directors		
Mr. Lin Zuoming (Note i)	2/5	
Mr. Tan Ruisong	5/5	
Mr. Wu Xiandong	5/5	
Mr. Zhang Hongbiao (Note ii)	3/5	
Non-executive directors		
Mr. Gu Huizhong (Note i)	2/5	
Mr. Xu Zhanbin (Note i)	2/5	
Mr. Geng Ruguang (Note i)	1/5	
Mr. Zhang Xinguo (Note i)	2/5	
Mr. Li Fangyong (Note i)	2/5	
Mr. Wang Yong	4/5	
Mr. Maurice Savart	4/5	
Mr. Liang Zhenhe (Note ii)	3/5	2/2
Mr. Song Jingang (Note ii)	3/5	
Mr. Tian Min (Note ii)	3/5	
Mr. Wang Bin (Note ii)	3/5	
Mr. Chen Huaiqiu (Note ii)	3/5	
Independent non-executive directors		
Mr. Guo Chongqing	5/5	2/2
Mr. Li Xianzong	5/5	2/2
Mr. Lau Chung Man, Louis	5/5	2/2

Note i: Directors appointed on 16 October 2008
Note ii: Directors resigned on 16 October 2008

INTERESTS HELD AND SECURITIES TRANSACTIONS BY DIRECTORS

All Directors should declare to the Board whether they hold offices or positions in other companies or entities upon their appointments as directors and they are required to update the Board annually in respect of their relevant interests. If the Board considers that a director has conflict of interest in any motion or transaction, the director shall declare his interests and abstain from voting. If required, the director should be excused from the meeting.

Interests of the Company held by the Directors as at 31st December 2008 have been disclosed on page 40 of the Report of the Board of the Annual Report. The Company has adopted the Model Code for Securities Transactions by Directors of Listed Issuers (the "Model Code") set out in Appendix 10 to the Listing Rules as its own guidelines for securities transactions by Directors, Supervisors and employees of the Company. All directors and supervisors have been provided with a copy of the Model Code upon appointments. The Directors and supervisors of the Company will receive written reminders of the restrictions on dealing in any securities or derivatives of the Company. The written reminders will be provided one month prior to the board meeting of the Company for approving annual or interim results. All Directors and Supervisors of the Company have confirmed their compliance with the Model Code in 2008 upon specific enquiries with them.

Employees who may likely possess unpublished price sensitive information of the Group are also required to comply with the Model Code. The Company is not aware of any breach in this regard in 2008.

REMUNERATION OF DIRECTORS, SUPERVISORS AND SENIOR MANAGEMENT

The Board has established a remuneration committee which comprises one executive director Mr. Tan Ruisong, as the chairman and three independent non-executive directors, Mr. Guo Chongqing, Mr. Li Xianzong and Mr. Lau Chung Man, Louis. The remuneration committee is responsible for approving policies on remuneration of all directors, supervisors and senior management, as well as making recommendations to the Board on revising policies and structure for remuneration. In determining the remuneration of directors and supervisors, the Remuneration Committee will take into account factors such as the responsibilities and work experience of the directors and supervisors. The remuneration committee reports to the Board after every meeting. During the year ended 31st December 2008, the Remuneration Committee did not convene any meeting. The remuneration of the newly appointed directors and supervisors in 2008 was determined by the Board at a Board meeting on 3rd April 2009 pursuant to the resolutions passed at the general meeting of the Company on 16 October 2008. Terms of reference of the remuneration committee are published on the website of the Company.

Details of the remunerations of the directors, supervisors and senior management of the Company for the year ended 31st December 2008 are set out in note 14 to the financial statement.

ACCOUNTABILITY AND AUDIT

FINANCIAL REPORTS

The Directors are responsible for monitoring the preparation of the financial statements for every financial period and ensuring those financial statements provide a true and fair view on the results of operations, financial position and cash flow of the Group in the relevant financial period. In preparing the financial statements for the year ended 31st December 2008, the directors have:

– selected appropriate accounting policies and applied them consistently;

– adopted all the relevant standards in the International Financial Reporting Standards; and

– made a prudent and reasonable judgment and estimation and prepared financial statements on a going concern basis.

In accordance with the requirements of the Listing Rules, the Company has timely announced its annual and interim results within four and two months respectively after the end of the relevant financial periods.

INTERNAL CONTROL

The Board is responsible for maintaining a steady, appropriate and efficient internal control system of the Group to safeguard the Group's assets. The Board reviews the effectiveness of the internal control system of the Group annually through the audit committee.

The Company has established an Internal Audit Department which acts as a daily operation office of the audit committee of the Board to monitor how the Company and its subsidiaries establish and improve their respective internal control systems and give guidance in this respect, to supervise and review the implementation of regulations on internal control systems at proper times. In 2008, the Internal Audit Department prepared an annual assessment list on the internal control system and carried out a questionnaire, based on which the department evaluates the internal control system of the Group as a whole. The department also requested the senior management of each subsidiary to provide statements on the healthiness, reasonableness and effective implementation of their respective internal control procedures. The Internal Audit Department then conducted an evaluation based on the activities mentioned above and reported the results of such evaluation to the audit committee and the Board.

The audit committee and the Board confirmed that the internal control system of the Group is effective in implementing the measures required in monitoring and controlling material aspects of the Group, preventing critical mistakes or severe damages to the Group, securing the safety of the Group's assets, ensuring proper maintenance of accounting records and compliance with laws and regulations as well as in accordance with the requirements on the internal control system set out in the Code as a whole.

However, due to inherent limits of the internal control system, the establishment of the Group's internal control system could manage potential risks but not be able to eliminate risks completely. Therefore, the internal control system could only provide a reasonable means, rather than an absolute means for the Group to achieve its operational targets. Likewise, the internal control system will not completely eliminate all material inaccurate statements made or damages done to the Group.

AUDIT COMMITTEE

The Board has established an audit committee and set out the terms of reference of the audit committee in accordance with the Guide for the Effective Audit Committee issued by the Hong Kong Institute of Certified Public Accountants.

The audit committee is responsible for monitoring the financial operation and audit procedures of the Company, assessing effectiveness of the internal control system and risk control system of the Company, maintaining effective communication with the management, internal audit department and external auditors of the Company, as well as performing other duties and responsibilities assigned by the Board. The audit committee comprises four members, namely, Mr. Guo Chongqing, Mr. Li Xianzong, Mr. Lau Chung Man, Louis, who are independent non-executive directors, and Mr. Gu Huizhong who is a non-executive director. Mr. Li Xianzong is the chairman of the committee. Mr. Li Xianzong, Mr. Lau Chung Man, Louis and Mr. Gu Huizhong have appropriate professional qualifications in accounting or related financial management expertise as required by the Listing Rules.

The terms of reference of the audit committee are published on the website of the Company.

The audit committee held two meetings during 2008 with the presence of management, chief financial officer and external auditors of the Company. In 2008, the audit committee reviewed and evaluated the audit results of the Company's external auditors, the accounting principles and standards applied by the Group and the internal control system and the financial statements of the Company. The audit committee reported to the Board its scope of work, discussion results and advice after every meeting. During 2008, the audit committee:

- reviewed the audited financial statements and the relevant annual results announcement of the Group for the year ended 31st December 2007;
- reviewed the interim financial information and the relevant interim results announcement of the Group for the six months ended 30th June 2008;
- reviewed resolution relating to appointments of international and PRC auditors of the Company for the financial year 2008 and determination of their respective remunerations; and
- reviewed the self-assessment report on the internal control of the Company and the brief on the surveillance of connected transactions of the Company and provided recommendations to the management of the Company.

The audit committee had reviewed the Group's annual results and consolidated financial statements for the year ended 31st December 2008.

SUPERVISORY COMMITTEE

The Supervisory Committee is accountable to the general meetings of the Company. The committee comprises four supervisors selected from representatives of the Company's shareholders, three supervisors selected from employees of the Company and two independent supervisors. In 2008, the Supervisory Committee held three meetings and considered and approved ten resolutions. It supervised, on behalf of shareholders of the Company, the financial position of the Group, the legality of directors and senior management of the Company during the performance of their duties, attended the board meetings and general meetings and fulfilled its duties diligently.

EXTERNAL AUDITORS

In 2008, the payment to the Company's external auditors in relation to auditing services amounted to RMB5.5 million. The payments mentioned above had been approved by the audit committee, the Board and the general meeting.

The Board has resolved to propose at the forthcoming annual general meeting to re-appoint PricewaterhouseCoopers and PricewaterhouseCoopers Zhong Tian CPAs Limited Company as the international and PRC auditors of the Company to assume statutory audit work of the Company for the financial year 2009. The resolution is subject to the approval of shareholders at the annual general meeting of the Company for the year 2008.

The statement of the external auditor of the Company about their reporting responsibilities on the consolidated financial statements is set out on pages 50 to 51 of this annual report.

INFORMATION DISCLOSURE AND INVESTOR RELATIONS

The Board secretaries are responsible for information disclosure of the Company. The Company has established Rules on Information Disclosure to ensure information disclosed by the Company is accurate, complete and timely made. During the reporting period, the Company published its annual report, interim report and relevant announcements (including the overseas regulatory announcements which covered the announcements published by the subsidiaries of the Company whose shares are listed on other stock exchanges) in accordance with the Listing Rules and made detailed disclosures on material information and reported the progress of any significant issues relating to the Company.

General meetings of the Company have absolute power to perform its functions according to laws and regulations and make decisions on significant issues. The annual general meeting and extraordinary general meetings of the Company provide an open platform for shareholders to exchange opinions with the Board. In 2008, the Company convened one annual general meeting and four extraordinary general meetings, at which twenty seven resolutions were considered and approved. Directors, Supervisors and management of the Company endeavored to attend the general meetings.

At the general meetings, each resolution such as the appointment of directors would be dealt with and resolved separately. Details about the procedures for voting by poll at the general meeting and the right of the shareholders to require a voting by poll are set out in the circular despatched to the shareholders. The circular will also contain details of the proposed resolutions. Results of voting by poll are published on the websites of the Company and the Stock Exchange respectively.

The Company has assigned specific employees to assume the role of contacting and communicating with investors. During the reporting period, due to the change of information disclosure methods required by the Stock Exchange, the Company had put more efforts in the maintenance of its websites to ensure that information is disclosed accurately and in a timely manner. The Company not only renews and modifies its Chinese and English websites continuously, but also regularly publishes and updates business news and information contained in its website to help investors understand the up-to-date situation of the Company clearly and timely. Details on the businesses of the Group and announcements such as interim results and annual results could also be downloaded from the Company's websites.

The Company also emphasized the mutual communication with its investors. During 2008, the Company communicated effectively with its investors through receiving investors during their visits or holding telephone conferences and effectively exchanged opinions with them.

PRICEWATERHOUSECOOPERS

羅兵咸永道會計師事務所

PricewaterhouseCoopers
22nd Floor Prince's Building
Central, Hong Kong

INDEPENDENT AUDITOR'S REPORT TO THE SHAREHOLDERS OF
AVICHINA INDUSTRY & TECHNOLOGY COMPANY LIMITED
(A joint stock company incorporated in the People's Republic of China with limited liability)

We have audited the consolidated financial statements of AviChina Industry & Technology Company Limited (the "Company") and its subsidiaries (together, the "Group") set out on pages 52 to 137, which comprise the consolidated and company balance sheets as of 31st December 2008, and the consolidated income statement, the consolidated statement of changes in equity and the consolidated cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

DIRECTORS' RESPONSIBILITY FOR THE FINANCIAL STATEMENTS

The directors of the Company are responsible for the preparation and the true and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards and the disclosure requirements of the Hong Kong Companies Ordinance. This responsibility includes designing, implementing and maintaining internal control relevant to the preparation and the true and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

AUDITOR'S RESPONSIBILITY

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance as to whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and true and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

OPINION

In our opinion, the consolidated financial statements give a true and fair view of the financial position of the Company and of the Group as of 31st December 2008, and of the Group's financial performance and cash flows for the year then ended in accordance with International Financial Reporting Standards and have been properly prepared in accordance with the disclosure requirements of the Hong Kong Companies Ordinance.

OTHER MATTERS

This report, including the opinion, has been prepared for and only for you, as a body, and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

PricewaterhouseCoopers
Certified Public Accountants

Hong Kong, 9th April 2009

Consolidated Income Statement

For the year ended 31st December 2008

	Note	2008 RMB'000	2007 RMB'000
Revenue	5	**16,384,884**	16,540,645
Cost of sales		**(14,818,736)**	(14,780,935)
Gross profit		**1,566,148**	1,759,710
Other income	6	**105,915**	113,796
Other gains, net	7	**22,498**	99,082
Selling and distribution expenses		**(872,292)**	(980,648)
General and administrative expenses		**(1,216,235)**	(1,049,823)
Other operating expenses		**—**	(466,112)
Operating loss		**(393,966)**	(523,995)
Finance income	9	**79,280**	57,966
Finance costs	9	**(447,281)**	(387,391)
Finance costs, net		**(368,001)**	(329,425)
Share of results of associates	19	**40,068**	56,711
Loss before income tax		**(721,899)**	(796,709)
Income tax expense	10	**(188,596)**	(51,635)
Loss for the year		**(910,495)**	(848,344)
Attributable to:			
Equity holders of the Company	11	**(1,156,611)**	(1,026,226)
Minority interests		**246,116**	177,882
		(910,495)	(848,344)
Loss per share for loss attributable to equity holders of the Company during the year		**RMB**	RMB
- Basic and diluted	12	**(0.249)**	(0.221)

The notes on pages 58 to 137 are an integral part of these consolidated financial statements.

Balance Sheets

As at 31st December 2008

	Note	Group 2008 RMB'000	Group 2007 RMB'000	Company 2008 RMB'000	Company 2007 RMB'000
ASSETS					
Non-current assets					
Property, plant and equipment	15	**6,897,248**	7,325,989	**6,788**	7,413
Land use rights	16	**151,307**	81,375	**—**	—
Intangible assets	17	**240,120**	331,614	**—**	—
Interests in subsidiaries	18	**—**	—	**3,506,886**	3,544,134
Interests in associates	19	**329,969**	297,921	**30,000**	30,000
Available-for-sale financial assets	20	**230,379**	587,417	**—**	—
Deferred income tax assets	21	**97,603**	126,241	**—**	—
		7,946,626	8,750,557	**3,543,674**	3,581,547
Current assets					
Accounts receivable	22	**3,759,684**	3,237,673	**—**	—
Advances to suppliers	23	**314,736**	519,014	**—**	—
Other receivables and prepayments	24	**1,170,638**	1,203,537	**193,017**	151,358
Inventories	25	**5,120,762**	5,277,527	**—**	—
Financial assets at fair value through profit or loss		**11,488**	7,414	**—**	—
Pledged deposits	27	**536,605**	638,350	**—**	—
Term deposits with initial term of over three months	28	**1,259,962**	691,820	**687,638**	661,820
Cash and cash equivalents	37(d)	**2,324,130**	2,452,706	**232,026**	143,266
		14,498,005	14,028,041	**1,112,681**	956,444
Total assets		**22,444,631**	22,778,598	**4,656,355**	4,537,991

The notes on pages 58 to 137 are an integral part of these consolidated financial statements.

Balance Sheets

As at 31st December 2008

	Note	Group 2008 RMB'000	Group 2007 RMB'000	Company 2008 RMB'000	Company 2007 RMB'000
EQUITY					
Capital and reserves attributable to equity holders of the Company					
Share capital	35	**4,643,609**	4,643,609	**4,643,609**	4,643,609
Reserves	36	**(2,310,956)**	(1,155,536)	**(482,323)**	(601,370)
		2,332,653	3,488,073	**4,161,286**	4,042,239
Minority interests		**3,240,885**	3,170,322	**—**	—
Total equity		**5,573,538**	6,658,395	**4,161,286**	4,042,239
LIABILITIES					
Non-current liabilities					
Long-term borrowings	34	**934,191**	1,111,540	**—**	—
Deferred income from government grants		**135,491**	149,886	**—**	—
Deferred income tax liabilities	21	**36,816**	156,332	**—**	—
		1,106,498	1,417,758	**—**	—
Current liabilities					
Accounts payable	29	**7,218,591**	6,761,213	**—**	—
Advances from customers	30	**688,750**	884,568	**—**	—
Other payables and accruals	31	**1,364,177**	1,324,343	**30,771**	31,454
Amounts payable to ultimate holding company	32	**520,524**	520,524	**464,298**	464,298
Provisions	33	**205,128**	174,431	**—**	—
Current portion of long-term borrowings	34	**728,000**	650,457	**—**	—
Short-term borrowings	34	**4,910,404**	4,312,163	**—**	—
Current income tax liabilities		**129,021**	74,746	**—**	—
		15,764,595	14,702,445	**495,069**	495,752
Total liabilities		**16,871,093**	16,120,203	**495,069**	495,752
Total equity and liabilities		**22,444,631**	22,778,598	**4,656,355**	4,537,991
Net current (liabilities)/ assets		**(1,266,590)**	(674,404)	**617,612**	460,692
Total assets less current liabilities		**6,680,036**	8,076,153	**4,161,286**	4,042,239

Director
Tan Ruisong

Director
Gu Huizhong

The notes on pages 58 to 137 are an integral part of these consolidated financial statements.

	Attributable to equity holders of the Company							
	Share capital RMB'000	Capital reserve RMB'000	Available-for-sale financial assets reserve RMB'000	Statutory surplus reserve RMB'000	Accumulated losses RMB'000	Subtotal RMB'000	Minority interests RMB'000	Total RMB'000
	(Note 35)	(Note 36(b))		(Note 36(c))	(Note 36(d))			
For the year ended 31st December 2008								
Balance at 1st January 2008	4,643,609	77,475	185,510	31,178	(1,449,699)	3,488,073	3,170,322	6,658,395
Gain on disposal of certain interests in a subsidiary(note 36(e))	–	140,332	–	–	–	140,332	12,616	152,948
Change in fair value of available-for-sale financial assets								
- gross	–	–	(177,358)	–	–	(177,358)	(143,419)	(320,777)
- deferred taxation	–	–	49,845	–	–	49,845	40,307	90,152
Realisation of gain on available-for-sale financial assets in income statement upon disposal								
- gross	–	–	(19,433)	–	–	(19,433)	(15,715)	(35,148)
- deferred taxation	–	–	8,232	–	–	8,232	6,295	14,527
Others	–	(427)	–	–	–	(427)	(346)	(773)
Net income/(expense) recognised directly in equity	–	139,905	(138,714)	–	–	1,191	(100,262)	(99,071)
(Loss)/profit for the year	–	–	–	–	(1,156,611)	(1,156,611)	246,116	(910,495)
Total recognised income/(expense) for the year	–	139,905	(138,714)	–	(1,156,611)	(1,155,420)	145,854	(1,009,566)
Purchase of additional interests in a subsidiary	–	–	–	–	–	–	(11)	(11)
Disposal of certain interests in subsidiaries	–	–	–	–	–	–	13,930	13,930
Dividend to minority shareholders of subsidiaries	–	–	–	–	–	–	(89,210)	(89,210)
Balance at 31st December 2008	4,643,609	217,380	46,796	31,178	(2,606,310)	2,332,653	3,240,885	5,573,538

The notes on pages 58 to 137 are an integral part of these consolidated financial statements.

Consolidated Statement of Changes in Equity

For the year ended 31st December 2008

	Attributable to equity holders of the Company							
	Share capital RMB'000	Capital reserve RMB'000	Available-for-sale financial assets reserve RMB'000	Statutory surplus reserve RMB'000	Accumulated losses RMB'000	Subtotal RMB'000	Minority interests RMB'000	Total RMB'000
	(Note 35)	(Note 36(b))		(Note 36(c))	(Note 36(d))			
For the year ended 31st December 2007								
Balance at 1st January 2007	4,643,609	77,585	—	26,712	(419,007)	4,328,899	3,793,213	8,122,112
Transfer to statutory reserve	—	—	—	4,466	(4,466)	—	—	—
Change in fair value of available-for-sale financial assets								
- gross	—	—	251,845	—	—	251,845	203,653	455,498
- deferred taxation	—	—	(66,335)	—	—	(66,335)	(53,280)	(119,615)
Others	—	(110)	—	—	—	(110)	(2,281)	(2,391)
Net (expense)/income recognised directly in equity	—	(110)	185,510	4,466	(4,466)	185,400	148,092	333,492
(Loss)/profit for the year	—	—	—	—	(1,026,226)	(1,026,226)	177,882	(848,344)
Total recognised (expense) /income for the year	—	(110)	185,510	4,466	(1,030,692)	(840,826)	325,974	(514,852)
Contributions from minority shareholders of subsidiaries	—	—	—	—	—	—	2,000	2,000
Purchase of additional interests in a subsidiary	—	—	—	—	—	—	(2,909)	(2,909)
Disposal of certain interests in subsidiaries	—	—	—	—	—	—	14,973	14,973
Disposal of a subsidiary	—	—	—	—	—	—	(2,203)	(2,203)
Dividend to minority shareholders of subsidiaries	—	—	—	—	—	—	(37,230)	(37,230)
Effect on proportionate consolidation of a jointly controlled entity (Note 3(a)(iii))	—	—	—	—	—	—	(923,496)	(923,496)
Balance at 31st December 2007	4,643,609	77,475	185,510	31,178	(1,449,699)	3,488,073	3,170,322	6,658,395

The notes on pages 58 to 137 are an integral part of these consolidated financial statements.

For the year ended 31st December 2008

	Note	2008 RMB'000	2007 RMB'000
Cash flows from operating activities			
Net cash generated from operations	37(a)	**1,032,394**	503,390
Interest received		**79,280**	57,966
Interest paid		**(427,238)**	(398,171)
Enterprise income tax paid		**(120,520)**	(65,911)
Net cash generated from operating activities		**563,916**	97,274
Cash flows from investing activities			
Purchase of property, plant and equipment		**(769,579)**	(894,643)
Purchase of land use rights		**(79,644)**	—
Payments for intangible assets		**(1,201)**	(6,392)
Addition of available-for-sale financial assets		**(14,000)**	—
Disposal of available-for-sale financial assets		**55,381**	380
Decrease in pledged deposits		**101,745**	56,041
(Increase)/decrease in term deposits with initial term of over three months		**(568,142)**	359,308
Proceeds from sale of property, plant and equipment	37(b)	**1,852**	14,819
Net cash outflow from disposal of a subsidiary	37(c)	**—**	(1,559)
Effect on proportionate consolidation of a jointly controlled entity (Note 3(a)(iii))		**—**	(136,257)
Proceeds from disposal of certain interests in subsidiaries		**166,878**	47,413
Additional investments in associates		**(42,631)**	(30,000)
Disposal of interests in associates		**7,750**	99
Dividends received from associates		**39,539**	33,256
Dividends received from available-for-sale financial assets		**2,428**	4,870
Purchase of additional interests in a subsidiary		**(11)**	(2,909)
Net cash used in investing activities		**(1,099,635)**	(555,574)
Cash flows from financing activities			
Proceeds from borrowings		**5,399,750**	7,896,298
Repayments of borrowings		**(4,911,193)**	(8,077,298)
Contributions from minority shareholders of subsidiaries		**—**	2,000
Dividend paid to minority shareholders of subsidiaries		**(81,414)**	(37,451)
Dividend paid to holding company		**—**	(28,070)
Net cash generated from/(used in) financing activities		**407,143**	(244,521)
Net decrease in cash and cash equivalents		**(128,576)**	(702,821)
Cash and cash equivalents at 1st January		**2,452,706**	3,155,527
Cash and cash equivalents at 31st December	37(d)	**2,324,130**	2,452,706

The notes on pages 58 to 137 are an integral part of these consolidated financial statements.

1 ORGANISATION AND PRINCIPAL ACTIVITIES

AviChina Industry & Technology Company Limited (the "Company") was established in the People's Republic of China (the "PRC") on 30th April 2003 as a joint stock company with limited liability under the PRC laws as a result of a group reorganisation (the "Reorganisation") of China Aviation Industry Corporation II ("AVIC II"). The Company's H shares were listed on the Main Board of The Stock Exchange of Hong Kong Limited on 30th October 2003.

The Company and its subsidiaries are collectively referred to as the "Group". The Group is principally engaged in the research, development, manufacture and sale of aviation and automobile products.

The Company's directors regard AVIC II, a company established in the PRC, as being the ultimate holding company of the Company, up to 6th November 2008 when AVIC II merged with China Aviation Industry Corporation I to form China Aviation Industry Group Corporation ("AVIC Group") which then became the Company's ultimate holding company. AVIC Group, AVIC I and AVIC II are all state-owned enterprises under control of the State Council of the PRC government.

These consolidated financial statements are presented in Renminbi ("RMB"), unless otherwise stated, and have been approved for issue by the Board of Directors on 9th April 2009.

2 BASIS OF PREPARATION

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") under the historical cost convention, as modified by the revaluation of available-for-sale financial assets, and financial assets at fair value through profit or loss, as appropriate.

The preparation of financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgements in the process of applying the Group's accounting policies. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the financial statements are disclosed in Note 4.

In preparing these financial statements, the directors have taken into account all information that could reasonably be expected to be available including the proposed transactions as disclosed in note 42 and have ascertained that the Group has obtained adequate financial resources to support the Group to continue in operational existence for the foreseeable future. Under these circumstances, the directors consider that it is proper to prepare the financial statements on a going concern basis notwithstanding that at 31st December 2008, the Group's current liabilities exceeded its current assets by RMB 1,266,590,000.

2 BASIS OF PREPARATION (continued)

(a) Amendments and interpretations effective in 2008

IAS 39 and IFRS 7 (Amendments)	Reclassification of Financial Assets
IFRIC Int 11	IFRS 2 - Group and Treasury Share Transactions
IFRIC Int 12	Service Concession Arrangements
IFRIC Int 14	IFRS 19 - The Limit on a Defined Benefit Asset, Minimum Funding Requirement and Their Interaction

The adoption of these amendments and interpretations to the standards does not have any significant impact to the results and financial position of the Group.

(b) Standards, amendments and interpretations to existing standards that are not yet effective and have not been early adopted by the Group

IFRS 1 (Revised)	First-time Adoption of International Financial Reporting Standards (effective for annual periods beginning on or after 1st January 2009)
IFRS 1 and IAS 27 (Amendments)	Cost of an Investment in a Subsidiary, Jointly Controlled Entity or Associate (effective for annual periods beginning on or after 1st January 2009)
IFRS 2 (Amendment)	Share-based Payment - Vesting Conditions and Cancellations (effective for annual periods beginning on or after 1st January 2009)
IFRS 3 (Revised)	Business Combinations (effective for annual periods beginning on or after 1st July 2009)
IFRS 7 (Amendments)	Improving Disclosures about Financial Instruments (effective for annual periods beginning on or after 1st January 2009)
IFRS 8	Operating Segments (effective for annual periods beginning on or after 1st January 2009)
IAS 1 (Revised)	Presentation of Financial Statements (effective for annual periods beginning on or after 1st January 2009)
IAS 23 (Revised)	Borrowing Costs (effective for annual periods beginning on or after 1st January 2009)
IAS 27 (Revised)	Consolidated and Separate Financial Statements (effective for annual periods beginning on or after 1st July 2009)
IAS 32 and IAS 1 (Amendments)	Puttable Financial Instruments and Obligations arising on Liquidation (effective for annual periods beginning on or after 1st January 2009)
IAS 39 (Amendment)	Eligible Hedged Items (effective for annual periods beginning on or after 1st July 2009)

2 BASIS OF PREPARATION (continued)

(b) Standards, amendments and interpretations to existing standards that are not yet effective and have not been early adopted by the Group (continued)

IFRIC Int 9 and IAS 39 (Amendments)	Embedded Derivatives (effective for annual periods ending on or after 30th June 2009)
IFRIC Int 13	Customer Loyalty Programmes (effective for annual periods beginning on or after 1st July 2008)
IFRIC Int 15	Agreements for the Construction of Real Estate (effective for annual periods beginning on or after 1st January 2009)
IFRIC Int 16	Hedges of a Net Investment in a Foreign Operation (effective for annual periods beginning on or after 1st October 2008)
IFRIC Int 17	Distributions of Non-cash Assets to Owners (effective for annual periods beginning on or after 1st July 2009)
IFRIC Int 18	Transfers of Assets from Customers (effective for transfers of assets from customers received on or after 1st July 2009)

The effect that the adoption of IFRS 3 (Revised), IAS 27 (Revised) and IFRIC Int 17 will have on the results and financial position of the Group will depend on the incidence and timing of transactions within the scope of these standards and interpretation occurring on or after 1st January 2010. The effect of adoption of IFRS 8 will result in certain presentational changes in the Group's financial statements. The directors anticipate that the adoption of other new standards, amendments and interpretations to standards will not result in a significant impact on the results and financial position of the Group.

In addition, the International Accounting Standards Board also published a number of amendments for the existing standards under its annual improvement project. These amendments are not expected to have a significant financial impact on the results and financial position of the Group.

3 PRINCIPAL ACCOUNTING POLICIES

(a) Consolidation

The consolidated financial statements include the financial statements of the Company and all its subsidiaries made up to 31st December.

(i) Subsidiaries

Subsidiaries are all entities over which the Group has the power to govern the financial and operating policies generally accompanying a shareholding of more than one half of the voting rights. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether the Group controls another entity. Subsidiaries are fully consolidated from the date on which control is transferred to the Group. They are de-consolidated from the date that control ceases.

The purchase method of accounting is used to account for the acquisition of subsidiaries by the Group. The cost of an acquisition is measured as the fair value of the assets given, equity instruments issued and liabilities incurred or assumed at the date of exchange, plus costs directly attributable to the acquisition. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date, irrespective of the extent of any minority interests. The excess of the cost of acquisition over the fair value of the Group's share of the identifiable net assets acquired is recorded as goodwill. If the cost of acquisition is less than the fair value of the net assets of the subsidiary acquired, including any contingent liabilities assumed, the difference is recognised directly in the consolidated income statement.

Inter-company transactions, balances and unrealised gains on transactions between group companies are eliminated. Unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred. Accounting policies of subsidiaries have been changed where necessary to ensure consistency with the policies adopted by the Group.

In the Company's balance sheet, interests in subsidiaries are stated at cost less provision for impairment losses. The results of the subsidiaries are accounted for by the Company on the basis of dividends received and receivable.

3 PRINCIPAL ACCOUNTING POLICIES (continued)

(a) Consolidation (continued)

(ii) Transactions and minority interests

The Group applies a policy of treating transactions with minority interests as transactions with equity owners of the Group. For purchases from minority interests, the difference between any consideration paid and the relevant share acquired of the carrying value of net assets of the subsidiary is deducted from equity. Gains or losses on disposals to minority interests are also recorded in equity. For disposals to minority interests, differences between any proceeds received and the relevant share of minority interests are also recorded in equity.

(iii) Jointly ventures

A jointly controlled entity is a joint venture in respect of which a contractual arrangement is established between the participating ventures and whereby the Group together with the other venturers undertake an economic activity which is subject to joint control and none of the venturers has unilateral control over the economic activity.

The Group's interest in a jointly controlled entity is accounted for by proportionate consolidation. The Group combines its share of the jointly controlled entity's individual income and expenses, assets and liabilities and cash flows on a line-by-line basis with similar items in the Group's consolidated financial statements. The Group recognises the portion of gains or losses on the sale of assets by the Group to the jointly controlled entity that it is attributable to the other venturers. The Group does not recognise its share of profits or losses from the jointly controlled entity that result from the Group's purchase of assets from the jointly controlled entity until it resells the assets to an independent party. However, a loss on the transaction is recognised immediately if the loss provides evidence of a reduction in the net realisable value of current assets, or an impairment loss. As a result of a change in management roles and responsibilities in Jiangxi Changhe Suzuki Automobile Co., Ltd. ("JCSA"), a former subsidiary indirectly held by the Group, the directors of the Company consider that the Group no longer controls JCSA as a subsidiary and therefore have reclassified JCSA as a jointly controlled entity of the Group during the year ended 31st December 2007 and accounted for JCSA using proportionate consolidation from the date when the Group's control over JCSA ceased.

Certain of the Group's activities are conducted through joint ventures where the venturers have a direct ownership interest in and jointly control the assets of the venture. The income, expenses, assets and liabilities of these jointly controlled assets are included in the consolidated financial statements in proportion to the Group's interest.

3 PRINCIPAL ACCOUNTING POLICIES (continued)

(a) Consolidation (continued)

(iv) Associates

Associates are all entities over which the Group has significant influence but not control, generally accompanying a shareholding of between 20% and 50% of the voting rights. Investments in associates are accounted for using the equity method of accounting and are initially recognised at cost. The Group's investment in associates includes goodwill (net of any accumulated impairment loss) identified on acquisition.

The Group's share of its associates' post-acquisition profits or losses is recognised in the income statement, and its share of post-acquisition movements in reserves is recognised in reserves. The cumulative post-acquisition movements are adjusted against the carrying amount of the investment. When the Group's share of losses in an associate equals or exceeds its interest in the associate, including any other unsecured receivables, the Group does not recognise further losses, unless it has incurred obligations or made payments on behalf of the associate.

Unrealised gains on transactions between the Group and its associates are eliminated to the extent of the Group's interest in the associates. Unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred. Accounting policies of associates have been changed where necessary to ensure consistency with the policies adopted by the Group.

In the Company's balance sheet the investments in associates are carried at cost less provision for impairment losses. The results of associates are accounted for by the Company on the basis of dividends received and receivable.

(b) Property, plant and equipment

Property, plant and equipment other than construction-in-progress are stated at historical cost less accumulated depreciation and accumulated impairment losses. Historical cost includes expenditure that is directly attributable to the acquisition of the items.

Subsequent costs are included in the asset's carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably. The carrying amount of the replaced part is derecognised. All other repairs and maintenance are expensed in the income statement during the financial period in which they are incurred.

3 PRINCIPAL ACCOUNTING POLICIES (continued)

(b) Property, plant and equipment

Depreciation is calculated on a straight-line basis to write off the cost less accumulated impairment losses of each asset to their residual values over their estimated useful lives as follows:

Buildings	20 - 45 years
Plant and equipment	3 - 16 years
Furniture and fixtures, other equipment and motor vehicles	5 - 12 years

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date. During the year, the directors reassessed the estimate useful lives of certain plant and equipment in the Group mainly in relation to its automobile segment, after taking into account the current business environment, market conditions and the expected pattern of economic benefits from the respective assets, and revised their accounting estimates accordingly. The revised accounting estimates on depreciation are within the range of the Group as shown above. The aggregate effect of the changes is that the depreciation charge and the Group's loss for the year has been increased by RMB 212,620,000.

An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount (Note 3 (f)).

Gains and losses on disposals are determined by comparing net sales proceeds and the carrying amount of the relevant assets, and are included in the income statement.

(c) Construction-in-progress

Construction-in-progress represents buildings, plant and machinery under construction and pending installation and is stated at cost less accumulated impairment losses, if any. Cost includes the costs of construction of buildings, the costs of plant and machinery, and interest charges arising from borrowings used to finance these assets during the period of construction or installation and testing. All other borrowing costs are expensed. No provision for depreciation is made on construction-in-progress until such time as the relevant assets are completed and ready for intended use. When the assets concerned are brought to use, the costs are transferred to property, plant and equipment and depreciated in accordance with the policy as stated in Note 3(b) to the financial statements.

(d) Land use rights

Land use rights are stated at cost less accumulated amortisation and accumulated impairment losses. Cost represents consideration paid for the rights to use the land on which various plants and buildings are situated for periods varying from 30 to 50 years.

Amortisation of land use rights is calculated on a straight-line basis over the period of the land use rights.

3 PRINCIPAL ACCOUNTING POLICIES (continued)

(e) Intangible assets

Research expenditure is recognised as an expense as incurred. Costs incurred on development projects (relating to the design and testing of new or improved products) are recognised as intangible assets when it is probable that the project will be a success considering its commercial and technical feasibility and its costs can be measured reliably. Other development expenditures that do not meet their criteria are recognised as an expense as incurred. Development costs previously recognised as an expense are not recognised as an asset in a subsequent period. Capitalised development costs are recorded as intangible assets and amortised from the point at which the asset is ready for use on a straight-line basis over its expected useful life, not exceeding five years; and tested for impairment according to Note 3(f) below.

Where the research phase and the development phase of an internal project cannot be clearly distinguished, all expenditure incurred on the project is charged to the income statement.

Technology know-how is initially recognised at cost. Technology know-how that has a definite useful life is carried at cost less accumulated amortisation and accumulated impairment losses, if any. Amortisation is calculated using the straight-line method to allocate the cost of technology know-how over their estimated useful lives of 6 years.

(f) Impairment of investments in subsidiaries, associates and non-financial assets

Assets that have an indefinite useful life or have not yet available for use are not subject to amortisation/ depreciation and are at least tested annually for impairment. Assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units).

Non-financial assets other than goodwill that suffered an impairment are reviewed for possible reversal of the impairment at each reporting date. Where an impairment loss subsequently reverses, the carrying amount of the asset (cash-generating unit) is increased to the revised estimate of its recoverable amount to the extent that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset (cash-generating unit) in prior years. A reversal of an impairment loss is recognised immediately in the income statement.

3 PRINCIPAL ACCOUNTING POLICIES (continued)

(g) Financial assets

The Group classifies its financial assets in the following categories: at fair value through profit or loss, loans and receivables, held-to-maturity and available-for-sale. The classification depends on the purpose for which the financial assets were acquired. Management determines the classification of its financial assets at initial recognition.

(i) Financial assets at fair value through profit or loss

Financial assets at fair value through profit or loss are financial assets held for trading. A financial asset is classified in this category if acquired principally for the purpose of selling in the short term. Derivatives are classified as held for trading unless they are designated as hedges. Assets in this category are classified as current assets.

(ii) Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They are included in current assets, except for maturities greater than 12 months after the balance sheet date. These are classified as non-current assets. Loans and receivables include accounts and other receivables.

(iii) Held-to-maturity investments

Held-to-maturity financial assets are non-derivative financial assets with fixed or determinable payments and fixed maturities that the Group's management has the positive intention and ability to hold to maturity. During the year, the Group did not hold any financial asset in this category.

(iv) Available-for-sale financial assets

Available-for-sale financial assets are non-derivatives that are either designated in this category or not classified in any of the other categories. They are included in non-current assets unless management intends to dispose of the investment within 12 months of the balance sheet date.

3 PRINCIPAL ACCOUNTING POLICIES (continued)

(g) Financial assets (continued)

Regular purchases and sales of financial assets are recognised on the trade-date - the date on which the Group commits to purchase or sell the asset. Investments are initially recognised at fair value plus transaction costs for all financial assets not carried at fair value through profit or loss. Financial assets carried at fair value through profit or loss are initially recognised at fair value, and transaction costs are expensed in the income statement. Financial assets are derecognised when the rights to receive cash flows from the investments have expired or have been transferred and the Group has transferred substantially all risks and rewards of ownership. Available-for-sale financial assets and financial assets at fair value through profit or loss are subsequently carried at fair value. Loans and receivables and held-to-maturity investments are carried at amortised cost using the effective interest method.

Gains or losses arising from changes in the fair value of the "financial assets at fair value through profit or loss" category are presented in the income statement in the period in which they arise. Dividend income from financial assets at fair value through profit or loss is recognised in the income statement when the Group's right to receive payments is established.

Changes in the fair value of monetary securities denominated in a foreign currency and classified as available-for-sale are analysed between translation differences resulting from changes in amortised cost of the security and other changes in the carrying amount of the security. The translation differences on monetary securities are recognised in profit or loss; translation differences on non-monetary securities are recognised in equity. Changes in the fair value of monetary and non-monetary securities classified as available for sale are recognised in equity.

When securities classified as available-for-sale are sold or impaired, the accumulated fair value adjustments recognised in equity are included in the income statement as gains and losses from investment securities.

Interest on available-for-sale securities calculated using the effective interest method is recognised in the income statement. Dividends on available-for-sale equity instruments are recognised in the income statement when the Group's right to receive payments is established.

The fair values of quoted investments are based on current bid prices. If the market for a financial asset is not active (and for unlisted investments), the Group establishes fair value by using valuation techniques. These include the use of recent arm's length transactions, reference to other instruments that are substantially the same, discounted cash flow analysis and option pricing models, making maximum use of market inputs and relying as little as possible on entity-specific inputs. However, if the range of reasonable fair value estimate is significant and the probabilities of the various estimate cannot be reasonably assessed, such financial assets are carried at cost less accumulated impairment losses.

3 PRINCIPAL ACCOUNTING POLICIES (continued)

(g) Financial assets (continued)

The Group assesses at each balance sheet date whether there is objective evidence that a financial asset or a group of financial assets is impaired. In the case of equity securities classified as available-for-sale, a significant or prolonged decline in the fair value of the security below its cost is considered as an indicator that the securities are impaired. If any such evidence exists for available-for-sale financial assets, the cumulative loss - measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognised in profit or loss - is removed from equity and recognised in the income statement. Impairment losses recognised in the income statement on equity instruments are not reversed through the income statement. Impairment testing of receivables is described in Note 3(j).

(h) Inventories

Inventories are stated at the lower of cost and net realisable value. Cost is determined by the weighted average method. The cost of finished goods and work in progress comprises raw materials, direct labor, other direct costs and related production overheads (based on normal operating capacity). Net realisable value is the estimated selling price in the ordinary course of business, less the estimated costs of completion and the estimated costs necessary to make the sale.

(i) Contracts in progress

Contracts in progress in connection with the manufacturing of aircraft are accounted for under construction contracts.

When the outcome of a construction contract cannot be estimated reliably, contract revenue is recognised only to the extent of contract costs incurred and that it is probable to be recoverable; and contract costs are recognised when incurred.

When the outcome of a construction contract can be estimated reliably and it is probable that the contract will be profitable, contract revenue is recognised over the period of the contract. When it is probable that total contract costs will exceed total contract revenue, the expected loss is recognised as an expense immediately.

The Group uses the percentage of completion method to determine the appropriate amount to recognise in a given period. The stage of completion is measured by reference to the contract costs incurred up to the balance sheet date as a percentage of total estimated costs for each contract. Costs incurred in the year in connection with future activity on a contract are excluded from contract costs in determining the stage of completion. They are presented as inventories, prepayments or other assets, depending on their nature.

3 PRINCIPAL ACCOUNTING POLICIES (continued)

(i) Contracts in progress (continued)

The Group presents as an asset the gross amount due from customers for contract work for all contracts in progress for which costs incurred plus recognised profits (less recognised losses) exceed progress billings. Progress billings not yet paid by customers and retention are included within "accounts receivable".

The Group presents as a liability the gross amount due to customers for contract work for all contracts in progress for which progress billings exceed costs incurred plus recognised profits (less recognised losses).

(j) Receivables

Receivables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method, less provision for impairment. A provision for impairment of receivables is established when there is objective evidence that the Group will not be able to collect all amounts due according to the original term of receivables. The amount of the provision is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the original effective interest rate. The carrying amount of the assets is reduced through the use of an allowance account and the amount of the loss is recognised in the income statement within "general and administrative expenses". When a receivable is uncollectible, it is written off against the allowance account for receivables. Subsequent recoveries of amounts previously written off are credited against general and administrative expenses in the income statement.

(k) Cash and cash equivalents

Cash and cash equivalents includes cash in hand, deposits held at call with banks and term deposit with initial terms of less than three months.

(l) Financial liabilities and equity

Financial liabilities and equity instruments issued by the Group are classified according to the substance of the contractual arrangements entered into and the definitions of a financial liability and an equity instrument. Financial liabilities (including accounts payables) are initially measured at fair value, and are subsequently measured at amortised cost, using the effective interest method. An equity instrument is any contract that does not meet the definition of financial liability and evidences a residual interest in the assets of the Group after deducting all of its liabilities.

Equity shares are classified as equity. Incremental costs, net of tax, directly attributable to the issue of new shares are shown in equity as a deduction from the proceeds.

3 PRINCIPAL ACCOUNTING POLICIES (continued)

(m) Borrowings

Borrowings are recognised initially at fair value, net of transaction costs incurred. Borrowings are subsequently stated at amortised cost; any difference between proceeds (net of transaction costs) and the redemption value is recognised in the income statement over the period of the borrowings using the effective interest method.

Borrowings are classified as current liabilities unless the Group has an unconditional right to defer settlement of the liability for at least 12 months after the balance sheet date.

(n) Borrowing costs

Borrowing costs incurred for the construction of qualifying asset are capitalised during the period of time that is required to complete and prepare the asset for its intended use. All other borrowing costs are expensed as incurred.

(o) Current and deferred income tax

The current income tax charge is calculated on the basis of the tax laws enacted or substantively enacted at the balance sheet date in the countries where the Group operates and generates taxable income. Management periodically evaluates positions taken in tax returns with respect to situations in which applicable tax regulation is subject to interpretation and establishes provisions where appropriate on the basis of amounts expected to be paid to the relevant tax authorities.

Deferred income tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. However, the deferred income tax is not accounted for if it arises from initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit or loss. Deferred income tax is determined using tax rates (and laws) that have been enacted or substantively enacted by the balance sheet date and are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability is settled.

Deferred income tax assets are recognised to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised.

Deferred income tax is provided on temporary differences arising on investments in subsidiaries and associates, except where the timing of the reversal of the temporary difference can be controlled by the Group and it is probable that the temporary difference will not reverse in the foreseeable future.

3 PRINCIPAL ACCOUNTING POLICIES (continued)

(p) Employee benefits

(i) Pension obligations

The Group contributes on a monthly basis to various defined contribution retirement benefit plans organised by relevant municipal and provincial governments in the PRC. The municipal and provincial governments undertake to assume the retirement benefit obligations payable to all existing and future retired employees under these plans and the Group has no further obligation for post-retirement benefits beyond the contributions made. Contributions to these plans are expensed as incurred.

(ii) Early retirement benefits

Early retirement benefits are recognised as expense in the period the Group reaches agreements with the relevant employees for the early retirement.

(iii) Housing benefits

The Group sold staff quarters to its employees, subject to a number of eligibility requirements, at preferential prices. When staff quarters are identified as being subject to sale under these arrangements, the carrying value of the staff quarters is written down to the net recoverable amount. Upon sale, any difference between sales proceeds and the carrying amount of the staff quarters is charged to the income statement.

The above discounted quarters allocation plans were phased out in accordance with the policies of the PRC government. In 1998, the State Council of the PRC issued a circular which stipulated that the sale of quarters to employees at preferential prices should be withdrawn. In 2000, the State Council further issued a circular stating that cash subsidies should be made to the employees following the withdrawal of allocation of staff quarters. However, the specific timetable and procedures of implementation of these policies are to be determined by individual provincial or municipal government based on the particular situation of the province or municipality.

Based on the relevant detailed local government regulations promulgated, certain entities within the Group have adopted cash housing subsidy plans. In accordance with these plans, for those eligible employees who have not been allocated with quarters at all or who have not been allocated with quarters up to the prescribed standards before the discounted quarters sale plans were terminated, the Group is required to pay them one-off cash housing subsidies based on their years of service, positions and other criteria. These cash housing subsidies are charged to the income statement in the year in which it was determined that the payment of such subsidies is probable and the amounts can be reasonably estimated. Based on the available information and its best estimate, the Group estimated the required provision for these cash housing subsidies which was charged to the income statement in the year ended 31st December 2000 when the State Council circular in respect of cash subsidies was issued.

3 PRINCIPAL ACCOUNTING POLICIES (continued)

(p) Employee benefits (continued)

(iii) Housing benefits (continued)

Pursuant to the Reorganisation, AVIC II would bear any further one-off cash housing subsidies in excess of the amount provided for in the consolidated balance sheet of the Group. Employees joining the Group after the incorporation of the Company would not be entitled to any one-off cash housing subsidies.

In addition, all full-time employees of the Group are entitled to participate in various government-sponsored housing funds. The Group contributes on a monthly basis to these funds based on certain percentages of the salaries of the employees. The Group's liability in respect of these funds is limited to the contributions payable in each period.

(q) Provisions

Provisions are recognised when the Group has a present legal or constructive obligation as a result of past events; it is probable that an outflow of resources will be required to settle the obligation; and the amount has been reliably estimated. Provisions are not recognised for future operating losses.

Where there are a number of similar obligations, the likelihood that an outflow will be required in settlement is determined by considering the class of obligations as a whole. A provision is recognised even if the likelihood of an outflow with respect to any one item included in the same class of obligations may be small.

Warranty obligations are accrued at the time the sales are recognised, based on the estimated amounts of fulfilling the total obligations, including handling and transportation costs. The assumptions used to estimate warranty expenses are evaluated periodically and based on historical experience.

(r) Operating leases

Leases in which a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments made under operating leases are charged to the income statement on a straight-line basis over the period of the lease.

Assets leased out under operating leases are included in property, plant and equipment in the balance sheet. They are depreciated over their expected useful lives on a basis consistent with similar owned property, plant and equipment. Rental income is recognised on a straight-line basis over the lease term.

(s) Financial guarantee contract liabilities

Financial guarantee contract liabilities are measured initially at their fair values and are subsequently measured at the higher of (i) the amount initially recognised less, where appropriate, cumulative amortisation recognised in the income statement over the period of the relevant liabilities and (ii) the amount of which the Group is obliged to reimburse the recipient under the financial guarantee contracts.

3 PRINCIPAL ACCOUNTING POLICIES (continued)

(t) Foreign currency translation

(i) Functional and presentation currency

Items included in the financial statements of each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates (the "Functional Currency"). The financial statements are presented in Renminbi ("RMB"), which is the Company's functional and presentation currency.

(ii) Transactions and balances

Foreign currency transactions are translated into the Functional Currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement.

Translation differences on non-monetary financial assets and liabilities such as equity instruments held at fair value through profit or loss are recognised in profit or loss as part of the fair value gain or loss. Translation differences on non-monetary financial assets such as equities classified as available-for-sale are included in the fair value reserve in equity.

(iii) Group companies

The results and financial position of all the group entities (none of which has the currency of a hyperinflationary economy) that have a Functional Currency different from the presentation currency are translated into the presentation currency as follows:

(a) assets and liabilities for each balance sheet presented are translated at the closing rate at the date of that balance sheet;

(b) income and expenses for each income statement are translated at average exchange rates (unless this average is not a reasonable approximation of the cumulative effect of the rates prevailing on the transaction dates, in which case income and expenses are translated at the dates of the transactions); and

(c) all resulting exchange differences are recognised as a separate component of equity.

3 PRINCIPAL ACCOUNTING POLICIES (continued)

(u) Revenue recognition

Revenue comprises the fair value of the consideration received or receivable for the sales of goods and services in the ordinary course of the Group's activities. Revenue is shown net of value-added tax, returns, rebates and discounts after eliminated sales within the Group.

The Group recognises revenue when the amount of revenue can be reliably measured and it is probable that future economic benefits will flow to the Group. The amount of revenue is not considered to be reliably measurable until all contingencies relating to the sale have been resolved. The Group bases its estimates on historical results, taking into consideration the type of customer, the type of transaction and the specifics of each arrangement. Revenue and income are recognised as follows:

Turnover represents revenues recognised on sales of automobiles and aviation products. Sales of goods are recognised when a group entity has delivered products to the customer, the customer has accepted the products and collectibility of the related receivables is reasonably assured.

The Group combines its proportionate share of the jointly controlled entity's turnover as described in Note 3(a)(iii) with similar recognition policies mentioned above.

Recognition policy of revenue relating to long-term construction contracts is disclosed in Note 3(i) above.

Dividend income and income from investments are recognised when the right to receive payment is established.

Revenue from the provision of services is recognised when the services are rendered.

Rental income under operating leases is recognised on a straight-line basis over the lease periods.

Interest income from bank deposits is recognised on a time proportion basis using the effective interest method.

(v) Government grants

Grants from the government are recognised at their fair value where there is a reasonable assurance that the grant will be received and the Group will comply with all attached conditions.

Government grants relating to costs are deferred and recognised in the income statement over the period necessary to match them with the costs they are intended to compensate.

Government grants relating to the purchase of property, plant and equipment are included in non-current liabilities as deferred income from government grants and are credited to the income statement on a straight-line basis over the expected lives of the related assets.

3 PRINCIPAL ACCOUNTING POLICIES (continued)

(w) Dividend distribution

Dividend distribution to the Company's shareholders is recognised as a liability in the Group's financial statements in the period in which the dividends are approved by the Company's shareholders or directors, where appropriate.

(x) Derivative financial instruments

Derivative financial instruments are initially recognised at fair value on the date a derivative contract is entered into and are subsequently remeasured at their fair value. During the year, the Group did not enter into any derivative financial instruments.

(y) Segment reporting

A business segment is a group of assets and operations engaged in providing products or services that are subject to risks and returns that are different from those of other business segments. A geographical segment is engaged in providing products or services within a particular economic environment that are subject to risks and returns that are different from those of segments operating in other economic environments.

4 CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS

Estimates and judgements used in preparing the financial statements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. The resulting accounting estimates will, by definition, seldom equal the related actual results. The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below.

(i) Depreciation and amortisation

The Group's management determines the estimated useful lives and related deprecation/amortisation charges for the property, plant and equipment and intangible assets with reference to the estimated periods that the Group intends to derive future economic benefits from the use of these assets. Management will revise the depreciation and amortisation charge where useful lives are different to previously estimated, or it will write-off or write-down technically obsolete or non-strategic assets that have been abandoned or sold.

(ii) Development costs

The Group's management determines the capitalisation of development costs when it is probable that the project will be a success considering its commercial and technology feasibility. It could change significantly as a result of technological innovations and the changes of estimated projections. Management will write-off or write-down development costs when there are adverse changes in technological innovations or estimated projections.

4 CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS (continued)

(iii) Impairment of non-financial assets

Assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of the asset exceeds its recoverable amount in accordance with the accounting policy stated in Note 3(f). The recoverable amount of an asset or a cash-generating unit is determined based on the higher of its fair value less costs to sell and value-in-use. The value-in-use calculation requires the entity to estimate the future cash flows expected to arise from the cash-generating unit and a suitable discount rate in order to calculate present value, which has been prepared on the basis of management's assumptions and estimates.

(iv) Impairment of account and other receivables

Provision for impairment of account and other receivables is determined based on the evaluation of collectibility of account and other receivables. A considerable amount of judgment is required in assessing the ultimate realisation of these receivables, including the current creditworthiness, the past collection history of each customer and the current market condition.

(v) Inventories

Management estimates the net realisable value for finished goods and work-in progress based primarily on the latest invoice prices and current market conditions. The Group carries out an inventory review on a product-by-product basis at each balance sheet date and will make provision for impairment on obsolete and slow-moving items or will write-off or write-down inventories to net realisable value.

(vi) Revenue recognition

The Group uses the percentage of completion method in accounting for its contract revenues. Use of the percentage of completion method requires the Group to estimate the contract costs incurred up to the balance sheet date as a proportion of the total estimated cost for each contract. Based on the Group's experience and nature of the construction contracts undertaken by the Group, the Group makes estimates of the point at which it considers the work is sufficiently advanced such that costs to complete and revenue can be reliably estimated. Management is confident that the actual outcome will not materially differ from the estimates made at the balance sheet date.

(vii) Income taxes

The Group is subject to income taxes in the PRC. There are certain transactions and calculations for which the ultimate tax determination is uncertain during the ordinary course of business. Where the final tax outcome of these matters is different from the amounts that were initially recorded, such differences will impact the income tax and deferred tax provisions in the period in which such determination is made.

Deferred income tax assets relating to certain temporary differences and tax losses are recognised when management considers it is probable that future taxable profits will be available against which the temporary differences or tax losses can be utilised. When the expectation is different from the original estimate, such differences will impact the recognition of deferred income tax assets and taxation charges in the period in which such estimate is changed.

4 CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS (continued)

(viii) Provisions

The Group gives warranties on certain automobile and aviation products and undertakes to repair or replace items that fail to perform satisfactorily based on certain pre-determined conditions. Management estimates the related warranty claims based on historical warranty claim information including level of repairs and returns as well as recent trends that might suggest that past cost information may differ from future claims.

Factors that could impact the estimated claim information include the success of the Group's product quality initiatives, as well as parts and labor costs. Any increase or decrease in the provision would affect profit or loss in future years.

5 SEGMENT INFORMATION

The Group is principally engaged in the manufacturing, assembly, sales and servicing of civilian aircrafts and automobiles . In accordance with the Group's internal financial reporting system, the Group has determined business segments be presented as the primary reporting format.

(a) Primary reporting format - business segments

The Group is organised into two main business segments:

- Aviation - manufacturing, assembly, sales and servicing of helicopters, trainers and other aircrafts.

- Automobiles - manufacturing, assembly, sales and servicing of automobiles.

All segment revenues were made to external parties.

Operating expenses are allocated to the relevant segment which is the predominant user of the services provided by the unit. Operating expenses of other shared services which cannot be allocated to a specific segment are included as unallocated costs. Unallocated costs mainly represent corporate expenses.

Segment assets consist primarily of property, plant and equipment, land use rights, intangible assets, investments in associates, inventories, operating receivables, prepayments, deposits and cash and cash equivalents, and mainly exclude corporate assets. Segment liabilities comprise operating liabilities and exclude corporate liabilities. Capital expenditures mainly comprise additions to property, plant and equipment, land use rights and intangible assets.

5 SEGMENT INFORMATION (continued)

Primary reporting format - business segments

	As at and for the year ended 31st December 2008		
	Aviation RMB'000	Automobiles RMB'000	Total RMB'000
Operating results			
Segment revenue	4,596,140	11,788,744	16,384,884
Segment results	248,542	(633,359)	(384,817)
Unallocated income			17,304
Unallocated costs			(26,453)
Operating loss			(393,966)
Finance costs, net	(88,377)	(279,624)	(368,001)
Share of results of associates	38,420	1,648	40,068
Loss before income tax			(721,899)
Income tax expense			(188,596)
Loss for the year			(910,495)
Assets			
Segment assets	8,809,718	12,266,867	21,076,585
Interests in associates	302,750	27,219	329,969
Unallocated assets			1,038,077
Total assets			22,444,631
Liabilities			
Segment liabilities	3,751,898	6,014,716	9,766,614
Borrowings	2,487,991	4,084,604	6,572,595
Unallocated liabilities			531,884
Total liabilities			16,871,093
Other segment information			
Capital expenditures	177,278	868,458	1,045,736
Depreciation	104,042	1,173,456	1,277,498
Amortisation	2,270	66,268	68,538
Provision/(reversal of provision) for impairments	23,989	(6,370)	17,619
Write-off of intangible assets	—	33,869	33,869

5 SEGMENT INFORMATION (continued)

Primary reporting format - business segments (continued)

	As at and for the year ended 31st December 2007		
	Aviation	Automobiles	Total
	RMB'000	RMB'000	RMB'000
Operating results			
Segment revenue	5,327,408	11,213,237	16,540,645
Segment results	306,241	(852,840)	(546,599)
Unallocated income			48,745
Unallocated costs			(26,141)
Operating loss			(523,995)
Finance costs, net	(73,707)	(255,718)	(329,425)
Share of results of associates	53,389	3,322	56,711
Loss before income tax			(796,709)
Income tax expense			(51,635)
Loss for the year			(848,344)
Assets			
Segment assets	8,855,603	12,812,702	21,668,305
Interests in associates	240,552	57,369	297,921
Unallocated assets			812,372
Total assets			22,778,598
Liabilities			
Segment liabilities	3,888,127	5,505,832	9,393,959
Borrowings	2,080,340	3,993,820	6,074,160
Unallocated liabilities			652,084
Total liabilities			16,120,203
Other segment information			
Capital expenditures	217,461	702,851	920,312
Depreciation	89,145	936,147	1,025,292
Amortisation	2,309	62,795	65,104
Provision for impairments	24,549	359,772	384,321
Write-off of intangible assets	—	83,117	83,117

5 SEGMENT INFORMATION (continued)

(b) Secondary reporting format - geographical segments

All assets and operations of the Group for the year were located in the PRC, which is considered as one geographical location in an economic environment with similar risk and returns.

No geographical segments analysis is presented as less than 10% of the Group's revenue and assets are attributable to markets not located in the PRC.

6 OTHER INCOME

	2008 RMB'000	2007 RMB'000
Profit from sale of scrap materials	24,592	22,312
Income from government grants	69,050	70,000
Refund of value-added tax and real estate tax	1,829	3,683
Rental income from plant and equipment	6,578	1,074
Income from rendering of other services	1,438	11,857
Dividend income from available-for-sale financial assets	2,428	4,870
	105,915	113,796

7 OTHER GAINS, NET

	2008 RMB'000	2007 RMB'000
Amortisation of deferred income relating to government grants	17,755	33,161
Fair value (loss)/gain on financial assets at fair value through profit or loss	(1,991)	338
(Loss)/gain on disposal of		
– Property, plant and equipment	(9,082)	16,838
– Certain interests in subsidiaries	—	32,440
– Associates	794	—
– Available-for-sale financial assets	36,112	—
– Financial assets at fair value through profit or loss	(21,090)	16,305
	22,498	99,082

8 EXPENSES BY NATURE

	2008 RMB'000	2007 RMB'000
Advertising costs	**192,474**	171,949
Amortisation of		
– Intangible assets (Note 17)	**58,826**	58,875
– Land use rights (Note 16)	**9,712**	6,229
Auditors' remuneration	**7,650**	7,190
Changes in inventories of finished goods and work-in-progress	**394,442**	(424,184)
Contract costs incurred	**2,282,697**	2,726,946
Depreciation on property, plant and equipment (Note 15)	**1,277,498**	1,025,292
Fuel	**324,273**	395,295
Insurance	**16,725**	19,334
Operating lease rentals		
– Land and buildings	**45,985**	45,548
– Property, plant and equipment	**—**	216
Provision/(reversal of provision) for impairment		
– Available-for-sale financial assets	**—**	(1,326)
– Intangible assets (Note 17)	**—**	5,958
– Inventories	**7,914**	121,875
– Property, plant and equipment (Note 15)	**—**	243,421
– Receivables	**9,705**	13,067
Raw materials and consumables used	**9,573,180**	10,047,509
Repairs and maintenance expense	**174,663**	229,257
Research expenditures and development costs	**235,794**	244,539
Staff costs, including directors' emoluments (Note 13)	**1,090,027**	945,478
Sub-contracting charges	**216,271**	218,664
Sundries	**413,815**	392,157
Transportation expenses	**351,827**	400,887
Travelling	**48,077**	53,322
Warranty expenses (Note 33)	**141,839**	246,903
Write-off of intangible assets (Note 17)	**33,869**	83,117
Total cost of sales, selling and distribution expenses, general and administrative expenses, and other operating expenses	**16,907,263**	17,277,518

9 FINANCE COSTS, NET

	2008 RMB'000	2007 RMB'000
Finance income:		
Interest income on bank balances and deposits	**79,280**	57,966
Finance costs:		
Interest expense on bank borrowings		
– Wholly repayable within 5 years	**414,736**	381,010
– Not wholly repayable within 5 years	**22,193**	17,054
Interest expense on other borrowings		
– Not wholly repayable within 5 years	**186**	107
	437,115	398,171
Less: Amount capitalised in property, plant and equipment (note)	**(24,646)**	(26,111)
Government interest subsidies	**—**	(33,245)
	412,469	338,815
Exchange (gains)/losses	**(15,913)**	35,183
Other finance costs	**50,725**	13,393
	447,281	387,391
	368,001	329,425

Note: Interest expenses capitalised are borrowing costs related to funds borrowed specifically for the purpose of obtaining qualifying assets. Interest rates on such capitalised borrowings are as follows:

	2008	2007
Interest rates per annum at which finance costs were capitalised	**6.89%-7.47%**	5.49% -6.57%

10 INCOME TAX EXPENSE

	2008 RMB'000	2007 RMB'000
PRC enterprise income tax	**174,795**	106,520
Deferred income taxes	**13,801**	(54,885)
	188,596	51,635

Notes:

(a) Except for certain subsidiaries which are taxed at a transitional preferential rate of 18% (2007: preferential rates from 7.5% to 15%), in accordance with the relevant PRC enterprise income tax rules and regulations, provision for PRC enterprise income tax is calculated based on the statutory income tax rate of 25% on the assessable income of the Group (2007: 33%).

(b) The reconciliation between the Group's actual tax charge and the amount which is calculated based on the statutory tax rate of 25% (2007: 33%) in the PRC is as follows:

	2008 RMB'000	2007 RMB'000
Loss before income tax	**(721,899)**	(796,709)
Tax calculated at the statutory tax rate of 25% (2007: 33%)	**(180,475)**	(262,914)
Preferential tax rates on the income of certain subsidiaries	**(87,148)**	(214,523)
Non-taxable income	**(90,721)**	(61,811)
Expenses not deductible for tax purposes	**142,347**	124,669
Tax losses for which no deferred income tax asset was recognised	**330,763**	483,181
Utilisation of previously unrecognised tax losses	**—**	(6,769)
Effect of changes in future tax rates	**(10,628)**	(18,297)
Write-off of previously recognised deferred tax assets	**84,144**	15,347
Others	**314**	(7,248)
Tax charge	**188,596**	51,635

(c) Share of taxation attributable to associates for the year ended 31st December 2008 is RMB 11,148,000 (2007: RMB 4,686,000).

11 LOSS ATTRIBUTABLE TO EQUITY HOLDERS OF THE COMPANY

The loss attributable to equity holders of the Company is dealt with in the financial statements of the Company to the extent of a profit of RMB 119,047,000 (2007: a loss of RMB 462,588,000).

12 LOSS PER SHARE

The calculation of basic loss per share is based on the Group's loss attributable to equity holders of the Company of RMB 1,156,611,000 (2007: RMB 1,026,226,000) and based on the weighted average number of 4,643,608,500 (2007: 4,643,608,500) shares in issue during the year.

There was no dilution effect on the basic loss per share for the years ended 31st December 2008 and 2007 as there were no potential dilutive shares outstanding during the years ended 31st December 2008 and 2007.

13 STAFF COSTS, INCLUDING DIRECTORS' EMOLUMENTS

	2008	2007
	RMB'000	RMB'000
Wages, salaries and bonuses	**689,186**	605,951
Housing benefits	**64,268**	62,626
Contributions to pension plans	**174,729**	160,080
Welfare and other expenses	**161,844**	116,821
	1,090,027	945,478

14 DIRECTORS', SUPERVISORS' AND SENIOR MANAGEMENT'S EMOLUMENTS

(a) Directors' emoluments

The emoluments of each of the directors of the Company for the years ended 31st December 2008 and 2007 are set out below.

	Year ended 31st December 2008				
Name of director	Fees	Basic salaries, housing allowance, other allowances and benefits in kind	Bonuses	Employer's contributions to retirement schemes	Total
	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000
Executive directors					
Lin Zuoming (note (ii))	—	30	—	—	30
Zhang Hongbiao (note (i))	—	150	—	—	150
Tan Ruisong	—	160	—	—	160
Wu Xiandong	—	160	—	—	160
Non-executive directors					
Gu Huizhong (note (ii))	20	—	—	—	20
Xu Zhanbin (note (ii))	20	—	—	—	20
Geng Ruguang (note (ii))	20	—	—	—	20
Zhang Xinguo (note (ii))	20	—	—	—	20
Li Fangyong (note (ii))	20	—	—	—	20
Wang Yong	35	—	—	—	35
Maurice Savart	—	—	—	—	—
Liang Zhenhe (note (i))	100	—	—	—	100
Song Jingang (note (i))	100	—	—	—	100
Tian Min (note (i))	100	—	—	—	100
Chen Huaiqiu (note (i))	100	—	—	—	100
Wang Bin (note (i))	100	—	—	—	100
Independent non-executive directors					
Lau Chungman	119	—	—	—	119
Guo Chongqing	60	—	—	—	60
Li Xianzong	60	—	—	—	60
	874	500	—	—	1,374

Notes:

(i) Resigned on 16th October 2008.

(ii) Appointed on 16th October 2008.

14 DIRECTORS', SUPERVISORS' AND SENIOR MANAGEMENT'S EMOLUMENTS (continued)

(a) Directors' emoluments (continued)

	Year ended 31st December 2007				
Name of director	Fees	Basic salaries, housing allowance, other allowances and benefits in kind	Bonuses	Employer's contributions to retirement schemes	Total
	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000
Executive directors					
Zhang Hongbiao	—	180	—	—	180
Wu Xiandong	—	160	—	—	160
Tan Ruisong	—	160	—	—	160
Non-executive directors					
Liang Zhenhe	120	—	—	—	120
Song Jingang	120	—	—	—	120
Tian Min	120	—	—	—	120
Chen Huaiqiu	120	—	—	—	120
Wang Bin	120	—	—	—	120
Wang Yong	35	—	—	—	35
Maurice Savart	—	—	—	—	—
Independent non-executive directors					
Lau Chungman	119	—	—	—	119
Guo Chongqing	60	—	—	—	60
Li Xianzong	60	—	—	—	60
	874	500	—	—	1,374

14 DIRECTORS', SUPERVISORS' AND SENIOR MANAGEMENT'S EMOLUMENTS (continued)

(b) Supervisors' emoluments

The emoluments of each of the supervisors of the Company for the years ended 31st December 2008 and 2007 are set out below.

	Year ended 31st December 2008				
Name of supervisor	Fees	Basic salaries, housing allowance, other allowances and benefits in kind	Bonuses	Employer's contributions to retirement schemes	Total
	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000
Supervisors					
Hu Wenming (note (ii))	27	—	—	—	27
Tang Jianguo	133	—	—	—	133
Li Yuhai (note (iv))	20	—	—	—	20
Gao Jianshe (note (iv))	20	—	—	—	20
Bai Ping	120	—	—	—	120
Yu Yan	—	—	—	—	—
Wang Yuming (note (ii))	4	—	—	—	4
Wang Shouxin (note (i))	100	—	—	—	100
Li Shentian (note (iii))	100	—	—	—	100
Han Xiaoyang (note (iii))	100	—	—	—	100
Li Deqing (note (i))	21	—	—	—	21
Independent supervisors					
Zheng Li	35	—	—	—	35
Xie Zhihua	35	—	—	—	35
	715	—	—	—	715

Notes:

(i) Resigned on 16th October 2008.

(ii) Appointed on 16th October 2008.

(iii) Resigned on 25th August 2008.

(iv) Appointed on 25th August 2008.

14 DIRECTORS', SUPERVISORS' AND SENIOR MANAGEMENT'S EMOLUMENTS (continued)

(b) Supervisors' emoluments (continued)

	Year ended 31st December 2007				
Name of supervisor	Fees	Basic salaries, housing allowance, other allowances and benefits in kind	Bonuses	Employer's contributions to retirement schemes	Total
	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000
Supervisors					
Tang Jianguo	160	—	—	—	160
Wang Shouxin	120	—	—	—	120
Li Shentian	120	—	—	—	120
Bai Ping	120	—	—	—	120
Han Xiaoyang	120	—	—	—	120
Li Deqing	25	—	—	—	25
Yu Yan	—	—	—	—	—
Independent supervisors					
Zheng Li	35	—	—	—	35
Xie Zhihua	35	—	—	—	35
	735	—	—	—	735

14 DIRECTORS', SUPERVISORS' AND SENIOR MANAGEMENT'S EMOLUMENTS (continued)

(c) Five highest paid individuals

The five individuals whose emoluments were the highest in the Group for the year are as follows:

	Number of individuals	
	2008	2007
In the capacity as:		
Director	**3**	3
Supervisor	**—**	1
Senior management	**2**	1
	5	5

The five individuals whose emoluments were highest in the Group for the year included three (2007: four) directors/supervisors whose emoluments are reflected in the analyses presented above. The emoluments payable to the remaining two (2007: one) individuals during the years ended 31st December 2008 and 2007 are as follows:

	2008	2007
	RMB'000	RMB'000
Basic salaries, housing allowance, other allowances and benefits in kind	**280**	140
Contributions to retirement schemes	**—**	—
	280	140

The emoluments fell within the following band:

	Number of individuals	
	2008	2007
Nil - RMB 881,900 (equivalent to HKD 1,000,000)	**2**	1

(d) No directors or supervisors of the Company waived any emoluments during the years ended 31st December 2007 and 2008. During the year, no emoluments have been paid by the Group to the directors or supervisors of the Company or any of the five highest paid individuals as an inducement to join or upon joining the Group or as compensation for loss of office (2007: Nil).

15 PROPERTY, PLANT AND EQUIPMENT

	Group				
	Construction in progress RMB'000	Buildings RMB'000	Plant and equipment RMB'000	Furniture and fixtures, other equipment and motor vehicles RMB'000	Total RMB'000
Cost					
As at 1st January 2008	526,674	2,082,120	9,195,253	781,504	12,585,551
Additions	695,396	218,147	32,186	19,162	964,891
Transfer upon completion	(545,218)	144,868	358,169	42,181	—
Disposals/write-off	(6,144)	(49,380)	(332,651)	(20,792)	(408,967)
As at 31st December 2008	670,708	2,395,755	9,252,957	822,055	13,141,475
Accumulated depreciation and impairment					
As at 1st January 2008	—	627,080	4,267,078	365,404	5,259,562
Depreciation	—	93,482	1,113,867	70,149	1,277,498
Disposals/write-off	—	(5,458)	(271,559)	(15,816)	(292,833)
As at 31st December 2008	—	715,104	5,109,386	419,737	6,244,227
Net book value					
As at 31st December 2008	670,708	1,680,651	4,143,571	402,318	6,897,248

15 PROPERTY, PLANT AND EQUIPMENT (continued)

	Group				
	Construction in progress RMB'000	Buildings RMB'000	Plant and equipment RMB'000	Furniture and fixtures, other equipment and motor vehicles RMB'000	Total RMB'000
Cost					
As at 1st January 2007	737,969	2,194,278	9,822,664	735,264	13,490,175
Additions	507,430	136,975	27,849	199,773	872,027
Transfer upon completion	(602,388)	84,227	496,943	21,218	—
Disposals/write-off	—	(138,705)	(358,999)	(35,393)	(533,097)
Effect on proportionate consolidation of a jointly controlled entity (Note 3(a)(iii))	(116,337)	(194,655)	(793,204)	(139,358)	(1,243,554)
As at 31st December 2007	526,674	2,082,120	9,195,253	781,504	12,585,551
Accumulated depreciation and impairment					
As at 1st January 2007	—	638,964	3,464,096	337,577	4,440,637
Depreciation	—	48,374	888,726	88,192	1,025,292
Impairment charge (note (c))	—	—	243,421	—	243,421
Disposals/write-off	—	(45,263)	(205,675)	(20,460)	(271,398)
Effect on proportionate consolidation of a jointly controlled entity (Note 3(a)(iii))	—	(14,995)	(123,490)	(39,905)	(178,390)
As at 31st December 2007	—	627,080	4,267,078	365,404	5,259,562
Net book value					
As at 31st December 2007	526,674	1,455,040	4,928,175	416,100	7,325,989

15 PROPERTY, PLANT AND EQUIPMENT (continued)

	Company		
	Plant and equipment RMB'000	Furniture and fixtures, other equipment and motor vehicles RMB'000	Total RMB'000
Cost			
As at 1st January 2008	**6,637**	**8,584**	**15,221**
Additions	**—**	**330**	**330**
As at 31st December 2008	**6,637**	**8,914**	**15,551**
Accumulated depreciation and impairment			
As at 1st January 2008	**3,630**	**4,178**	**7,808**
Depreciation	**328**	**627**	**955**
As at 31st December 2008	**3,958**	**4,805**	**8,763**
Net book value			
As at 31st December 2008	**2,679**	**4,109**	**6,788**
Cost			
As at 1st January 2007	6,637	8,654	15,291
Additions	—	180	180
Disposals	—	(250)	(250)
As at 31st December 2007	6,637	8,584	15,221
Accumulated depreciation and impairment			
As at 1st January 2007	3,340	3,746	7,086
Depreciation	290	607	897
Disposals	—	(175)	(175)
As at 31st December 2007	3,630	4,178	7,808
Net book value			
As at 31st December 2007	3,007	4,406	7,413

15 PROPERTY, PLANT AND EQUIPMENT (continued)

Notes:

(a) Carrying value of the Group's property, plant and equipment pledged as securities for bank borrowings were set out as follows:

	Group	
	2008	2007
	RMB'000	RMB'000
Property, plant and equipment pledged (Note 34(h))	**507,134**	542,303

(b) As at 31st December 2008, certain of the Group's property, plant and equipment with carrying value of approximately RMB 617,960,000 (2007: RMB 700,993,000) were situated on leasehold land in the PRC which are granted by AVIC Group (2007: AVIC II) for the Group's use at no cost or have been leased from certain fellow subsidiaries under long-term leases. The remaining period of the Group's rights on the leasehold land at 31st December 2008 ranged from 14 to 41 years (2007: 15 to 42 years).

(c) During 2007, the Group reviewed the recoverable amount of its property, plant and equipment, taking into account the product lines of the Group and the market conditions, which consequently led to the recognition of an impairment loss of RMB 243,421,000 mainly in relation to its automobile segment. The recoverable amount of the relevant assets has been determined on the basis of their value in use. The pre-tax discount rate used in measuring value in use was 9.7% per annum.

16 LAND USE RIGHTS

	Group	
	2008	2007
	RMB'000	RMB'000
Cost		
As at 1st January	**115,871**	125,286
Additions	**79,644**	—
Disposal	**—**	(2,093)
Effect on proportionate consolidation of a jointly controlled entity (Note 3(a)(iii))	**—**	(7,322)
As at 31st December	**195,515**	115,871
Accumulated amortisation		
As at 1st January	**34,496**	28,955
Amortisation	**9,712**	6,229
Disposal	**—**	(311)
Effect on proportionate consolidation of a jointly controlled entity (Note 3(a)(iii))	**—**	(377)
As at 31st December	**44,208**	34,496
Net book amount		
As at 31st December	**151,307**	81,375

17 INTANGIBLE ASSETS

	Group		
	Development costs	**Technology know-how**	**Total**
	RMB'000	**RMB'000**	**RMB'000**
	(note (i))	(note (ii))	
Cost			
As at 1st January 2008	**781,629**	**32,983**	**814,612**
Additions	**1,201**	**—**	**1,201**
Write-off (note (iii))	**(171,248)**	**—**	**(171,248)**
As at 31st December 2008	**611,582**	**32,983**	**644,565**
Accumulated amortisation and impairment			
As at 1st January 2008	**477,643**	**5,355**	**482,998**
Amortisation	**54,361**	**4,465**	**58,826**
Write-off (note (iii))	**(137,379)**	**—**	**(137,379)**
As at 31st December 2008	**394,625**	**9,820**	**404,445**
Net book amount			
As at 31st December 2008	**216,957**	**23,163**	**240,120**
Cost			
As at 1st January 2007	848,951	41,710	890,661
Additions	36,574	11,711	48,285
Write-off (note (iii))	(103,896)	—	(103,896)
Effect on proportionate consolidation of a jointly controlled entity (note 3(a)(iii))	—	(20,438)	(20,438)
As at 31st December 2007	781,629	32,983	814,612
Accumulated amortisation and impairment			
As at 1st January 2007	437,838	2,169	440,007
Impairment charge (note (iii))	5,958	—	5,958
Amortisation	54,626	4,249	58,875
Write-off (note (iii))	(20,779)	—	(20,779)
Effect on proportionate consolidation of a jointly controlled entity (note 3(a)(iii))	—	(1,063)	(1,063)
As at 31st December 2007	477,643	5,355	482,998
Net book amount			
As at 31st December 2007	303,986	27,628	331,614

17 INTANGIBLE ASSETS (continued)

Notes:

(i) In 2005, the Group entered into a jointly controlled asset arrangement with a fellow subsidiary to develop a new model of aircraft in which the Group has 60.56% participating interests. As at 31st December 2008, the aggregate amounts of development costs incurred by the Group amounted to RMB 201,486,000 (2007: RMB 201,486,000).

(ii) Technology know-how represents upfront license fees paid for acquiring technical details in connection with certain new automobile and engine models.

(iii) Management determined to write-off certain development costs for automobile segment as a result of a change in production plan based on the latest market conditions.

During 2007, impairment losses on intangible assets were mainly in relation to certain development costs of automobile segment for which management estimated that the carrying amounts of these assets have exceeded their recoverable amounts as determined based on value-in-use calculations. The key assumptions and discount rate used in determining the recoverable amounts are consistent to those applied for reviewing other assets impairment.

18 INTERESTS IN SUBSIDIARIES

	Company	
	2008	2007
	RMB'000	RMB'000
Investments, at cost		
- Shares listed in the PRC	**2,168,509**	2,205,757
- Unlisted investments	**1,295,171**	1,295,171
	3,463,680	3,500,928
Less: Provision for impairment losses	**(491,794)**	(491,794)
	2,971,886	3,009,134
Loans to subsidiaries (note)	**535,000**	535,000
	3,506,886	3,544,134
Market value of listed shares	**4,819,142**	10,538,842

Particulars of the principal subsidiaries of the Group as at 31st December 2008 are set out in Note 43.

Note:

Loans to subsidiaries are unsecured and non-interest bearing. These loans have no fixed terms of repayment and are regarded as equity contributions to the subsidiaries.

19 SHARE OF RESULTS OF / INTERESTS IN ASSOCIATES

	Group	
	2008	2007
	RMB'000	RMB'000
Share of net assets, as at 1st January	**297,921**	247,967
Share of results of associates		
- Profit before income tax	**51,216**	61,397
- Income tax expense	**(11,148)**	(4,686)
	40,068	56,711
	337,989	304,678
Dividends received from associates	**(39,539)**	(33,256)
New investments	**42,631**	30,000
Disposals	**(11,112)**	(3,501)
Share of net assets, as at 31st December	**329,969**	297,921

	Company	
	2008	2007
	RMB'000	RMB'000
Unlisted investment, at cost	**30,000**	30,000

Particulars of the principal associates of the Group as at 31st December 2008 are set out in Note 43.

20 AVAILABLE-FOR-SALE FINANCIAL ASSETS

	Group	
	2008	2007
	RMB'000	RMB'000
Listed equity securities, at fair value	**166,430**	528,719
Other investments, unlisted (note)	**74,978**	69,727
Less: Provision for impairment	**(11,029)**	(11,029)
	63,949	58,698
	230,379	587,417

Note:

These assets principally represent interests in certain unlisted companies which do not have a quoted market price in an active market and for which the range of other methods of reasonably estimating fair value is significant and the probabilities of the various estimates cannot be reasonably assessed. Accordingly, these investments are carried at cost less accumulated impairment losses.

21 DEFERRED INCOME TAXES

Deferred income taxes are calculated in respect of temporary differences under the liability method using the tax rates enacted or substantively enacted by the balance sheet date.

The movement on the deferred income tax accounts is as follows:

Deferred income tax assets:

	Group	
	2008	2007
	RMB'000	RMB'000
As at 1st January	**126,241**	75,305
(Charged)/credited to consolidated income statement	**(28,638)**	55,730
Effect on proportionate consolidation of a jointly controlled entity (Note 3(a)(iii))	**—**	(4,794)
As at 31st December	**97,603**	126,241

21 DEFERRED INCOME TAXES (continued)

Deferred income tax liabilities:

	Group	
	2008	2007
	RMB'000	RMB'000
As at 1st January	**(156,332)**	(35,872)
Credited/(charged) to consolidated income statement	**14,837**	(845)
Credited/(charged) to available-for-sale financial assets reserve	**104,679**	(119,615)
As at 31st December	**(36,816)**	(156,332)

The deferred income taxes are provided for, prior to offsetting of balances within the same tax jurisdiction, in respect of:

	Group	
	2008	2007
	RMB'000	RMB'000
Deferred income tax assets:		
Provision for impairment of receivables	**9,765**	64,765
Provision for impairment of inventories	**9,899**	18,437
Provision for impairment of investments	**—**	2,545
Provision for impairment of property, plant and equipment	**726**	4,667
Provision for warranty expense	**31,582**	43,443
Other temporary differences	**60,242**	20,710
	112,214	154,567
Deferred income tax liabilities:		
Development costs	**32,011**	59,341
Fair value changes on available-for-sale financial assets	**14,936**	119,615
Other temporary differences	**4,480**	5,702
	51,427	184,658
Total deferred income tax assets less total deferred income tax liabilities	**60,787**	(30,091)

21 DEFERRED INCOME TAXES (continued)

Deferred income tax assets and liabilities are offset when there is a legally enforceable right to set off current tax assets against current tax liabilities and when the deferred income taxes related to the same fiscal authority. The following amounts, determined after appropriate offsetting, are shown in the consolidated balance sheet:

	Group	
	2008	2007
	RMB'000	RMB'000
Representing:		
Deferred income tax assets	**97,603**	126,241
Deferred income tax liabilities	**(36,816)**	(156,332)
Total deferred income tax assets less total deferred income tax liabilities	**60,787**	(30,091)

Deferred income tax assets are recognised for tax losses carried forward to the extent that the realisation of the related tax benefit through the future taxable profits is probable. The Group did not recognise deferred income tax assets of approximately RMB 654 million (2007: RMB 323 million) in respect of tax losses amounting to approximately RMB 2,616 million (2007: RMB1,465 million) that can be carried forward against future taxable income. These unrecognised tax losses are expiring within 5 years.

22 ACCOUNTS RECEIVABLE

	Group	
	2008	2007
	RMB'000	RMB'000
Trade receivables, gross (note (a))		
- Related parties (note (b))	**1,740,897**	1,165,491
- Third parties	**1,039,864**	1,266,414
	2,780,761	2,431,905
Less: Provision for impairment of receivables	**(214,090)**	(234,264)
	2,566,671	2,197,641
Notes receivable (note (c))		
- Related parties (Note 40(b))	**520,600**	209,000
- Third parties	**672,413**	831,032
	1,193,013	1,040,032
	3,759,684	3,237,673

22 ACCOUNTS RECEIVABLE (continued)

Notes:

(a) Certain of the Group's sales were on advance payment or documents against payment. Sales to small, new or short-term customers are normally expected to be settled shortly after delivery. A credit period of up to six months may be granted in respect of sales to customers with good credit history and long-established relationship with the Group. Terms offered to related parties are similar to those offered to third parties. Ageing analysis of trade receivables is as follows:

	Group	
	2008	2007
	RMB'000	RMB'000
Current to 1 year	**2,531,081**	2,109,716
1 year to 2 years	**43,260**	87,174
2 years to 3 years	**10,450**	58,255
Over 3 years	**195,970**	176,760
	2,780,761	2,431,905

The credit quality of accounts receivable that are neither past due nor impaired can be assessed by reference to the historical information about counter parties default rates. The existing counter parties do not have significant default in the past.

As of 31st December 2008, trade receivables of RMB 149,197,000 (2007: RMB 176,228,000) were past due but not impaired. These relate mainly to a number of customers in the aviation segment for whom there is no recent history of default. The ageing analysis of these past due but not impaired receivables is as follows:

	Group	
	2008	2007
	RMB'000	RMB'000
Up to 1 year	**107,464**	64,666
1 year to 2 years	**41,733**	61,920
2 years to 3 years	**—**	47,336
Over 3 years	**—**	2,306
	149,197	176,228

As of 31st December 2008, trade receivables of RMB 214,090,000 (2007: RMB 234,264,000) were impaired. The individually impaired receivables mainly relate to smaller customers which are in financial difficulties. The ageing of these impaired receivables is as follows:

	Group	
	2008	2007
	RMB'000	RMB'000
Current to 1 year	**6,143**	23,637
1 year to 2 years	**1,527**	25,254
2 years to 3 years	**10,450**	10,919
Over 3 years	**195,970**	174,454
	214,090	234,264

22 ACCOUNTS RECEIVABLE (continued)

Movements on the provision for impairment of accounts receivable are as follows:

	Group	
	2008	2007
	RMB'000	RMB'000
At 1st January	**234,264**	222,108
Provision for impairment of accounts receivable	**14,750**	16,734
Unused amounts reversed	**(15,793)**	(4,578)
Write-off	**(19,131)**	—
At 31st December	**214,090**	234,264

(b) Trade receivables from related parties are unsecured, non-interest bearing and are repayable in accordance with the relevant trading terms. Details of the balances with these related parties are disclosed in Note 40(b).

(c) Substantially all of the notes receivable are bank acceptance notes with average maturity period of within six months.

(d) Substantially all of the accounts receivable are denominated in RMB and the carrying amounts of accounts receivable approximate their fair values.

(e) Certain notes receivable were pledged as security for bank loans (Note 34(h)) as at 31st December 2007.

23 ADVANCES TO SUPPLIERS

	Group	
	2008	2007
	RMB'000	RMB'000
Advances to suppliers		
- Related parties (Note 40(b))	**87,243**	176,551
- Third parties	**227,493**	342,463
	314,736	519,014

In the ordinary course of business, the Group is required to make advance payments to certain suppliers according to the terms of respective agreements. The advance payments made to these parties are unsecured, non-interest bearing and will be settled or utilised in accordance with the terms of relevant agreements.

24 OTHER RECEIVABLES AND PREPAYMENTS

	Group		Company	
	2008	2007	**2008**	2007
	RMB'000	RMB'000	**RMB'000**	RMB'000
Advances for purchases of property, plant and equipment	**—**	4,788	**—**	—
Amounts due from customers for contract work (Note 26)	**367,843**	422,596	**—**	—
Dividends receivable from subsidiaries	**—**	—	**178,994**	151,128
Other advances from related parties (note)	**333,003**	250,885	**—**	—
Other receivables	**285,704**	379,485	**—**	—
Prepayments and deposits	**67,246**	56,000	**14,023**	—
Other current assets	**116,842**	89,783	**—**	230
	1,170,638	1,203,537	**193,017**	151,358

Note:

Other advances mainly represent current account balances with the respective related parties which are unsecured, non-interest bearing and are repayable on demand. Details of the balances with these related parties are disclosed in Note 40(b).

25 INVENTORIES

	Group	
	2008	2007
	RMB'000	RMB'000
Raw materials	**2,490,870**	2,272,486
Work in progress	**1,163,873**	924,117
Finished goods	**1,529,735**	2,163,933
Consumables	**88,598**	105,212
	5,273,076	5,465,748
Less: Provision for impairment losses	**(152,314)**	(188,221)
	5,120,762	5,277,527

The cost of inventories recognised as expense amounted to RMB 14,521,841,000 (2007: RMB 14,662,735,000).

26 CONTRACTS IN PROGRESS

	Group	
	2008	2007
	RMB'000	RMB'000
Contracts in progress at balance sheet date:		
Amounts due from customers for contract work (Note 24)	**367,843**	422,596
Contract costs incurred and recognised profits to date	**2,541,277**	3,031,092

At 31st December 2008, no retentions were held by customers for contract work and no advances were received on construction contracts (2007: Nil).

27 PLEDGED DEPOSITS

	Group	
	2008	2007
	RMB'000	RMB'000
Renminbi denominated deposits	**536,605**	638,350

As at 31st December 2008, trade finance facilities utilised by the Group for issuing notes payable to its suppliers amounting to RMB 1,460,105,000 (2007: RMB 1,487,488,000) were secured by these pledged deposits (Note 29(c)).

Pledged deposits earn interest at rates ranging from 0.36% to 3.78% (2007: 0.72% to 3.78%). The conversion of Renminbi denominated balances into foreign currencies is subject to the rules and regulations of foreign exchange control promulgated by the PRC Government.

28 TERM DEPOSITS WITH INITIAL TERM OF OVER THREE MONTHS

Term deposits with initial term of over three months are denominated in the following currencies:

	Group		Company	
	2008	2007	**2008**	2007
Currency	**RMB'000**	RMB'000	**RMB'000**	RMB'000
Renminbi *	**1,242,324**	645,000	**670,000**	615,000
Hong Kong Dollar	**17,638**	46,820	**17,638**	46,820
	1,259,962	691,820	**687,638**	661,820

The weighted average effective interest rates of the Group and the Company on term deposits with initial term of over three months were 2.55% (2007: 2.36%) and 3.27% (2007: 2.41%) per annum respectively.

* The conversion of Renminbi denominated balances into foreign currencies is subject to the rules and regulations of foreign exchange control promulgated by the PRC Government.

29 ACCOUNTS PAYABLE

	Group	
	2008	2007
	RMB'000	RMB'000
Trade payables (note (a))		
- Related parties (note (b))	**1,310,843**	807,856
- Third parties	**4,100,522**	4,122,331
	5,411,365	4,930,187
Notes payable (note (c))		
- Related parties (Note 40(b))	**735,074**	846,294
- Third parties	**1,072,152**	984,732
	1,807,226	1,831,026
	7,218,591	6,761,213

29 ACCOUNTS PAYABLE (continued)

Notes:

(a) The normal credit period for trade payables generally ranges from 0 to 6 months. Ageing analysis of trade payables is as follows:

	Group	
	2008	2007
	RMB'000	RMB'000
Current to 1 year	**4,909,432**	4,287,572
1 year to 2 years	**449,696**	489,816
2 years to 3 years	**4,188**	116,883
Over 3 years	**48,049**	35,916
	5,411,365	4,930,187

(b) Trade payables to related parties are unsecured, non-interest bearing and will be settled in accordance with the relevant trading terms. Details of the balances with these related parties are disclosed in Note 40(b).

(c) Substantially all of the notes payable are bank acceptance notes with average maturity period of within six months. As at 31st December 2008, notes payable of RMB 1,460,105,000 (2007: RMB 1,487,488,000) were secured by pledged deposits to the extent of RMB 536,605,000 (2007: RMB 638,350,000).

(d) The carrying amounts of accounts payable approximate their fair values.

30 ADVANCES FROM CUSTOMERS

	Group	
	2008	2007
	RMB'000	RMB'000
Advances from customers		
- Related parties	**380,764**	466,457
- Third parties	**307,986**	418,111
	688,750	884,568

In the ordinary course of the Group's business, certain of the Group's customers are required to pay advance deposits according to terms of the respective agreements. The advances from related parties are unsecured, non-interest bearing and will be settled or utilised in accordance with the terms of relevant agreements. Details of the balances with these related parties are disclosed in Note 40(b).

31 OTHER PAYABLES AND ACCRUALS

	Group		Company	
	2008	2007	**2008**	2007
	RMB'000	RMB'000	**RMB'000**	RMB'000
Payable for property, plant and equipment				
- Fellow subsidiaries (note (i))	**6,992**	6,767	**—**	—
- Others	**114,268**	130,583	**—**	—
Wages, salaries and bonuses payables	**283,131**	308,234	**623**	137
Accrued expenses	**321,336**	356,613	**4,824**	4,705
Deferred income from government grants	**73,445**	17,755	**—**	—
Consumption tax, business tax and other taxes payable	**25,394**	31,253	**13**	50
Other advances (note (ii))				
- Ultimate holding company	**2,940**	13,680	**9,420**	12,240
- Fellow subsidiaries	**302,904**	161,971	**15,891**	14,322
- Other related parties	**—**	1,795	**—**	—
Payable relating to share reform	**—**	96,029	**—**	—
Other current liabilities	**233,767**	199,663	**—**	—
	1,364,177	1,324,343	**30,771**	31,454

Notes:

(i) Payable for property, plant and equipment is unsecured, non-interest bearing and will be settled in accordance with the relevant trading terms.

(ii) Other advances mainly represent current account balances with the respective related parties which are unsecured, non-interest bearing and are repayable on demand.

Details of the balances with these related parties are disclosed in Note 40(b).

32 AMOUNTS PAYABLE TO ULTIMATE HOLDING COMPANY

	Group		Company	
	2008	2007	**2008**	2007
	RMB'000	RMB'000	**RMB'000**	RMB'000
Supplementary pension subsidies (note (a))	**464,298**	464,298	**464,298**	464,298
One-off housing benefit (note (b))	**56,226**	56,226	**—**	—
	520,524	520,524	**464,298**	464,298

Notes:

(a) Prior to the Reorganisation, the Group paid supplementary pension subsidies to its retired employees who retired prior to the Reorganisation. In addition, the Group was committed to make periodic benefits payments to certain former employees who retired early in accordance with various rationalisation programmes adopted by the Group prior to the Reorganisation. Pursuant to the Reorganisation, the Group and AVIC II agreed that, upon establishment of the Company, the Group's obligations to make these supplementary pension benefits and early retirement payments as at 30th June 2002 were assumed by AVIC II and the actual payments of these obligations will be made by AVIC II. The Group is not obliged to any further liabilities in respect of these supplementary pension benefits and early retirement payments to these former employees after 30th June 2002. The above obligations were actuarially determined by a PRC insurance company using the projected unit credit method and are repayable to AVIC II with no fixed repayment terms under the Reorganisation. The balance is unsecured and non-interest bearing.

(b) This represents provision made by a subsidiary in connection with one-off housing subsidies for its eligible employees as at 31st December 2000 as detailed in Note 3(p)(iii). AVIC II has undertaken to bear any final actual cash settlement to those eligible employees in excess of RMB 56,226,000. During 2006, it was agreed that such one-off housing subsidies and future settlements shall be handled by AVIC II and accordingly the balance payable was transferred to AVIC II.

During the year AVIC Group undertook all the assets and liabilities of AVIC I and AVIC II upon their merger on 6th November 2008 as detailed in Note 1. Accordingly the above amounts became payable to AVIC Group as of 31st December 2008.

33 PROVISIONS

	Group Warranty RMB'000
As at 1st January 2008	**174,431**
Additional provisions	**141,839**
Utilised during the year	**(111,142)**
As at 31st December 2008	**205,128**
As at 1st January 2007	103,284
Additional provisions	246,903
Utilised during the year	(171,364)
Effect on proportionate consolidation of a jointly controlled entity (Note 3(a)(iii))	(4,392)
As at 31st December 2007	174,431

Note:

The Group provides warranties to its customers on certain automobile and aviation products and undertakes to repair or replace items that fail to perform up to certain specified standard. Provision for expected warranty claims has been determined based on historical warranty information after taking into account of the Group's recent claim experience.

34 BORROWINGS

	Group 2008 RMB'000	Group 2007 RMB'000
Short-term borrowings		
Bank borrowings		
- Secured (note (h))	**3,423,774**	2,664,794
- Unsecured	**1,066,630**	1,637,369
	4,490,404	4,302,163
Other short-term borrowings		
- Secured (notes (c)(i) and (h))	**100,000**	—
- Unsecured (note (c)(ii))	**320,000**	10,000
	4,910,404	4,312,163
Current portion of long-term borrowings	**728,000**	650,457
	5,638,404	4,962,620
Long-term borrowings		
Bank borrowings		
- Secured (note (h))	**1,442,890**	1,611,890
- Unsecured	**60,000**	—
	1,502,890	1,611,890
Other borrowings		
- Secured (note (h))	**9,301**	10,650
- Unsecured (note (d))	**150,000**	139,457
	159,301	150,107
	1,662,191	1,761,997
Less: Current portion of long-term borrowings	**(728,000)**	(650,457)
	934,191	1,111,540
Total borrowings	**6,572,595**	6,074,160

34 BORROWINGS (continued)

Notes:

(a) The long-term borrowings are analysed as follows:

	Group	
	2008	2007
	RMB'000	RMB'000
Wholly repayable within five years		
- Bank borrowings	**1,217,000**	1,340,000
- Other borrowings	**150,000**	139,457
	1,367,000	1,479,457
Not wholly repayable within five years		
- Bank borrowings	**285,890**	271,890
- Other borrowings	**9,301**	10,650
	295,191	282,540
	1,662,191	1,761,997

(b) The long-term borrowings are repayable as follows:

	Group	
	2008	2007
	RMB'000	RMB'000
Bank borrowings:		
- Within one year	**578,000**	511,000
- In the second year	**370,000**	319,000
- In the third to fifth year	**269,000**	510,000
- After the fifth year	**285,890**	271,890
	1,502,890	1,611,890
Other borrowings:		
- Within one year	**150,000**	139,457
- After the fifth year	**9,301**	10,650
	159,301	150,107
	1,662,191	1,761,997

34 BORROWINGS (continued)

Notes: (continued)

(c) (i) As at 31st December 2008, other short-term secured borrowings represented a loan granted by a fellow subsidiary of the Group which bears interest at 5.045% per annum and is repayable in full in 2009;

(ii) As at 31st December 2008, other short-term unsecured borrowings represented:

— loans of RMB 310,000,000 granted by certain unrelated parties of the Group which bear interest at 4.374% per annum and are repayable in full in 2009; and

— a loan of RMB 10,000,000 (2007: RMB 10,000,000) granted by Shenzhen Finance Bureau to a subsidiary of the Group which is non-interest bearing and is repayable on demand.

(d) Other long-term borrowings

Other long-term unsecured borrowings represent a loan granted by Shenzhen Finance Bureau to a subsidiary of the Group which is non-interest bearing and is repayable on demand as at 31st December 2008.

(e) The exposure of the total borrowings of the Group to interest rate changes is as follows:

	Group	
	2008	2007
	RMB'000	RMB'000
Bank borrowings		
- Fixed rates	**3,121,795**	2,830,963
- Floating rates	**2,871,499**	3,083,090
	5,993,294	5,914,053
Other borrowings		
- Fixed rates	**579,301**	160,107
	6,572,595	6,074,160

The annual effective interest rates of long-term and short-term borrowings at balance sheet date were as follows:

	Group	
	2008	2007
	RMB'000	RMB'000
Weighted average effective interest rates		
- Bank borrowings	**6.13%**	6.39%
- Other borrowings	**3.24%**	0.07%

34 BORROWINGS *(continued)*

Notes: (continued)

(f) The carrying amounts of long-term and short-term borrowings are denominated in the following currencies:

	Group	
Currency	**2008**	2007
	RMB'000	RMB'000
Renminbi	**6,285,599**	5,536,316
United States Dollar	**139,751**	10,650
Euro	**48,295**	455,500
Others	**98,950**	71,694
	6,572,595	6,074,160

(g) The carrying amount and fair value of non-current portion of long-term borrowings are as follows:

	Group			
	Carrying amount		Fair value	
	2008	2007	**2008**	2007
	RMB'000	RMB'000	**RMB'000**	RMB'000
Bank borrowings	**924,890**	1,100,890	**916,837**	1,027,450
Other borrowings	**9,301**	10,650	**5,582**	4,359
	934,191	1,111,540	**922,419**	1,031,809

The fair values are based on discounted cash flows using applicable discount rates based upon the prevailing market rates of interest available to the Group for financial instruments with substantially the same terms and characteristic as at the balance sheet dates. Such discount rates ranged from 5.40% to 5.94% as at 31st December 2008 (2007: 7.56% to 7.83%), depending on the type of the debt.

(h) The Group's long-term and short-term borrowings are secured as follows:

	Group	
	2008	2007
	RMB'000	RMB'000
Securities over the Group's assets, at carrying value		
- Property, plant and equipment, at net book value (Note 15(a))	**507,134**	542,303
- Notes receivable (Note 22(e))	**—**	59,866
Guarantees provided by		
- Related parties (Note 40(c))	**2,001,345**	480,540
- Subsidiaries within the Group (cross guarantees)	**2,773,620**	3,702,094
- Third parties	**—**	50,000

34 BORROWINGS (continued)

Notes: (continued)

(i) As at 31st December 2008, the Group had the following undrawn committed borrowing facilities.

	Group	
	2008	2007
	RMB'000	RMB'000
At floating rates		
- Expiring within one year	**1,579,509**	—
- Expiring beyond one year	**200,000**	1,476,567
	1,779,509	1,476,567

35 SHARE CAPITAL

	Company	
	2008	2007
	RMB'000	RMB'000
Registered:	**4,643,609**	4,643,609
Issued and fully paid:		
2,963,808,000 Domestic Shares of RMB 1 each	**2,963,808**	2,963,808
1,679,800,500 H Shares of RMB 1 each	**1,679,801**	1,679,801
	4,643,609	4,643,609

The H Shares rank pari passu in all respects with the Domestic Shares and rank equally for all dividends or distributions declared, paid or made except that all dividends in respect of H Shares are to be paid by the Company in Hong Kong dollars and H Shares may only be subscribed for by, and traded in Hong Kong dollars between legal or natural persons of Hong Kong, Macau, Taiwan or any other country other than the PRC. The transfer of the Domestic Shares is subject to such restrictions as the PRC laws may impose from time to time.

36 RESERVES

	Company			
	Capital reserve	Statutory surplus reserve	Accumulated losses	Total
	RMB'000	RMB'000	RMB'000	RMB'000
	(Note (b))	(Note (c))	(Note (d))	
Balance at 1st January 2008	(2,073)	31,178	(630,475)	(601,370)
Profit for the year	—	—	119,047	119,047
As at 31st December 2008	(2,073)	31,178	(511,428)	(482,323)
Balance at 1st January 2007	(2,073)	26,712	(163,421)	(138,782)
Loss for the year	—	—	(462,588)	(462,588)
Transfer to statutory reserve	—	4,466	(4,466)	—
As at 31st December 2007	(2,073)	31,178	(630,475)	(601,370)

Notes:

(a) Movements in the reserves of the Group are set out in the consolidated statement of changes in equity on pages 55 to 56.

(b) Capital reserve

Capital reserve of the Company represents the difference between the amount of share capital issued by the Company and the historical net value of the assets, liabilities and interests transferred to the Company upon its establishment, set off by net premium on issue of shares upon listing of the Company.

Capital reserves of the Group also included reserves arising from the issuance of additional shares by a subsidiary, capital contributions in associates and gains/losses on disposals to minority interests (Note 36(e)).

(c) Statutory surplus reserve

In accordance with the relevant PRC laws and financial regulations, every year the Company is required to transfer 10% of the profit after taxation determined in accordance with the PRC accounting standards to the statutory surplus reserve until the balance reaches 50% of the paid-up share capital. Such reserve can be used to reduce any losses incurred and to increase share capital. Except for the reduction of losses incurred, any other usage should not result in this reserve balance falling below 25% of the registered capital.

(d) Retained earnings available for distribution

In accordance with the relevant PRC regulations and Articles of Association of the Company, retained earnings available for distribution by the Company will be deemed to be the lower of the amounts determined in accordance with the PRC GAAP and the amount determined in accordance with IFRS. As at 31st December 2007 and 2008, there were no retained earnings available for distribution under both PRC GAAP and IFRS.

36 RESERVES (continued)

Notes:

(e) Disposal of certain interests in a subsidiary

During the year the Group disposed of an aggregate of 16,140,000 A shares of Jiangxi Changhe Automobile Co., Ltd. ("Changhe Automobile") representing 3.94% of its total share capital, at market price.

In accordance with the Group's accounting policy, transactions with minority shareholders are dealt with in reserves. Accordingly, the aggregate effect on the gain on disposal of equity interests in Changhe Automobile of RMB 152,948,000 was accounted for as an addition to the Group's equity in the consolidated financial statements for the year ended 31st December 2008.

In the Company's financial statements, the effect of disposal of the Company's directly owned equity interests in Changhe Automobile totalling RMB 93,799,000 was credited directly to the Company's income statement for the year ended 31st December 2008.

37 CONSOLIDATED CASH FLOW STATEMENT

(a) Cash generated from operations

	Group	
	2008	2007
	RMB'000	RMB'000
Loss before income tax	**(721,899)**	(796,709)
Adjustments for:		
Share of results of associates	**(40,068)**	(56,711)
Loss/(gain) on disposal of		
- Property, plant and equipment	**9,082**	(16,838)
- Certain interests in subsidiaries	**—**	(32,440)
- Associates	**(794)**	—
- Available-for-sale financial assets	**(36,112)**	—
Amortisation of		
- Intangible assets	**58,826**	58,875
- Land use rights	**9,712**	6,229
Amortisation of deferred income relating to government grants	**(17,755)**	(33,161)
Depreciation on property, plant and equipment	**1,277,498**	1,025,292
Write-off of intangible assets	**33,869**	83,117
Provision/(reversal of provision) for impairment		
- Property, plant and equipment	**—**	243,421
- Intangible assets	**—**	5,958
- Available-for-sale financial assets	**—**	(1,326)
- Receivables	**9,705**	13,067
- Inventories	**7,914**	121,875
Dividend income from available-for-sale financial assets	**(2,428)**	(4,870)
Interest income	**(79,280)**	(57,966)
Interest expense	**412,469**	338,815
	920,739	896,628
Changes in working capital (excluding the effects of disposals of subsidiaries):		
- (Increase)/decrease in accounts receivable	**(520,968)**	289,938
- Decrease/(increase) in advances to suppliers, other receivables and prepayments	**341,771**	(284,615)
- Decrease/(increase) in inventories	**148,851**	(851,867)
- Increase in financial assets at fair value through profit or loss	**(4,074)**	(7,414)
- Increase in accounts payable	**457,378**	57,108
- (Decrease)/increase in advance from customers, other payables and accruals	**(342,000)**	328,073
- Increase in provisions	**30,697**	75,539
Net cash generated from operations	**1,032,394**	503,390

37 CONSOLIDATED CASH FLOW STATEMENT (continued)

(b) In the cash flow statement, proceeds from sale of property, plant and equipment comprise:

	Group	
	2008	2007
	RMB'000	RMB'000
Net book amount (Note 15)	**116,134**	261,699
(Loss)/gain on sale of property, plant and equipment (Note 7)	**(9,082)**	16,838
Receivables from sale of property, plant and equipment	**(105,200)**	(263,718)
Proceeds from sale of property, plant and equipment	**1,852**	14,819

(c) Disposal of a subsidiary

	Group	
	2008	2007
	RMB'000	RMB'000
Property, plant and equipment	**—**	516
Current assets	**—**	43,588
Total assets	**—**	44,104
Total liabilities	**—**	(51)
Minority interests	**—**	(2,203)
Net assets sold	**—**	41,850
Total consideration	**—**	41,850
Result on disposal of a subsidiary	**—**	—
Net cash outflow from disposal is determined as follows:		
Proceeds received from disposal of a subsidiary	**—**	41,850
Less: Cash and cash equivalents in a subsidiary disposed	**—**	(43,409)
Net cash outflow from disposal of a subsidiary	**—**	(1,559)

37 CONSOLIDATED CASH FLOW STATEMENT (continued)

(d) Analysis of cash and cash equivalents

	Group		Company	
	2008	2007	**2008**	2007
	RMB'000	RMB'000	**RMB'000**	RMB'000
Bank balances and cash	**2,124,130**	2,375,706	**232,026**	98,266
Term deposits with initial term of less than three months	**200,000**	77,000	**—**	45,000
	2,324,130	2,452,706	**232,026**	143,266

The cash and cash equivalents are denominated in the following currencies:

	Group		Company	
	2008	2007	**2008**	2007
	RMB'000	RMB'000	**RMB'000**	RMB'000
Renminbi*	**2,285,801**	2,384,976	**230,370**	140,916
Other currencies	**38,329**	67,730	**1,656**	2,350
	2,324,130	2,452,706	**232,026**	143,266

The weighted average effective interest rate of the Group and the Company on term deposits with initial term of less than three months was 1.71% (2007: 1.71%) per annum. Bank balances earn interest at floating rates based on daily bank deposit rates.

* The conversion of these RMB denominated balances into foreign currencies is subject to the rules and regulations of foreign exchange control promulgated by the PRC Government.

38 COMMITMENTS

(a) Capital commitments

The Group has the following capital commitments not provided for as at 31st December 2008:

	Group	
	2008	2007
	RMB'000	RMB'000
Acquisition of property, plant and equipment		
- Authorised but not contracted for	**998,476**	48,557
- Contracted but not provided for	**313,690**	228,001
	1,312,166	276,558
Construction commitments		
- Authorised but not contracted for	**30,000**	14,070
- Contracted but not provided for	**13,012**	57,846
	43,012	71,916
Investment in a jointly controlled asset		
- Contracted but not provided for	**—**	40,764
Investments in an associate		
- Contracted but not provided for	**34,000**	88,175
	1,389,178	477,413

38 COMMITMENTS (continued)

(b) Operating lease commitments

The Group has commitments to make the following future minimum lease payments under non-cancellable operating leases as at 31st December 2008:

	Group	
	2008	2007
	RMB'000	RMB'000
Land and buildings		
- Not later than one year	**27,110**	17,406
- Later than one year and not later than five years	**39,690**	47,170
- Later than five years	**10,798**	21,426
	77,598	86,002

Generally, the Group's operating leases are for terms of 1 to 20 years.

(c) The Company did not have any significant commitment as at 31st December 2008 (2007: Nil).

39 INTEREST IN A JOINTLY CONTROLLED ENTITY

Particulars of the jointly controlled entity of the Group as at 31st December 2008 are set out in Note 43.

The following amounts represent the Group's share of the jointly controlled entity's assets and liabilities as at 31st December 2008, and the Group's share of its income and results for the year then ended, which are included in the Group's consolidated balance sheet and consolidated income statement:

	2008	2007
	RMB'000	RMB'000
Assets:		
Non-current assets	**1,002,813**	1,097,546
Current assets	**641,615**	609,947
	1,644,428	1,707,493
Liabilities:		
Non-current liabilities	**10,080**	—
Current liabilities	**1,190,041**	1,033,513
	1,200,121	1,033,513
Net assets	**444,307**	673,980
Income	**1,297,537**	1,263,021
Expenses	**(1,527,210)**	(1,685,139)
Net loss	**(229,673)**	(422,118)
Proportionate interest in the jointly controlled entity's capital commitments	**111,731**	92,729

The jointly controlled entity did not have any material operating lease commitments as at 31st December 2008 (2007: Nil).

There are no contingent liabilities relating to the Group's interest in the jointly controlled entity and the jointly controlled entity did not have any material contingent liabilities as at 31st December 2008 (2007: Nil).

40 SIGNIFICANT RELATED PARTY TRANSACTIONS

The Group is controlled by AVIC Group (2007: AVIC II), which owns 61.06% of the Company's shares as at 31st December 2008. The remaining 38.94% of the shares are widely held.

Related parties refer to entities in which AVIC Group (2007: AVIC II) has the ability, directly or indirectly, to control the other party or exercise significant influence over the other party in making financial and operating decisions; or directors or officers of the Company and of its ultimate holding company, associates or jointly controlled entity. Given that the PRC government still owns a significant portion of the productive assets in the PRC despite the continuous reform of the government structure, a majority of the Group's business activities had been conducted with enterprises directly or indirectly owned or controlled by the PRC government ("state-owned enterprises"), including AVIC Group (2007: AVIC II), its subsidiaries, associates and jointly controlled entities in the ordinary course of business.

In accordance with IAS 24, "Related Party Disclosures", state-owned enterprises and their subsidiaries, other than entities under AVIC Group (2007: AVIC II) (also a state-owned enterprise), directly or indirectly controlled by the PRC government are also defined as related parties of the Group. Neither AVIC Group (2007: AVIC II) nor the PRC government publishes financial statements for public use. In the normal course of the Group's business, it may either enter into various transactions with one or more of such state-owned enterprises and their subsidiaries.

40 SIGNIFICANT RELATED PARTY TRANSACTIONS (continued)

The following is a summary of significant related party transactions entered into in the ordinary course of business between the Group and its related parties and the balances arising from related party transactions in addition to the related party information shown elsewhere in the financial statements. Management of the Group are of the opinion that meaningful information relating to related party disclosures has been adequately disclosed.

(a) Significant transactions with related parties:

	Group	
	2008	2007
	RMB'000	RMB'000
Income		
Revenue from sale of goods and materials		
- Fellow subsidiaries	**4,467,323**	4,685,494
- A jointly controlled entity	**141,498**	163,066
- Other related parties	**—**	14,948
- Other state-owned enterprises	**882,020**	1,115,196
Income from rendering of services		
- Fellow subsidiaries	**1,438**	11,857
Expenses		
Purchases of goods and raw materials		
- Fellow subsidiaries	**1,849,753**	2,553,654
- A jointly controlled entity	**48,732**	34,445
- Other related parties	**147,632**	248,272
- Other state-owned enterprises	**62,372**	1,206,301
Service fees payable		
- Fellow subsidiaries	**204,606**	166,988
- Other related parties	**91,247**	14,067
- Other state-owned enterprises	**243**	63,654
Rental expenses		
- Fellow subsidiaries	**31,770**	41,892
Interest expense		
- Other state-owned enterprises	**359,590**	355,140
Key management compensations		
- Salaries, bonuses and other welfares	**2,715**	2,648

Notes:

In the opinion of the directors of the Company, the above transactions were carried out in the ordinary course of the Group's business and were determined based on mutually agreed terms.

40 SIGNIFICANT RELATED PARTY TRANSACTIONS (continued)

(b) Significant balances with related parties:

	Group	
	2008	2007
	RMB'000	RMB'000
Assets		
Trade receivables		
- Fellow subsidiaries	**1,415,068**	992,205
- A jointly controlled entity	**266,370**	109,007
- Other related parties	**862**	949
- Other state-owned enterprises	**58,597**	63,330
Notes receivable		
- Fellow subsidiaries	**520,600**	209,000
Advances to suppliers		
- Fellow subsidiaries	**71,923**	76,718
- A jointly controlled entity	**904**	—
- Other related parties	**14,283**	6,242
- Other state-owned enterprises	**133**	93,591
Other receivables and prepayments		
- Ultimate holding company	**4,522**	6,011
- Fellow subsidiaries	**189,808**	181,181
- A jointly controlled entity	**50,028**	43,051
- Other related parties	**18,084**	20,258
- Other state-owned enterprises	**70,561**	384
Pledged deposits		
- Other state-owned enterprises	**536,605**	638,350
Term deposits with initial term of over three months		
- Other state-owned enterprises	**1,109,962**	691,820
Cash and cash equivalents deposited with		
- Other state-owned enterprises	**2,257,898**	2,126,852

40 SIGNIFICANT RELATED PARTY TRANSACTIONS (continued)

(b) Significant balances with related parties: (continued)

	Group	
	2008	2007
	RMB'000	RMB'000
Liabilities		
Trade payables		
- Fellow subsidiaries	**928,432**	529,067
- A jointly controlled entity	**17,565**	2,774
- Other related parties	**15,523**	8,372
- Other state-owned enterprises	**349,323**	267,643
Notes payable		
- Fellow subsidiaries	**468,566**	366,881
- Other state-owned enterprises	**266,508**	479,413
Advances from customers		
- Fellow subsidiaries	**359,486**	405,917
- Other state-owned enterprises	**21,278**	60,540
Other payables and accruals		
- Ultimate holding company	**2,940**	13,680
- Fellow subsidiaries	**309,896**	168,738
- A jointly controlled entity	**—**	192
- Other state-owned enterprises	**—**	1,603
Amounts payable to ultimate holding company	**520,524**	520,524
Bank borrowings		
- Other state-owned enterprises	**5,003,141**	5,161,985

40 SIGNIFICANT RELATED PARTY TRANSACTIONS (continued)

(c) Other items:

	Group	
	2008	2007
	RMB'000	RMB'000
Guarantees on bank loans granted to the Group from		
- Ultimate holding company	**1,167,590**	389,890
- Fellow subsidiaries	**594,301**	90,650
- Other related parties	**239,454**	—

In addition, AVIC Group (2007: AVIC II) granted certain leasehold land for the Group's use at no cost, details of which are disclosed in Note 15(b).

(d) Whilst other state-owned enterprises are related parties of the Group as defined under IAS 24, the directors are of the opinion that each party is operating independently; and the above balances are arising in the ordinary course of the Group's businesses. Details of these balances are included under Notes 27, 28, 34 and 37(d) to the financial statements.

41 FINANCIAL RISK MANAGEMENT

(a) Financial risk factors

The Group's activities expose it to a variety of financial risks: market risks (including: foreign exchange risk, interest-rate risk and price risk), credit risk and liquidity risk. The Group's overall risk management programme focuses on the unpredictability of financial markets and seeks to minimise potential adverse effects on the Group's financial performance. The use of financial derivatives to hedge certain risk exposures is governed by the Group's policies approved by the board of directors. The Group does not use derivative financial instruments for speculative purposes.

(i) Foreign exchange risk

The Group mainly operates in the PRC with most of the transactions settled in RMB. Foreign exchange rate risk arises when future commercial translation or recognised assets and liabilities are denominated in a currency that is not the entity's functional currency. The Group is exposed to foreign exchange risk primarily with respect to the United States Dollar, Euro and Hong Kong Dollar.

The Group's assets and liabilities, and transactions arising from its operations primarily do not expose to material foreign exchange risk. Other than certain term deposits, bank balances and borrowings, the Group's assets and liabilities are primarily denominated in RMB. The Group generates RMB from sales in the PRC to meet its liabilities denominated in RMB. The Group has not used any forward contracts to hedge its exposure as the cost-benefit is considered not effective.

As at 31st December 2007 and 2008, certain of the Group's borrowings (Note 34), term deposits and bank balances (Notes 28 and 37(d)) were denominated in foreign currencies. RMB experienced certain appreciation in recent years which is the major reason for the exchange differences recognised by the Group for the years ended 31 December 2007 and 2008. Further appreciation or depreciation of RMB against these currencies will affect the Group's financial position and results of operations.

However, as foreign currency denominated assets and liabilities are relatively insignificant to the Group, management considers that the Group's volatility against changes in exchange rates of foreign currencies would not be significant. Accordingly, no sensitivity analysis is presented for foreign exchange risk.

41 FINANCIAL RISK MANAGEMENT (continued)

(a) Financial risk factors (continued)

(ii) Cash flow and fair value interest-rate risk

The Group's income and operating cash flows are substantially independent of changes in market interest rates and the Group has no significant interest-bearing assets except for the bank deposits and cash and cash equivalents, details of which have been disclosed in Notes 27, 28 and 37(d). The Group's exposure to changes in interest rates is mainly attributable to its borrowings, details of which have been disclosed in Note 34. Borrowings carried at floating rates expose the Group to cash flow interest-rate risk whereas those carried at fixed rates expose the Group to fair value interest-rate risk. As of 31st December 2008, 56% (2007: 49%) of the Group's borrowings were at fixed rates. The Group has not used any interest rate swaps to hedge its exposure to interest rate risk.

At 31st December 2008, if the interest rates on bank borrowings, deposits and bank balances had been 50 basis points higher/lower than the prevailing rate announced by People's Bank of China, with all other variables held constant, loss for the year would have been RMB 4,684,000 (2007: RMB 2,250,000) lower/ higher.

(iii) Price risk

The Group is exposed to equity securities price risk in respect of investments held by the Group which are classified as available-for-sale financial assets and financial assets at fair value through profit or loss. Some of these financial assets are publicly traded in recognised stock exchanges. At 31st December 2008, if the quoted market price of these equity investments held by the Group had increased/decreased by 10%, with all other variables held constant, loss for the year would have been RMB 861,600 (2007: RMB 556,000) lower/higher and equity would have been RMB 14,147,000 (2007: RMB 39,654,000) higher/lower as a result of the changes in fair value of financial assets at fair value through profit or loss and available-for-sale financial assets.

41 FINANCIAL RISK MANAGEMENT (continued)

(a) Financial risk factors (continued)

(iv) Credit risk

The carrying amounts of bank deposits and balances, receivables, available-for-sale financial assets and financial assets at fair value through profit or loss included in the consolidated balance sheet represent the Group's maximum exposure to credit risk in relation to its financial assets.

95% (2007: 91%) of the Group's pledged deposits, term deposits and cash and cash equivalents are held in state-owned financial institutions, which management believes are of high credit quality. Most of the Group's available-for-sale financial assets and financial assets at fair value through profit or loss are also publicly traded in recognised stock exchanges. Management does not expect any losses from non-performance by these counterparties.

The Group has no significant concentrations of credit risk. The carrying amount of receivables included in the consolidated balance sheet represents the Group's maximum exposure to credit risk in relation to these financial assets. Ageing analysis of the Group's accounts receivable is disclosed in Note 22. The Group has policies in place to ensure that sales of products and services are made to customers with an appropriate credit history and the Group performs periodic credit evaluations of its customers. Normally, the Group does not require collaterals from trade debtors. Management makes periodic collective assessment as well as individual assessment on the recoverability of account and other receivables based on historical payment records, the length of the overdue period, the financial strength of the debtors and whether there are any disputes with the relevant debtors. The Group's historical experience in collection of trade and other receivables falls within the recorded allowances and the directors are of the opinion that adequate provision for uncollectible receivables has been made in the financial statements.

(v) Liquidity risk

Prudent liquidity risk management implies maintaining sufficient cash and cash equivalents and the availability of funding through an adequate amount of committed credit facilities.

The Group's primary cash requirements have been for additions of and upgrades on property, plant and equipment, payment on related debts and payment for purchases and operating expenses. The Group finances its working capital requirements through a combination of internal resources and long-term and short-term bank borrowings.

As at 31st December 2008, the net current liabilities of the Group amounted to RMB 1,266,590,000 (2007: RMB 674,404,000). Management monitors regularly the Group's current and expected liquidity requirements to ensure it maintains sufficient cash and cash equivalents and has available funding through adequate amount of committed banking facilities to meet its working capital requirements. The amount of undrawn credit facilities at the balance sheet date are disclosed in Note 34 to the financial statements. The directors believe that the Group's current operating cash flows and credit facilities from PRC banks are sufficient for financing its capital commitments in the near future and for working capital purposes.

41 FINANCIAL RISK MANAGEMENT (continued)

(a) Financial risk factors (continued)

(v) Liquidity risk (continued)

The table below analyses the Group's and the Company's financial liabilities into relevant maturity groupings based on the remaining period at the balance sheet date to the contractual maturity date. The amounts disclosed in the table are the contractual undiscounted cash flows.

	Less than 1 year RMB'000	Between 1 and 2 years RMB'000	Between 2 and 5 years RMB'000	Over 5 years RMB'000
Group				
At 31st December 2008				
Bank and other borrowings	**6,027,434**	**421,816**	**348,107**	**314,603**
Accounts and other payables	**8,582,768**	**—**	**—**	**—**
Amounts payable to ultimate holding company	**520,524**	**—**	**—**	**—**
At 31st December 2007				
Bank and other borrowings	5,295,282	337,024	534,143	299,700
Accounts and other payables	8,085,556	—	—	—
Amounts payable to ultimate holding company	520,524	—	—	—
Company				
At 31st December 2008				
Other payables	**30,771**	**—**	**—**	**—**
Amounts payable to ultimate holding company	**464,298**	**—**	**—**	**—**
At 31st December 2007				
Other payables	31,454	—	—	—
Amounts payable to ultimate holding company	464,298	—	—	—

41 FINANCIAL RISK MANAGEMENT (continued)

(b) Capital risk management

The Group's objectives when managing capital are to safeguard the Group's ability to continue as a going concern in order to provide returns for shareholders and to maintain an optimal capital structure to reduce the cost of capital.

In order to maintain or adjust the capital structure, the Group may consider the macro economic conditions, prevailing borrowing rates in the market and adequacy of cash flows generating from operations and may raise funding through capital market or bank borrowings as necessary.

The Group monitors capital on the basis of the gearing ratio. This ratio is calculated as net debt divided by total capital. Net debt is calculated as total borrowings as shown in the consolidated balance sheet less cash and cash equivalents. Total capital is calculated as equity, as shown in the consolidated balance sheet, plus net debt.

During 2008, the Group's strategy, which was unchanged from 2007, was to maintain a stable gearing ratio. The gearing ratios at 31st December 2008 and at 31st December 2007 were as follows:

	Group	
	2008	2007
	RMB'000	RMB'000
Total borrowings	**6,572,595**	6,074,160
Less: Cash and cash equivalents (Note 37(d))	**(2,324,130)**	(2,452,706)
Net debt	**4,248,465**	3,621,454
Total equity	**5,573,538**	6,658,395
Total capital	**9,822,003**	10,279,849
Gearing ratio	**43%**	35%

The increase in the gearing ratio during 2008 resulted primarily from the decrease in total equity as a result of the loss for the year.

41 FINANCIAL RISK MANAGEMENT (continued)

(c) Fair value estimation

The fair value of financial instruments traded in active markets is based on quoted market prices at the balance sheet date. The quoted market price used for financial assets held by the Group is the current bid price.

The fair value of financial instruments that are not traded in an active market is determined by using valuation techniques. The Group uses a variety of methods and makes assumptions that are based on market conditions existing at each balance sheet date. Quoted market prices or dealer quotes for similar instruments are used for long-term debt. Other techniques, such as estimated discounted cash flows, are used to determine fair value for the remaining financial instruments. As detailed in Note 20 to the financial statements, there are no quoted market price in an active market for certain of the Group's available-for-sale financial assets in the PRC and for which the range of other methods of reasonably estimating fair value is significant and the probabilities of the various estimates cannot be reasonably assessed without incurring excessive costs. Accordingly, these investments are carried at cost less accumulated impairment losses.

The carrying amounts of the Group's current financial assets, including cash and cash equivalents, deposits, trade receivables, notes receivable and other receivables, and the Group's current financial liabilities, including trade and other payables and current borrowings, approximate their fair values. The fair value of non-current portion of borrowings are disclosed in Note 34 to the financial statements.

The carrying amounts of financial assets and liabilities with a maturity of less than one year are assumed to approximate their fair values. The fair value of financial liabilities for disclosure purposes is estimated by discounting the future contractual cash flows at the current market interest rate available to the Group for similar financial instruments.

42 SUBSEQUENT EVENTS

(a) Proposed transaction between Jiangxi Changhe Automobile Co., Ltd. ("Changhe Automobile") and AVIC Group

(i) Nature of the transaction

On 9th October 2008, Changhe Automobile, a subsidiary of the Company, and AVIC Group entered into a sale and purchase agreement, pursuant to which Changhe Automobile will conditionally:

- acquire from AVIC Group the entire equity interests in Shanghai Aviation Electric Co., Ltd. ("Shanghai Aviation") and Lanzhou Wanli Aviation Electrical Co., Ltd. ("Lanzhou Aviation");
- dispose of its entire assets and liabilities to AVIC Group; and
- issue consideration shares to AVIC Group.

The proposed transaction was approved by the independent shareholders of the Company on 15th December 2008. Up to the date of this report, completion of the transaction is conditional upon, among other things, the fulfillment of several conditions including the approval by the China Securities Regulatory Commission.

Upon completion of the transaction, Changhe Automobile will:

- dispose of its entire existing businesses, which recorded a loss of approximately RMB 400 million for the year ended 31st December 2008;
- acquire Shanghai Aviation and Lanzhou Aviation, which had an aggregate net current assets and net assets of approximately RMB 292 million and RMB 581 million respectively as at 31st December 2008; and
- allot and issue 74,625,174 consideration shares to AVIC Group.

42 SUBSEQUENT EVENTS (continued)

(a) Proposed transaction between Jiangxi Changhe Automobile Co., Ltd. ("Changhe Automobile") and AVIC Group (continued)

(ii) Estimated financial effect to the Group

The Group will commence to account for the business combinations with Shanghai Aviation and Lanzhou Aviation from the effective date when Changhe Automobile gains control over the relevant companies and businesses.

Given that Changhe Automobile, Shanghai Aviation and Lanzhou Aviation are all under common control of the PRC government before and after the business combinations, the Company will apply the principles of merger accounting in preparing the consolidated financial statements of the Group after those business combinations become effective, which is expected to be completed during the year ending 31st December 2009.

By applying the principles of merger accounting, the consolidated financial statements of the Group will include the results of the existing businesses of Changhe Automobile up to the date when Changhe Automobile disposes of its entire then existing assets and liabilities to AVIC Group. The consolidated financial statements of the Group will also include the financial positions, results and cash flows of those companies comprising the Group, when the business combination becomes effective, as if the resulting group structure had been in existence throughout the year. Comparative figures as at 31st December 2008 and for the year then ended will be re-presented on the same basis. However, since the aggregate results and financial positions of Shanghai Aviation and Lanzhou Aviation are relatively immaterial to the Group, the restatement of the comparative figures is not expected to significantly affect the Group's overall financial position and results as of and for the year ended 31st December 2008.

In addition, based on the directors' best estimates, as the value of net assets to be received by Changhe Automobile is likely to exceed the value of its aggregate considerations to be given, a gain is expected to arise from the proposed transaction which will be credited to the equity of the Group.

(b) Proposed disposal of Hafei Automobile to AVIC Group

Pursuant to a board resolution passed on 9th April 2009, the Group will dispose of its entire interest in a subsidiary, Harbin Hafei Automobile Industry Group Co., Ltd. ("Hafei Automobile"), and the remaining 10% equity interests of JCSA to AVIC Group for a cash consideration, subject to the approval of the independent shareholders of the Company and the relevant governing bodies. Based on the directors' best estimates, a gain on disposal is expected to arise from this proposed transaction which will be credited to the equity of the Group.

43 PARTICULARS OF PRINCIPAL SUBSIDIARIES, ASSOCIATES AND A JOINTLY CONTROLLED ENTITY

Name	Registered and paid up capital	Attributable equity interest	Type of legal entity	Principal activities
Subsidiaries				
Directly held				
Harbin Aviation Industry Group Ltd (哈爾濱航空工業（集團）有限責任公司)	RMB616,102	100%	Limited liability company	Manufacture and sale of general-purpose aeroplane and automobile
Jiangxi Changhe Aviation Industry Company Limited (江西昌河航空工業有限公司)	RMB421,037,974	100%	Limited liability company	Manufacture and sale of general-purpose aeroplane, automobile and automobile parts and components
Jiangxi Hongdu Aviation Industry Co., Ltd. (江西洪都航空工業股份有限公司)	RMB228,768,039	55.29%	Joint stock company (listed on the Shanghai Stock Exchange)	Design, development, manufacture and sale of basic trainers, general- purpose aeroplane and other aero products, including parts and components
Harbin Dongan Auto Engine Co., Ltd. (哈爾濱東安汽車動力股份有限公司)	RMB462,080,000	58.77%	Joint stock company (listed on the Shanghai Stock Exchange)	Manufacture and sale of automobile engine
Jiangxi Changhe Automobile Co., Ltd. (江西昌河汽車股份有限公司)	RMB410,000,000	59.02%	Joint stock company (listed on the Shanghai Stock Exchange)	Design, development, manufacture and sale of mini-sized vehicles
Harbin Hafei Automobile Industry Group Co., Ltd. (哈爾濱哈飛汽車工業集團有限公司)	RMB 758,035,000	100%	Joint stock company	Manufacture and sale of automobile products
Indirectly held				
Hafei Aviation Industry Co., Ltd. (哈飛航空工業股份有限公司)	RMB300,393,899	50.05%	Joint stock company (listed on the Shanghai Stock Exchange)	Research, development, design, manufacture and sale of aero products, including parts and components

43 PARTICULARS OF PRINCIPAL SUBSIDIARIES, ASSOCIATES AND A JOINTLY CONTROLLED ENTITY (continued)

Name	Registered and paid up capital	Attributable equity interest	Type of legal entity	Principal activities
Jiujiang Changhe Automobile Co., Ltd. (九江昌河汽車有限責任公司)	RMB161,250,000	72.89%	Limited liability company	Development, manufacture and sale of parts and components for mini-sized vehicles
Harbin Dongan Automotive Engine Manufacturing Co., Ltd. (哈爾濱東安汽車發動機製造有限公司)	RMB450,888,750	36.16%	Equity joint venture	Manufacture and sale of automobile engines
Hafei Motor Co., Ltd. (哈飛汽車股份有限公司)	RMB 804,322,000	74.81%	Joint stock company	Manufacture and sale of automobile products
Associates				
Directly held				
Baoding Huide Wind Power Engineering Co., Ltd. (保定惠德風電工程有限公司)	RMB150,000,000	20.00%	Equity joint venture	Development, manufacture and sale of large-scale wind power generation equipments
Indirectly held				
Harbin Wanxiang Hafei Motor Chassis System Co., Ltd. (哈爾濱萬向汽車底盤系統有限責任公司)	RMB60,000,000	35.00%	Limited liability company	Manufacture and sales of motor chassis system
Harbin Embraer Aircraft Industry Co., Ltd. (哈爾濱安博威飛機工業有限公司)	USD25,000,000	36.76%	Limited liability company	Production of regional jets and provision of relevant sales and after-sale services
Jointly controlled entity				
Indirectly held				
Jiangxi Changhe Suzuki Automobile Co., Ltd. (江西昌河鈴木汽車有限責任公司)	USD311,800,000	34.20%	Equity joint venture	Manufacture and sale of mini-sized vehicles

Notes:

(i) All the above subsidiaries, associates and the jointly controlled entity are established and operating in the PRC.

(ii) The English names of certain subsidiaries, associates and the jointly controlled entity referred to herein represent management's best effort at translating the Chinese names of these companies as no English names have been registered.

Definitions

In this Annual Report, unless the context otherwise requires, the following terms shall have the meanings indicated.

"Agusta"	Agusta S. p. A.
"Articles of Association"	Articles and Association of the Company (as amended from time to time)
"A Shares"	Renminbi-denominated Domestic Shares traded on the Shanghai Stock Exchange by PRC legal persons or individuals
"A Share listed subsidiaries"	Changhe Auto, Dongan Motor, Hafei Aviation and Hongdu Aviation, whose A shares are listed on Shanghai Stock Exchange
"AVIC"	中國航空工業集團公司 (Aviation Industry Corporation of China), a controlling shareholder of the Company holding 61.06% equity interests of the Company established in the PRC to complete the merger and reorganization of AVIC I and AVIC II
"AVIC Group"	AVIC and its subsidiaries (excluding the Group)
"AVIC II"	中國航空工業第二集團公司 (China Aviation Industry Corporation II), a former controlling shareholder of the Company and the predecessor of AVIC
"AVIC II Group"	AVIC II and its subsidiaries (excluding the Group)
"AVIC I"	中國航空工業第一集團公司 (China Aviation Industry Corporation I), the predecessor of AVIC
"AVIC Organizing Unit"	the organizing unit of AVIC which was established by the PRC State Council for the purpose of the merger and reorganization of AVIC I and AVIC II
"AviChina", "the Company"	中國航空科技工業股份有限公司 (AviChina Industry & Technology Company Limited), a joint stock limited company established in the PRC with limited liability on 30th April 2003
"Baoding Huide"	保定惠德風電工程有限公司 (Baoding Huide Wind Power Engineering Co., Ltd.), a subsidiary with 20% of its interests being held by the Company
"Board" or "Board of Directors"	the board of directors of the Company
"Changhe Agusta"	江西昌河阿古斯直升機有限責任公司 (Jiangxi Changhe-Agusta Helicopter Co., Ltd.), a sino-foreign joint venture held as to 60% by Changhe Aviation and 40% by Agusta
"Changhe Auto"	江西昌河汽車股份有限公司 (Jiangxi Changhe Automobile Co., Ltd.), a joint stock limited company whose shares are listed on the Shanghai Stock Exchange with 59.02% of its interests being directly held by the Company
"Changhe Suzuki"	江西昌河鈴木汽車有限公司 (Jiangxi Changhe Suzuki Automobile Co., Ltd.), a joint venture with 41%, 10%, 25.1%, 20.9% and 3% of its interests being held by Changhe Auto, Changhe Aviation, Suzuki, Suzuki (China) Investment Co., Ltd. and OKAYA & Co., Ltd. respectively

"Changhe Aviation"	江西昌河航空工業有限公司 (Jiangxi Changhe Aviation Industry Co., Ltd.), a wholly-owned subsidiary at the Company
"Directors"	the director(s) of the Company
"Domestic Shares"	ordinary shares of the Company, with a nominal value of RMB1.00 each, which are subscribed for or credited as fully paid in Renminbi by PRC corporate entities
"Dongan Motor"	哈爾濱東安汽車動力股份有限公司(Harbin Dongan Auto Engine Co., Ltd.), a joint stock limited company whose shares are listed on the Shanghai Stock Exchange with 58.77% of its interests being held by the Company
"Dongan Mitsubishi"	哈爾濱東安汽車發動機製造有限公司(Harbin Dongan Automotive Engine Manufacturing Co., Ltd.), a sino-foreign joint venture with 36% and 15% of its interests being held by Dongan Motor and Harbin Aviation Group
"economy sedan"	sedans with a total engine capacity below 1.6 litres (excluding 1.6 litres) and basic sales price below RMB100,000
"Eurocopter"	a subsidiary of European Aeronautic Defence and Space Company ("EADS")
"Former AVIC"	中國航空工業總公司 (Aviation Industry of China Corporation), the predecessor of AVIC I and AVIC II
"Group"	the Company and its subsidiaries
"H Shares"	overseas listed foreign invested shares in the share capital of the Company, with a nominal value of RMB1.00 each, which are traded in Hong Kong dollars and listed on the Stock Exchange
"Hafei Auto"	哈飛汽車股份有限公司 (Hafei Motor Co., Ltd.), a joint stock limited liability company with foreign investment which is held as to 74.81% by Harbin Automobile Group, a wholly-owned subsidiary of the Company
"Hafei Aviation"	哈飛航空工業股份有限公司 (Hafei Aviation Industry Co., Ltd.), a joint stock limited company whose shares are listed on the Shanghai Stock Exchange with 50.05% of its interests being held by Harbin Aviation Group
"Harbin Automobile Group"	哈爾濱哈飛汽車工業集團有限公司 (Harbin Hafei Automobile Industry Group Co., Ltd.), a wholly-owned subsidiary of the Company
"Harbin Aviation Group"	哈爾濱航空工業(集團)有限公司 (Harbin Aviation Industry (Group) Co., Ltd.), a wholly-owned subsidiary of the Company
"Harbin Embraer"	哈爾濱安博威飛機工業有限公司 (Harbin Embraer Aircraft Industry Co., Ltd.), a joint venture established in the PRC held as to 24.5% by Harbin Aviation Group, 24.5% by Hafei Aviation and 51% by Embraer-Empresa Brasileira de Aeronautica S.A. (Embraer)
"Hefei Changhe"	合肥昌河汽車有限責任公司 (Hefei Changhe Automobile Co., Ltd.), a wholly-owned subsidiary of Changhe Auto transferred from a former branch of Changhe Auto in May 2007

"Hongdu Aviation"	江西洪都航空工業股份有限公司(Jiangxi Hongdu Aviation Industry Co., Ltd.), a joint stock limited company whose shares are listed on the Shanghai Stock Exchange with 55.29% of its interests being held by the Company
"Hongdu Group"	江西洪都航空工業（集團）有限責任公司(Jiangxi Hongdu Aviation Industry Group Corporation), a wholly-owned subsidiary of AVIC II
"Listing Rules"	the Rules Governing the Listing of Securities on the Stock Exchange (as amended from time to time)
"mini-sized vehicles"	generally refers to mini-vans and mini-trucks with lengths not exceeding 3.5 metres, with engine capacity below 1.0 litre and total loading capability below 600 kilogrammes, according to "Motor Vehicles and Semi-trailer Types Terms and Definitions" (reference No.GB/T 3730-1-1998) issued by the China Association of Automobile Manufacturers. In recent years, the length of mini-sized vehicles was extended to 3.7 metres as a result of the implementation of the new anti-crash regulations
"Mitsubishi"	Mitsubishi Motor Corporation（三菱自動車工業株式會社）, a substantial shareholder of Dongan Mitsubishi
"Promoters"	AVIC II, China Hua Rong Asset Management Corporation, China Cinda Asset Management Corporation and China Orient Asset Management Corporation
"Shares"	Domestic Shares and H Shares
"Stock Exchange"	The Stock Exchange of Hong Kong Limited
"Supervisors"	the members of the Supervisory Committee of AviChina
"Suzuki"	Suzuki Motor Corporation（日本國鈴木株式會社）, a partner to a joint venture of the Company with 25.1% equity interests in Changhe Suzuki
"the Group"	AviChina and all or any of its subsidiaries
"the PRC"	People's Republic of China
"Trainer"	aeroplanes designed and used for pilot training purposes

BOARD OF DIRECTORS

Chairman	Lin Zuoming
Vice Chairman	Tan Ruisong
Executive Director	Wu Xiandong
Non-Executive Director	Gu Huizhong
Non-Executive Director	Xu Zhanbin
Non-Executive Director	Geng Ruguang
Non-Executive Director	Zhang Xinguo
Non-Executive Director	Li Fangyong
Non-Executive Director	Wang Yong
Non-Executive Director	Maurice Savart
Independent Non-Executive Director	Guo Chongqing
Independent Non-Executive Director	Li Xianzong
Independent Non-Executive Director	Lau Chung Man, Louis

SUPERVISORY COMMITTEE

Chairman	Hu Wenming
Supervisors	Tang Jianguo
	Li Yuhai
	Gao Jianshe
	Bai Ping
	Yu Yan
	Wang Yuming
	Zheng Li
	Xie Zhihua

SENIOR MANAGEMENT

President	Tan Ruisong
Vice President	Li Hui
	Li Yao
	Liu Tao
Board Secretary	Yan Lingxi
Company Secretary	Ip Kun Wan, Kiril

THE LEGAL NAME OF THE COMPANY

中國航空科技工業股份有限公司
AviChina Industry & Technology Company Limited

Abbreviation name in Chinese:	中航科工
Abbreviation name in English:	AVICHINA
Legal representative:	Lin Zuoming

PRINCIPAL PLACE OF BUSINESS IN HONG KONG

Unit B, 15/F, United Center, Queensway 95, Hong Kong

AUTHORISED REPRESENTATIVES

Wu Xiandong   Yan Lingxi

PRINCIPAL BANKERS

Industrial and Commercial Bank of China
No.55 Fuxingmen nei Street, Xicheng District,
Beijing, the PRC

Bank of China
No.1 Fuxingmen nei Street, Xicheng District,
Beijing, the PRC

China Construction Bank
No.25, Finance Street, Xicheng District,
Beijing, the PRC

Shanghai Pudong Development Bank Ltd.
No.500, Pudong South Road, Pudong New District,
Shanghai

PLACE OF LISTING, STOCK NAME AND STOCK CODE

Main Board of The Stock Exchange of Hong Kong Limited
(H Shares), AVICHINA, 2357

REGISTERED ADDRESS

8th Floor, Tower 2, No. 5A Rongchang East Street,
Beijing Economic Technological Development Area,
Beijing, the PRC

WEBSITE

www.avichina.com

CORRESPONDENCE ADDRESS

Postal Code: 100009
P.O. Box 1655, Beijing, the PRC

Telephone: 86-10-64094832
Facsimile: 86-10-64094826/36
E-mail Box: avichina@avichina.com

SHARE REGISTRAR

Computershare Hong Kong Investor Services Limited
Room 1712-1716, 17th Floor, Hopewell Centre,
183 Queen's Road East, Hong Kong

ANNUAL GENERAL MEETING

The annual general meeting of the Company for the year 2008 will be held on Tuesday, 9th June 2009 at 9:00 a.m. at Avic Hotel, No. 10 Yi, Central East Third Ring Road, Chaoyang District, Beijing, the PRC.

AUDITORS

International Auditors

PricewaterhouseCoopers
22nd Floor, Prince's Building
Central, Hong Kong

Auditors in the PRC

PricewaterhouseCoopers Zhong Tian CPAs Limited Company
11/F, PricewaterhouseCoopers Center,
No. 202 Hu Bin Road,
Shanghai 200021, the PRC

LEGAL ADVISERS

As to Hong Kong law

Baker & McKenzie
14th Floor, Hutchison House,
10 Harcourt Road, Central,
Hong Kong

As to PRC law

Beijing Jiayuan Law Firm
F407, Ocean Plaza,
158 Fuxingmennei Street,
Xicheng District,
Beijing, the PRC