

**China Airlines, Ltd.**

**Financial Statements for the  
Years Ended December 31, 2005 and 2004 and  
Independent Auditors' Report**

# CHINA AIRLINES, LTD.

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## INDEPENDENT AUDITORS' REPORT

The Board of Directors and the Stockholders  
China Airlines, Ltd.

We have audited the accompanying balance sheets of China Airlines, Ltd. as of December 31, 2005 and 2004 and the related statements of income, changes in stockholders' equity and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the Rules Governing the Audit of Financial Statements by Certified Public Accountants and auditing standards generally accepted in the Republic of China. Those rules and standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, based on our audits, the financial statements referred to above present fairly, in all material respects, the financial position of China Airlines, Ltd. as of December 31, 2005 and 2004 and the results of its operations and its cash flows for the years then ended, in conformity with the Guidelines Governing the Preparation of Financial Reports by Securities Issuers and accounting principles generally accepted in the Republic of China.

We have also audited the consolidated financial statements of China Airlines, Ltd. and its subsidiaries as of and the year ended December 31, 2005 and have issued a modified unqualified report thereon dated March 7, 2006.

March 7, 2006

### Notice to Readers

*The accompanying financial statements are intended only to present the financial position, results of operations and cash flows in accordance with accounting principles and practices generally accepted in the Republic of China and not those of any other jurisdictions. The standards, procedures and practices to audit such financial statements are those generally accepted and applied in the Republic of China.*

*For the convenience of readers, the auditors' report and the accompanying financial statements have been translated into English from the original Chinese version prepared and used in the Republic of China. If there is any conflict between the English version and the original Chinese version or any difference in the interpretation of the two versions, the Chinese-language auditors' report and financial statements shall prevail.*

**CHINA AIRLINES, LTD.**

**BALANCE SHEETS**

**DECEMBER 31, 2005 AND 2004**

(In Thousands of New Taiwan Dollars and Shares, Except Par Value)

ASSETS	2005		2004	
	Amount	%	Amount	%
<b>CURRENT ASSETS</b>				
Cash and cash equivalents (Notes 2 and 3)	\$ 2,049,127	1	\$ 5,082,480	2
Short-term investments, net (Notes 2 and 4)	4,823,118	2	3,508,718	2
Receivables:				
Notes and accounts, net (Notes 2 and 5)	9,290,641	4	7,856,326	4
Related parties (Note 22)	161,681	-	405,299	-
Other receivables (Note 6)	1,040,838	-	720,989	-
Inventories, net (Notes 2 and 7)	5,386,998	2	5,748,108	3
Prepaid expenses (Note 8)	73,291	-	696,139	-
Deferred income tax assets (Notes 2 and 19)	189,293	-	296,067	-
Pledged certificates of deposit (Note 23)	50,000	-	-	-
Other current assets	523,482	-	866,544	1
<b>Total current assets</b>	<b>23,588,469</b>	<b>9</b>	<b>25,180,670</b>	<b>12</b>
<b>INVESTMENTS IN SHARES OF STOCK (Notes 2 and 9)</b>				
Equity method	8,732,016	4	6,093,700	3
Cost method	836,275	-	974,366	-
<b>Total investments in shares of stock</b>	<b>9,568,291</b>	<b>4</b>	<b>7,068,066</b>	<b>3</b>
<b>OTHER FINANCIAL ASSETS - NONCURRENT</b>	<b>10,585</b>	<b>-</b>	<b>10,354</b>	<b>-</b>
<b>PROPERTIES (Notes 2, 10 and 23)</b>				
Cost				
Land	2,106,788	1	2,106,788	1
Buildings	7,494,919	3	7,420,190	4
Machinery and equipment	3,203,680	1	3,163,335	2
Flight equipment	196,945,625	81	154,531,276	71
Furniture	758,070	-	773,916	-
Leased flight and other equipment	23,023,806	10	22,523,849	10
Leasehold improvements	670,980	-	558,775	-
Revaluation increase	50,335	-	50,335	-
Total cost and revaluation increase	234,254,203	96	191,128,464	88
Accumulated depreciation	45,423,742	19	40,587,290	19
	188,830,461	77	150,541,174	69
Advance payments on equipment purchase contracts (Note 24 and 25)	13,873,058	6	25,992,050	12
<b>Net properties</b>	<b>202,703,519</b>	<b>83</b>	<b>176,533,224</b>	<b>81</b>
<b>INTANGIBLE ASSETS</b>				
Computer software, net (Note 2)	205,832	-	166,771	-
Deferred pension cost (Notes 2 and 16)	2,010,636	1	2,377,282	1
<b>Net intangible assets</b>	<b>2,216,468</b>	<b>1</b>	<b>2,544,053</b>	<b>1</b>
<b>OTHER ASSETS</b>				
Idle properties, net	368,640	-	339,753	-
Deposits (Notes 23 and 24)	3,710,040	2	3,971,005	2
Deferred charges (Note 2)	1,029,759	-	417,114	-
Deferred income tax assets (Notes 2 and 19)	1,519,019	1	985,629	1
Pledged certificates of deposit (Note 23)	264,901	-	258,065	-
<b>Net other assets</b>	<b>6,892,359</b>	<b>3</b>	<b>5,971,566</b>	<b>3</b>
<b>TOTAL</b>	<b>\$ 244,979,691</b>	<b>100</b>	<b>\$ 217,307,933</b>	<b>100</b>

LIABILITIES AND STOCKHOLDERS' EQUITY	2005		2004	
	Amount	%	Amount	%
<b>CURRENT LIABILITIES</b>				
Short-term loans (Note 11)	\$ 1,000,000	-	\$ 500,000	-
Commercial paper (Note 12)	849,115	-	899,626	-
Accounts payable	325,313	-	433,069	-
Payables to related parties (Note 22)	1,011,856	1	1,276,699	1
Accrued expenses (Note 2)	11,761,557	5	10,397,795	5
Bonds issued - current portion (Notes 2 and 13)	3,000,000	1	1,500,000	1
Advance ticket sales (Note 2)	5,440,605	2	3,712,610	2
Loans and debts - current portion (Notes 14 and 23)	20,627,781	9	15,083,694	7
Capital lease obligations - current portion (Notes 2 and 15)	1,368,538	1	1,239,617	1
Other current liabilities	693,486	-	1,169,194	-
<b>Total current liabilities</b>	<b>46,078,251</b>	<b>19</b>	<b>36,212,304</b>	<b>17</b>
<b>LONG-TERM DEBTS, NET OF CURRENT PORTION</b>				
Bonds issued (Notes 2 and 13)	20,616,500	8	14,875,600	7
Loans and debts (Notes 14 and 23)	105,334,441	43	92,388,836	42
Capital lease obligations (Notes 2 and 15)	9,787,747	4	10,868,380	5
<b>Total long-term debts</b>	<b>135,738,688</b>	<b>55</b>	<b>118,132,816</b>	<b>54</b>
<b>OTHER LIABILITIES</b>				
Accrued pension cost (Notes 2 and 16)	5,415,398	2	5,103,777	3
Deferred profit on sale-leaseback (Note 2)	2,965,829	1	4,523,472	2
Others	612,181	1	684,822	-
<b>Total other liabilities</b>	<b>8,993,408</b>	<b>4</b>	<b>10,312,071</b>	<b>5</b>
<b>Total liabilities</b>	<b>190,810,347</b>	<b>78</b>	<b>164,657,191</b>	<b>76</b>
<b>STOCKHOLDERS' EQUITY</b>				
Capital stock, \$10 par value				
Authorized - 5,000,000 shares in 2005 and 4,480,000 shares in 2004				
Issued and outstanding - 3,513,836 shares in 2005 and 3,103,698 shares in 2004	35,138,362	14	31,036,983	14
Capital surplus				
Issue of stock in excess of par value	8,327,028	4	7,843,057	4
Revaluation increment on properties	830,471	-	830,471	-
Gain on sale of treasury shares held by subsidiaries	72,541	-	71,836	-
Others	5,044	-	5,044	-
Total capital surplus	9,235,084	4	8,750,408	4
Retained earnings				
Legal reserve	4,590,391	2	4,172,117	2
Special reserve	1,530,165	1	194,184	-
Unappropriated earnings	4,983,518	2	10,062,707	5
Total retained earnings	11,104,074	5	14,429,008	7
Unrealized loss on investments in shares of stock	(127,966)	-	(62,697)	-
Cumulative translation adjustments	94,332	-	(826,444)	(1)
Unrecognized pension cost	(1,237,988)	(1)	(641,023)	-
Company shares held by subsidiaries reclassified as treasury stock	(36,554)	-	(35,493)	-
<b>Total stockholders' equity</b>	<b>54,169,344</b>	<b>22</b>	<b>52,650,742</b>	<b>24</b>
<b>TOTAL</b>	<b>\$ 244,979,691</b>	<b>100</b>	<b>\$ 217,307,933</b>	<b>100</b>

The accompanying notes are an integral part of the financial statements.

# CHINA AIRLINES, LTD.

## STATEMENTS OF INCOME FOR THE YEARS ENDED DECEMBER 31, 2005 AND 2004 (In Thousands of New Taiwan Dollars, Except Earnings Per Share)

	2005		2004	
	Amount	%	Amount	%
REVENUES (Notes 2 and 22)				
Passenger	\$ 55,656,343	51	\$ 48,595,448	50
Cargo	47,303,820	44	41,873,486	44
Others	<u>5,727,441</u>	<u>5</u>	<u>5,706,128</u>	<u>6</u>
Total revenues	<u>108,687,604</u>	<u>100</u>	<u>96,175,062</u>	<u>100</u>
COSTS (Notes 20 and 22)				
Flying operations	57,048,553	52	43,113,961	45
Terminal and landing fees	16,308,531	15	15,540,484	16
Passenger services	8,059,230	7	7,658,575	8
Aircraft maintenance	6,133,982	6	5,953,408	6
Others	<u>3,841,492</u>	<u>4</u>	<u>4,006,909</u>	<u>4</u>
Total costs	<u>91,391,788</u>	<u>84</u>	<u>76,273,337</u>	<u>79</u>
GROSS PROFIT	<u>17,295,816</u>	<u>16</u>	<u>19,901,725</u>	<u>21</u>
OPERATING EXPENSES (Note 20)				
Marketing and selling	11,672,717	11	11,872,487	12
General and administrative	<u>2,268,370</u>	<u>2</u>	<u>2,408,085</u>	<u>3</u>
Total operating expenses	<u>13,941,087</u>	<u>13</u>	<u>14,280,572</u>	<u>15</u>
OPERATING INCOME	<u>3,354,729</u>	<u>3</u>	<u>5,621,153</u>	<u>6</u>
NONOPERATING INCOME AND GAINS				
Interest	94,608	-	72,860	-
Equity in investees' net income, net (Notes 2 and 9)	749,579	1	487,738	1
Dividends income	167,417	-	131,802	-
Gain on disposal of properties (Note 2)	158,819	-	560,529	1
Gain on disposal of investments, net	74,678	-	264,628	-
Gain on physical inventory	10,968	-	13,880	-
Foreign exchange gain, net (Note 2)	483,381	1	-	-
Other	<u>257,730</u>	<u>-</u>	<u>407,280</u>	<u>-</u>
Total nonoperating income and gains	<u>1,997,180</u>	<u>2</u>	<u>1,938,717</u>	<u>2</u>
NONOPERATING EXPENSES AND LOSSES				
Interest	4,659,507	4	2,560,970	3
Foreign exchange loss, net (Note 2)	-	-	298,179	-
Other	<u>278,126</u>	<u>-</u>	<u>697,888</u>	<u>1</u>
Total nonoperating expenses and losses	<u>4,937,633</u>	<u>4</u>	<u>3,557,037</u>	<u>4</u>

(Continued)

	<u>2005</u>		<u>2004</u>	
	<b>Amount</b>	<b>%</b>	<b>Amount</b>	<b>%</b>
PRETAX INCOME	\$ 414,276	1	\$ 4,002,833	4
INCOME TAX BENEFIT (Notes 2 and 19)	<u>230,956</u>	<u>-</u>	<u>179,894</u>	<u>-</u>
NET INCOME	<u>\$ 645,232</u>	<u>1</u>	<u>\$ 4,182,727</u>	<u>4</u>
	<u>2005</u>		<u>2004</u>	
	<b>Before Tax</b>	<b>After Tax</b>	<b>Before Tax</b>	<b>After Tax</b>
EARNINGS PER SHARE (Note 21)				
Basic	<u>\$ 0.12</u>	<u>\$ 0.19</u>	<u>\$ 1.20</u>	<u>\$ 1.25</u>
Diluted	<u>\$ 0.10</u>	<u>\$ 0.15</u>	<u>\$ 1.03</u>	<u>\$ 1.07</u>

The accompanying notes are an integral part of the financial statements.

(Concluded)

**CHINA AIRLINES, LTD.**

**STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY  
FOR THE YEARS ENDED DECEMBER 31, 2005 AND 2004  
(In Thousands of New Taiwan Dollars and Shares, Except Cash Dividends Per Share)**

	Capital Stock		Capital Surplus (Notes 2, 10 and 17)						Retained Earnings (Notes 2 and 17)				Unrealized Loss on Investments in Shares of Stock (Notes 2, 9 and 17)	Cumulative Translation Adjustments (Notes 2 and 17)	Unrecognized Pension Cost (Notes 2, 16 and 17)	Company Shares Held by Subsidiaries Reclassified as Treasury Stock (Notes 2, 17 and 18)	Total Stockholders' Equity
	Issued		Issue of Stock in Excess of Par Value	Revaluation Increment on Properties	Share in Capital Surplus Reported by Equity-method Investees	Gain on Sale of Treasury Shares Held by Subsidiaries	Others	Total	Legal Reserve	Special Reserve	Unappropriated Earnings	Total					
	Shares	Amount															
BALANCE, JANUARY 1, 2004	2,848,929	\$ 28,489,288	\$ 7,157,448	\$ 830,471	\$ 660	\$ 71,502	\$ 5,044	\$ 8,065,125	\$ 3,994,172	\$ -	\$ 8,050,544	\$ 12,044,716	\$ (46,156)	\$ 144,476	\$ (292,504)	\$ (35,493)	\$ 48,369,452
Appropriation of 2003 earnings																	
Legal reserve	-	-	-	-	-	-	-	-	177,945	-	(177,945)	-	-	-	-	-	-
Special reserve	-	-	-	-	-	-	-	-	-	194,184	(194,184)	-	-	-	-	-	-
Bonus to employees	8,444	84,440	-	-	-	-	-	-	-	-	(84,440)	(84,440)	-	-	-	-	-
Cash dividends - \$0.1 per share	-	-	-	-	-	-	-	-	-	-	(284,893)	(284,893)	-	-	-	-	(284,893)
Stock dividends - 5%	142,446	1,424,464	-	-	-	-	-	-	-	-	(1,424,464)	(1,424,464)	-	-	-	-	-
Unrealized loss on investments in shares of stock	-	-	-	-	-	-	-	-	-	-	-	-	(16,541)	-	-	-	(16,541)
Reversal of share in capital surplus reported by equity-method investees	-	-	-	-	(119)	-	-	(119)	-	-	(8)	(8)	-	-	-	-	(127)
Conversion of bonds to capital stock	103,879	1,038,791	685,609	-	-	-	-	685,609	-	-	-	-	-	-	-	-	1,724,400
Capital surplus from cash dividends of company shares held by subsidiaries	-	-	-	-	-	334	-	334	-	-	-	-	-	-	-	-	334
Translation adjustments on a foreign operating entity on investments in shares of stocks	-	-	-	-	-	-	-	-	-	-	-	-	-	(905,134)	-	-	(905,134)
Translation adjustments on investments in shares of stocks	-	-	-	-	-	-	-	-	-	-	-	-	-	(65,786)	-	-	(65,786)
Net income in 2004	-	-	-	-	-	-	-	-	-	-	4,182,727	4,182,727	-	-	-	-	4,182,727
Net loss not recognized as pension cost	-	-	-	-	-	-	-	-	-	-	-	-	-	-	(348,519)	-	(348,519)
Adjustment due to nonproportional subscription for investees' issuance of new shares	-	-	-	-	(541)	-	-	(541)	-	-	(4,630)	(4,630)	-	-	-	-	(5,171)
BALANCE, DECEMBER 31, 2004	3,103,698	31,036,983	7,843,057	830,471	-	71,836	5,044	8,750,408	4,172,117	194,184	10,062,707	14,429,008	(62,697)	(826,444)	(641,023)	(35,493)	52,650,742
Appropriation of 2004 earnings																	
Legal reserve	-	-	-	-	-	-	-	-	418,274	-	(418,274)	-	-	-	-	-	-
Special reserve	-	-	-	-	-	-	-	-	-	1,335,981	(1,335,981)	-	-	-	-	-	-
Bonus to employees	14,571	145,708	-	-	-	-	-	-	-	-	(145,708)	(145,708)	-	-	-	-	-
Cash dividends - \$0.2 per share	-	-	-	-	-	-	-	-	-	-	(636,108)	(636,108)	-	-	-	-	(636,108)
Stock dividends - 10%	318,054	3,180,542	-	-	-	-	-	-	-	-	(3,180,542)	(3,180,542)	-	-	-	-	-
Unrealized loss on investments in shares of stock	-	-	-	-	-	-	-	-	-	-	-	-	(65,269)	-	-	-	(65,269)
Conversion of bonds to capital stock	77,513	775,129	483,971	-	-	-	-	483,971	-	-	-	-	-	-	-	-	1,259,100
Capital surplus from cash dividends of company shares held by subsidiaries	-	-	-	-	-	705	-	705	-	-	-	-	-	-	-	-	705
Translation adjustments on a foreign operating entity	-	-	-	-	-	-	-	-	-	-	-	-	-	898,666	-	-	898,666
Translation adjustments on investments in shares of stocks	-	-	-	-	-	-	-	-	-	-	-	-	-	22,110	-	-	22,110
Net income in 2005	-	-	-	-	-	-	-	-	-	-	645,232	645,232	-	-	-	-	645,232
Net loss not recognized as pension cost	-	-	-	-	-	-	-	-	-	-	-	-	-	-	(596,965)	-	(596,965)
Adjustment of treasury stocks from unproportionate subscription of new shares of investments in shares of stock	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	(1,061)	(1,061)
Adjustment due to nonproportional subscription for investees' issuance of new shares	-	-	-	-	-	-	-	-	-	-	(7,808)	(7,808)	-	-	-	-	(7,808)
BALANCE, DECEMBER 31, 2005	3,513,836	\$ 35,138,362	\$ 8,327,028	\$ 830,471	\$ -	\$ 72,541	\$ 5,044	\$ 9,235,084	\$ 4,590,391	\$ 1,530,165	\$ 4,983,518	\$ 11,104,074	\$ (127,966)	\$ 94,332	\$ (1,237,988)	\$ (36,554)	\$ 54,169,344

The accompanying notes are an integral part of the financial statements.

# CHINA AIRLINES, LTD.

## STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED DECEMBER 31, 2005 AND 2004 (In Thousands of New Taiwan Dollars)

	2005	2004
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net income	\$ 645,232	\$ 4,182,727
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Unrealized loss on short-term investments	124	-
Provision of allowance for doubtful receivables	-	30,000
Depreciation and amortization	9,895,599	8,053,363
Gain on disposal of investments in shares of stock, net	-	(149,651)
Gain on disposal of properties	(158,819)	(560,529)
Loss (gain) on disposal of idle properties, net	8,212	(35,467)
Net loss on inventories, properties and idle properties	170,506	613,519
Amortization of deferred profit on sale-leaseback	(668,485)	(1,111,123)
Amortization of deferred credits	(66,413)	(66,386)
Equity in investees' net gain less cash dividends received	(154,516)	(87,929)
Gain on liquidation of investments in shares of stock	-	(5,306)
Deferred income taxes	(426,616)	(251,632)
Net changes in operating assets and liabilities		
Notes and accounts receivable - third parties	(1,434,315)	(2,145,520)
Notes and accounts receivable - related parties	243,618	(104,289)
Other receivables	185,648	903,368
Inventories	(441,165)	(844,060)
Prepaid expenses	622,848	(409,140)
Other current assets	343,062	(74,860)
Accounts payable	(107,756)	(243,308)
Payable to related parties	(264,843)	386,169
Accrued expenses	1,363,762	2,087,929
Advance ticket sales	1,727,995	414,358
Other current liabilities	(475,708)	309,286
Accrued pension cost	81,302	253,032
Net cash provided by operating activities	<u>11,089,272</u>	<u>11,144,551</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Decrease (increase) in short-term investments	(1,314,524)	6,595,000
Decrease (increase) in pledged certificate of deposits	(56,836)	14,044
Proceeds from disposal of investments in shares of stock	-	216,655
Addition to investments in shares of stock	(2,427,032)	(114,743)
Proceeds from liquidation of investee	-	523,241
Investee's return of capital	30,000	306,000
Decrease (increase) in other financial assets - noncurrent	(231)	1,097
Proceeds from disposal of properties	2,329,741	7,192,213
Additions to properties	(34,874,638)	(50,313,778)

(Continued)

	<b>2005</b>	<b>2004</b>
Proceeds from disposal of idle properties	\$ 92,139	\$ 132,394
Decrease in deposits made	260,965	1,053,544
Decrease (increase) in computer software	(51,568)	5,436
Increase in deferred charges	<u>(719,616)</u>	<u>(369,730)</u>
Net cash used in investing activities	<u>(36,731,600)</u>	<u>(34,758,627)</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Proceeds from (repayments of) short-term loans	500,000	(3,100,000)
Repayments of commercial paper	(50,511)	(923,852)
Proceeds from long-term loans	38,049,857	43,209,586
Repayments of long-term loans and capital lease obligations	(22,816,848)	(22,744,479)
Proceeds from bonds issued	10,000,000	10,000,000
Redemption of bonds issued	(1,500,000)	(3,900,000)
Increase (decrease) in deposits-in	(6,228)	57,741
Decrease in deferred profit on sale - leaseback	(863,779)	(223,148)
Payments of cash dividends	<u>(636,108)</u>	<u>(284,893)</u>
Net cash provided by financing activities	<u>22,676,383</u>	<u>22,090,955</u>
DECREASE IN CASH AND CASH EQUIVALENTS	(2,965,945)	(1,523,121)
EFFECTS OF EXCHANGE RATE CHANGES	(67,408)	(154,215)
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	<u>5,082,480</u>	<u>6,759,816</u>
CASH AND CASH EQUIVALENTS, END OF YEAR	<u>\$ 2,049,127</u>	<u>\$ 5,082,480</u>
<b>SUPPLEMENTAL INFORMATION</b>		
Interest paid	\$ 5,039,275	\$ 3,047,437
Less: Capitalized interest	<u>390,835</u>	<u>345,147</u>
Interest paid (excluding capitalized interest)	<u>\$ 4,648,440</u>	<u>\$ 2,702,290</u>
Income taxes paid	<u>\$ 305,519</u>	<u>\$ 452,660</u>
<b>NONCASH FINANCING ACTIVITIES</b>		
Current portion of loans and debts	<u>\$ 20,627,781</u>	<u>\$ 15,083,694</u>
Current portion of capital lease obligations	<u>\$ 1,368,538</u>	<u>\$ 1,239,617</u>
Current portion of bonds issued	<u>\$ 3,000,000</u>	<u>\$ 1,500,000</u>
Conversion of convertible bonds to capital stock	<u>\$ 1,259,100</u>	<u>\$ 1,724,400</u>

The accompanying notes are an integral part of the financial statements.

(Concluded)

# CHINA AIRLINES, LTD.

## NOTES TO FINANCIAL STATEMENTS FOR THE YEARS ENDED DECEMBER 31, 2005 AND 2004 (Amounts in New Taiwan Dollars, Unless Specified Otherwise)

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### 1. ORGANIZATION AND OPERATIONS

China Airlines, Ltd. (the "Company") was founded in 1959 and its stocks are listed on the Taiwan Stock Exchange. The Company primarily provides air transport services for passengers and cargo. Its other operations include (a) mail services; (b) ground services and routine aircraft maintenance; (c) major maintenance of flight equipment; (d) communications and data processing services to other airlines; (e) sale of aircraft parts, equipment and entire aircraft; and (f) lease of aircraft.

The Company is a subsidiary of China Aviation Development Foundation, which held 65.63% and 67.51% of the shares of the Company as of December 31, 2005 and 2004, respectively. The Company had 9,833 and 9,490 employees as of December 31, 2005 and 2004, respectively.

### 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

#### Basis of Presentation

The accompanying financial statements have been prepared in conformity with the Guidelines Governing the Preparation of Financial Reports by Securities Issuers and accounting principles generally accepted in the Republic of China. Under these guidelines and principles, the Company has to make certain estimates and assumptions that could affect the allowance for doubtful receivables, loss on market value decline of inventories, property depreciation, asset impairment, accrued expenses - frequent flyer program, prepaid pension cost and loss on pending lawsuits. Actual results could differ from these estimates.

For the convenience of readers, the accompanying financial statements have been translated into English from the original Chinese version prepared and used in the Republic of China. If there is any conflict between the English version and the original Chinese version or any difference in the interpretation of the two versions, the Chinese-language financial statements shall prevail.

The Company's significant accounting policies are summarized as follows:

#### Current or Noncurrent Assets and Liabilities

Unrestricted cash and cash equivalents and other assets to be realized, received or used up within a year are classified as current. Liabilities to be paid off or settled within a year are classified as current. All other assets and liabilities are classified as noncurrent.

#### Cash Equivalents

Cash equivalents are bonds purchased under agreements to resell that are due in three months from the date of investment.

#### Short-term Investments

These are investments in marketable equity securities and mutual funds. Domestic and foreign investments are stated at aggregate cost less allowance for losses on decline in market value or the net asset value of mutual funds. The allowance is reversed when the market value and/or net asset value recovers. Costs of marketable equity securities and mutual fund beneficiary certificates sold are determined using the weighted-average method and the specific identification method, respectively.

## **Allowances for Doubtful Accounts**

Allowances for doubtful notes and accounts receivable are provided on the basis of an evaluation of their collectibility. The Company evaluates the collectibility of notes and accounts receivable periodically according to the aging analysis, the credit ratings and the economic environment, etc.

## **Inventories**

Inventories are primarily expendable and nonexpendable parts and materials, supplies used in operation and items for in-flight sale. These are valued using the weighted-average cost less allowance for obsolescence. Items for in-flight sale are stated at the lower of weighted-average cost or market (replacement cost or net realizable value). The costs of inventories sold or consumed are determined using the weighted-average method.

## **Investments in Shares of Stock**

Investments in shares of stock in which the Company exercises significant influence over the investee's operating and financial policy decisions are accounted for by the equity method. Under the equity method, investments are stated at cost on the acquisition date and subsequently adjusted for the Company's proportionate share or equity in the net income or net loss of the investees. When a stock is acquired or when the equity method is initially adopted, the difference between the investment acquisition cost and the Company's equity in the net assets of the investees is amortized over five years. Cash dividends received are accounted for as a reduction of the carrying values of the investments. When the Company subscribes to additional shares of stock issued by an investee at a rate not equal to the Company's current equity, the increase in the Company's equity in the investee's net assets is credited to capital surplus. Any decrease in the Company's equity in the investee's net assets is debited to capital surplus. If capital surplus is not enough for debiting purposes, the remaining difference is debited to unappropriated earnings.

Other investments in shares of stocks are stated at cost. Any unrealized loss on cost-method investments is also recognized at the Company's equity in the investee and shown as part of stockholders' equity. For stocks with quoted market prices, an allowance is recognized for a decline in market value below carrying value and is either debited to stockholders' equity if the decline is considered temporary or charged to income if the decline is other than temporary. For stocks with no quoted market prices, the carrying amount of the investment is reduced to reflect other than temporary decline of market value below carrying value. Cash dividends received a year after acquisition are recognized as investment income.

For investment in shares of stock accounted for by the cost method at initial recognition, a retrospective adjustment is not required for any difference between the cost and the investee's net assets that results when the investor subscribes to the investee's new shares at a proportion different from the previous one. The resulting difference is amortized over five years.

Gain or loss from the transactions involving depreciable assets between the Company and its equity-method investees is deferred and recognized over the estimated useful lives of the assets.

For both equity-method and cost-method investments, stock dividends received are recorded only as an increase in the number of shares held and not as investment income.

Costs of investments sold are determined using the weighted-average method.

In accordance with Statement of Financial Accounting Standards No. 30, Accounting for Treasury Stock, the Company reclassified its shares held by its subsidiaries as treasury stock at the carrying value as shown in the subsidiaries' books on January 1, 2002. Furthermore, when the Company recognized its investment income, the cash dividend income recognized by the subsidiaries from the Company's earnings appropriation was subtracted from investment income, and credited to paid-in capital.

## **Properties**

Properties are stated at cost plus revaluation increment (if any) less accumulated depreciation. Major betterments or renewals are capitalized, while maintenance and repairs are expensed when incurred. Interests on funds used to acquire flight equipment or to construct facilities before the date the equipment is used in operations are capitalized and included in the cost of the related assets.

Depreciation is calculated using the straight-line method over service lives estimated as follows (plus one year to represent estimated salvage value): buildings, 45 to 55 years; machinery and equipment, 5 to 6 years; flight equipment, 5 to 25 years; furniture, 5 years; leased assets, 6 to 25 years; and leasehold improvements, 5 years. Properties that have reached their residual value but are still in use are further depreciated over their newly estimated service lives.

Upon property sale or disposal, the cost, revaluation increment (if any) and the related accumulated depreciation are removed from the accounts, and gain or loss is credited or charged to nonoperating income or expenses.

## **Leased Flight and Other Equipment**

The amounts capitalized on flight and other equipment leased under agreements qualifying as capital lease are the lower of the present value of all payments required under the lease agreements or the fair value of the leased assets on the starting dates of the agreements. Interests implicit in lease payments are recorded as interest expense.

Amounts paid under operating lease agreements are charged to income over the term of the agreements. The imputed interest on rental deposits, calculated at the interest rate for one-year time deposits, is recorded both as rental expense and interest income.

## **Computer Software Costs**

Computer software costs are amortized using the straight-line method over the estimated useful lives of the software.

## **Other Assets - Deferred Charges**

Deferred charges mainly consist of (a) expenses for training pilots in operating new types of aircraft, (b) issue costs of corporate bonds and (c) costs incurred for syndicated loans. They are amortized using the straight-line method over the estimated useful lives or the terms of the bond or loan.

## **Frequent-flyer Program**

Passengers who are members of the Dynasty Club may accumulate mileage points that entitle them to choose among various awards (including an upgrade to a higher class or free tickets). A liability is accrued and charged to operating expense when a passenger reaches a certain award level. The amount accrued is based on the estimated incremental cost that will be incurred upon the provision of transport services.

## **Convertible Bonds**

Redemption price in excess of the face value of the bonds is accrued over the period from the issue date up to the redemption date using the effective interest rate method.

The net carrying amount of the bonds (the face amount plus redemption premium accrued to the date of conversion but will not be paid) is credited to the appropriate capital accounts (capital stock equal to par value, with the balance credited to capital surplus) upon conversion of the bonds. No gain or loss is recognized on such conversions.

## **Pension Costs**

Pension costs under the defined benefit pension plan are recognized on the basis of actuarial calculations. Unrecognized net transition obligation is amortized over 15 years, while pension gain or loss is amortized using the straight-line method based on the average remaining service years of employees.

If additional accrued pension cost based on actuarial calculations is not in excess of the sum of unamortized balance on prior service and unrecognized net transition obligation, “deferred pension cost” will be debited. Otherwise, the excess amount should be debited to “unrecognized pension cost” in stockholders’ equity.

According to the defined contribution pension plan, the contributed pension funds are recognized as expenses in the period of services employees provided.

## **Unearned Gain on Sale-Leasebacks**

A gain on the sale by the Company of assets that it leases back is deferred and amortized over the term of the lease agreements.

## **Income Tax**

Deferred tax assets are recognized for the tax effects of deductible temporary differences, loss carryforwards and unused investment credits, and deferred tax liabilities are recognized for the tax effects of taxable temporary differences. Deferred tax liabilities and assets are classified as current or noncurrent on the basis of the classification of the related asset or liability for financial reporting. A deferred tax asset or liability that cannot be related to an asset or liability for financial reporting, such as deferred tax assets related to net loss carryforwards, is classified according to the expected reversal or realization date of the temporary difference. Valuation allowance is recognized on deferred tax assets that are not expected to be realized.

Income tax credits for certain acquisitions of eligible equipment or technology, research and development expenses, personnel training expenses and investments in shares of stock are recognized in the period those acquisitions or expenses are incurred.

Adjustments to prior years’ tax liabilities are added to or deducted from the current year’s income tax expense.

Income tax (10%) on undistributed earnings is recorded as expense in the year when the stockholders resolve to retain the earnings.

## **Asset Impairment**

The Company began applying ROC Statement of Financial Accounting Standards (SFAS) No. 35, “Accounting for Asset Impairment” on January 1, 2005, which requires that certain assets - long-term investments accounted for by the equity method, property and equipment, intangible assets and other assets are subject to an impairment review.

SFAS No. 35 requires the Company to determine on each balance sheet date if an asset has been impaired. If there is impairment, then the Company must calculate the recoverable amount of the assets or the cash generating unit. An impairment loss should be recognized whenever the recoverable amount of the assets or the cash-generating unit is below the carrying amount, and this impairment loss is either charged to accumulated impairment or is used to reduce the carrying amount of the assets directly. If the Company revalued the properties under the law, an impairment loss on revalued properties should be charged to capital surplus - revaluation increment on properties, and if the capital surplus - revaluation increment on properties was not sufficient, the portion that exceed the balance will be recognized as loss in the statement of income. After the recognition of an impairment loss, the depreciation (amortization) charged to the asset should be adjusted in future periods for the revised asset carrying amount (net of accumulated impairment), less its salvage value, and calculated on a systematic basis over its remaining service life. If asset impairment loss (excluding goodwill) is reversed, the increase in the carrying amount resulting from reversal is credited to current income. However, loss reversal should not be more than the carrying amount (net of depreciation) had the impairment not been recognized.

The adoption of SFAS No. 35 had no significant effect on the Company's financial statements for the year ended December 31, 2005.

### **Revenues**

Passenger fares and cargo revenues are recognized when transportation is provided. The value of unused passenger tickets is recognized as "advance ticket sales."

### **Foreign-currency Transactions, Transactions of Foreign Subsidiaries or Foreign Operating Entity**

The Company maintains its accounts and expresses its financial statements in New Taiwan dollars. Foreign-currency transactions (except derivative transactions) are recorded in New Taiwan dollars at the rates of exchange in effect when the transactions occur. Gains or losses resulting from the application of different foreign exchange rates when foreign-currency assets and liabilities are settled, are credited or charged to income in the period of settlement.

The year-end balances of foreign-currency assets and liabilities are restated at the prevailing exchange rates, and the resulting differences are recorded as follows:

- a. Cost-method investments in shares of stock - as translation adjustment if the translated New Taiwan dollar amounts results in a lower amount; otherwise, no adjustment is made.
- b. Other assets and liabilities - as credits or charges to income.

Equity-method investments in foreign subsidiaries/affiliates are recorded in New Taiwan dollars using the rates of exchange in effect on acquisition dates. On balance sheet dates, the investments and the related equity in net income or net loss are restated at the prevailing exchange rates and weighted-average rates, respectively, and resulting differences are recorded as translation adjustments under stockholders' equity.

Under a regulation by the Securities and Futures Bureau, the carrying amount of an aircraft acquired and the related US dollar-denominated obligation incurred for the acquisition is accounted for as an investment in a foreign operating entity if the Company's use of the aircraft results in generating revenues and incurring expenses mainly in US dollars. On balance sheet date, the carrying amount of the aircraft and the related liability are restated at balance sheet date rates. The difference is recognized in stockholders' equity as translation adjustment.

## Derivative Financial Instruments

The Company uses derivative financial instruments for hedging purposes, as follows:

a. Forward exchange contracts

Forward exchange contracts are recorded in New Taiwan dollars as receivables and/or payables at spot rates on the starting dates of the contracts. The premium or discount, computed by multiplying the contract amount by the difference between the contracted forward rate and the starting date spot rates, is also recognized. The premium or discount is amortized using the straight-line method over the term of the forward contract, with the amortization charged to income. On the balance sheet dates, the gains or losses on the contracts, computed by multiplying the contract amounts by the difference between the spot rates on starting date and spot rates on the balance sheet date (or the spot rates last used to measure a gain or loss on that contract for an earlier period), are charged to income, fuel costs or adjusted to "advances for equipment acquisition" in the properties section of the balance sheets since advance payment for equipment is a hedged item. Also, the receivables and payables related to the forward contracts are netted out, and the resulting amount is presented as either an asset or a liability.

b. Foreign-currency options

Premiums paid or received for options are recorded as assets or liabilities, respectively. They are amortized equally over the term of the contract and recognized as revenue or expense. Gain or loss on the exercise of the options is credited or charged to current income of the item being hedged.

Effective from the fourth quarter of 2004, according to the promulgation issued by Accounting Research and Development Foundation, written foreign-currency option contracts should not be designated as hedging instruments (except for those used to offset the position of purchasing options which are equivalent to option written in terms of currency, account and terms.) On balance sheet dates, the carrying value of the option written is restated at fair value, and the resulting differences are credited or charged to current income.

c. Interest rate swaps

The contract (notional) amounts of interest rate swap agreements, which are entered into as hedges against interest rate fluctuations on existing obligations, are not recognized as assets or liabilities since the agreements do not require the exchange of such amounts. The net amounts paid or received under the agreements as of the balance sheets dates and on the settlement dates are recognized as adjustments to the interest income or expense of the hedged obligations.

d. Currency swap

Foreign-currency spot-position assets or liabilities on foreign-currency swap contracts are recorded at spot rates when the transactions occur, while the corresponding forward-position assets or liabilities are recorded at the contracted forward rates. The difference between the spot rate on the contract date and contracted forward rate is amortized using the straight-line method over the term of the contract and recorded as interest income or expense. On the balance sheet dates, receivables and payables of open contracts are netted out, and the net amount is recorded as an asset or a liability.

e. Fuel price hedging contracts

The Company enters into fuel price hedging contracts to manage its exposures of increases in jet fuel prices. The receivables or payables under these contracts are calculated on the basis of the difference between the agreed price and the market price of fuel products as of the settlement date or the balance sheet date and are recognized as a component of jet fuel expense.

### 3. CASH

	<u>December 31</u>	
	<u>2005</u>	<u>2004</u>
Cash on hand	\$ 34,082,290	\$ 29,459,962
Revolving fund	134,766,626	53,521,872
Cash in banks	1,814,052,502	3,610,706,228
Certificates of deposit	-	1,388,791,553
Reverse repurchase bonds	<u>66,225,109</u>	<u>-</u>
	<u>\$ 2,049,126,527</u>	<u>\$ 5,082,479,615</u>

### 4. SHORT-TERM INVESTMENTS

	<u>December 31</u>	
	<u>2005</u>	<u>2004</u>
Domestic marketable equity securities and mutual funds	\$ 4,674,755,878	\$ 3,419,755,878
Foreign marketable equity securities and mutual funds	<u>148,486,260</u>	<u>88,962,451</u>
	4,823,242,138	3,508,718,329
Less: Allowance for loss on short-term investments	<u>123,758</u>	<u>-</u>
	<u>\$ 4,823,118,380</u>	<u>\$ 3,508,718,329</u>
Market value		
Domestic marketable equity securities and mutual funds	\$ 4,674,632,120	\$ 3,432,178,493
Foreign marketable equity securities and mutual funds	<u>223,599,788</u>	<u>204,354,693</u>
	<u>\$ 4,898,231,908</u>	<u>\$ 3,636,533,186</u>

The total market value of the marketable equity securities and the open-end mutual funds are calculated at the average closing prices for December and the net asset values on December 31, 2005 and 2004, respectively.

### 5. NOTES AND ACCOUNTS RECEIVABLE - THIRD PARTIES

	<u>December 31</u>	
	<u>2005</u>	<u>2004</u>
Notes receivable	\$ 127,676,043	\$ 266,042,479
Accounts receivable	<u>9,219,677,320</u>	<u>7,658,396,572</u>
	9,347,353,363	7,924,439,051
Less: Allowance for doubtful accounts	<u>56,712,856</u>	<u>68,113,328</u>
	<u>\$ 9,290,640,507</u>	<u>\$ 7,856,325,723</u>

## 6. OTHER RECEIVABLES

	<u>December 31</u>	
	2005	2004
Credit note receivable for concessions from aircraft or engine manufacturer	\$ 505,497,142	\$ -
Accrued revenue	333,823,159	500,428,647
Tax refunds	170,313,520	126,593,105
Others	<u>31,204,170</u>	<u>93,967,068</u>
	<u>\$ 1,040,837,991</u>	<u>\$ 720,988,820</u>

## 7. INVENTORIES

	<u>December 31</u>	
	2005	2004
Aircraft spare parts	\$ 4,617,336,032	\$ 4,737,288,319
Items for in-flight sale	333,143,592	360,781,635
Work in process - maintenance services	<u>486,023,577</u>	<u>699,438,963</u>
	5,436,503,201	5,797,508,917
Less: Allowance for losses	<u>49,504,796</u>	<u>49,400,969</u>
	<u>\$ 5,386,998,405</u>	<u>\$ 5,748,107,948</u>

## 8. PREPAID EXPENSES

	<u>December 31</u>	
	2005	2004
Prepaid aircraft rentals	\$ 29,510,391	\$ 88,845,181
Prepaid insurance	11,001,380	522,932,206
Others	<u>32,779,519</u>	<u>84,361,566</u>
	<u>\$ 73,291,290</u>	<u>\$ 696,138,953</u>

## 9. INVESTMENTS IN SHARES OF STOCK

	<u>December 31</u>			
	<u>2005</u>		<u>2004</u>	
	Carrying Value	% of Ownership	Carrying Value	% of Ownership
<u>Equity method</u>				
Taiwan Air Cargo Terminal	\$ 1,764,771,295	54.00	\$ 1,747,484,730	54.00
Cal-Asia Investment	1,472,577,119	100.00	212,604,484	100.00
Mandarin Airlines	1,428,761,776	93.99	526,892,631	90.05
Cal-Dynasty International	844,269,204	100.00	823,787,451	100.00
Taoyuan International Airport Services	837,402,173	49.00	846,296,068	49.00
China Pacific Catering Services	628,245,974	51.00	618,000,629	51.00
Abacus Distribution Systems (Taiwan)	427,426,104	93.93	402,582,668	93.93

(Continued)

	<b>December 31</b>			
	<b>2005</b>		<b>2004</b>	
	<b>Carrying Value</b>	<b>% of Ownership</b>	<b>Carrying Value</b>	<b>% of Ownership</b>
Taiwan Airport Services	\$ 364,282,492	47.35	\$ 354,080,685	47.35
China Aircraft Service Ltd.	252,983,716	20.00	-	-
Kaohsiung Catering Services	168,040,746	31.76	166,449,852	31.76
Science Park Logistics Co.	153,127,612	28.48	-	-
Asian Compressor Technology Services	135,117,532	24.50	125,000,155	24.50
China Pacific Laundry Services	108,670,082	55.00	106,115,182	55.00
Hwa Hsia	82,956,113	100.00	93,156,433	100.00
Yestrip Co., Ltd.	34,887,394	100.00	-	-
Dynasty Holidays	22,525,138	51.00	25,162,759	51.00
Global Sky Express	5,868,415	25.00	5,623,390	25.00
Freighter Princess Ltd.	35,088	100.00	35,088	100.00
Freighter Prince Ltd.	34,602	100.00	34,602	100.00
Freighter Queen Ltd.	32,895	100.00	32,895	100.00
ICAS Co., Ltd.	-	48.21	40,360,311	48.21
	<u>8,732,015,470</u>		<u>6,093,700,013</u>	
<u>Cost method</u>				
Over-the-counter				
Far Eastern Air Transport	374,317,312	7.61	374,317,312	7.61
Trade-Van Information Services	<u>92,320,048</u>	5.98	<u>92,320,048</u>	5.98
	466,637,360		466,637,360	
Less: Allowance for losses	<u>127,966,229</u>		<u>62,697,368</u>	
	<u>338,671,131</u>		<u>403,939,992</u>	
With quoted market prices				
ABACUS International Holdings Ltd.	297,946,451	13.59	297,946,451	13.59
Fat Capital Management	120,000,000	10.00	150,000,000	10.00
Jardine Air Terminal Services	51,260,145	15.00	49,771,879	15.00
Chung Hwa Express Co.	22,000,000	11.00	22,000,000	11.00
Regal International Advertising	5,925,000	6.58	5,925,000	6.58
Science Park Logistics Co.	-	-	44,310,000	14.77
	<u>497,131,596</u>		<u>569,953,330</u>	
Unlisted preferred stocks				
ABACUS International Holdings Ltd.	<u>472,522</u>	-	<u>472,522</u>	-
	<u>836,275,249</u>		<u>974,365,844</u>	
	<u>\$ 9,568,290,719</u>		<u>\$ 7,068,065,857</u>	

The market value of investments in shares of OTC stocks were \$338,671,000 and \$403,940,000 for the years ended December 31, 2005 and 2004, respectively, based on the average closing prices of December 2005 and 2004, respectively.

The Company participated in subscription of new common shares of a subsidiary, Mandarin Airlines, in January of 2005, and the amount was \$799,322,000. After the subscription, the percentage of holding shares reached to 93.99%. The Company invested in Cal-Asia Investment with cash of \$1,242,217,000 in October and December of 2005 in order to invest in Yangtze River Express Airlines.

Because of adjustments in organizational framework, the Company bought all investments in shares of Yestrip Co., Ltd. from a subsidiary, Abacus Distribution Systems (Taiwan), in November of 2005.

The stockholders of Fat Capital Management (FCM) and China Pacific Catering Services (CPCS) resolved to reduce their companies' capital on June 24, 2005 and March 5, 2004, respectively. The Company received a return of capital of \$30,000,000 (FCM) and \$306,000,000 (CPCS) respectively, based on its percentage of ownership on the date of the authorities' approval of the capital reduction.

Information on equity-method investments in shares of stock is summarized as follows:

The equity in net income or loss on all equity-method investments (except Freighter Princess Ltd., Freighter Queen Ltd., Freighter Prince Ltd., China Aircraft Service Ltd. and ICAS Co., Ltd.) is calculated on the basis of the current year's audited financial statements. Since each of the total paid-in capital of Freighter Princess Ltd., Freighter Queen Ltd. and Freighter Prince Ltd. is less than \$30 million and each of their total operating revenue is less than \$50 million or less than 10% of the total operating revenues of the Company, the recognition of equity in net income is based on unaudited financial statements. The book value of investments in shares of the investee, China Aircraft Service Ltd., and the calculation of related investment income or loss for the year of 2005 was based on unaudited financial statements. The Company believes that there would have been no material effect on the presentation of its financial statements as a whole had those investees' statements been audited. ICAS Co., Ltd. has been liquidated based on a resolution in the special stockholders' meeting held in August of 2005. Consequently, the Company wrote off the carrying value of investment in ICAS Co., Ltd. to zero. Information on the equity in net income or loss on all equity-method investments is shown in Table 6.

## 10. PROPERTIES

	<b>December 31</b>	
	<b>2005</b>	<b>2004</b>
Revaluation increase - cost		
Building	\$ <u>50,335,009</u>	\$ <u>50,335,009</u>
Accumulated depreciation		
Building	\$ 2,680,486,060	\$ 2,516,400,617
Machinery and equipment	2,565,906,550	2,511,128,518
Flight equipment	33,233,089,556	29,615,179,704
Furniture	605,149,523	601,478,961
Leased flight and other equipment	5,937,957,830	4,946,956,969
Leasehold improvements	<u>401,152,626</u>	<u>396,145,335</u>
	<u>\$ 45,423,742,145</u>	<u>\$ 40,587,290,104</u>

In 1976 and 1982, the Company revalued its properties in accordance with government regulations. Revaluation increments were recorded as increases in the carrying amounts of the assets and credits to capital surplus.

Capitalized interest for the years ended December 31, 2005 and 2004 amounted to \$390,835,000 and \$345,147,000, respectively. These interests were calculated at rates ranging from 1.2927% to 3.7611% and 1.257% to 1.470% in the years ended December 31, 2005 and 2004, respectively.

## 11. SHORT-TERM LOANS

	<b>December 31</b>	
	<b>2005</b>	<b>2004</b>
Unsecured loans. Interest - 1.40% to 1.47% and 1.29% in the years ended December 31, 2005 and 2004, respectively	<u>\$ 1,000,000,000</u>	<u>\$ 500,000,000</u>

## 12. COMMERCIAL PAPER

	<u>December 31</u>	
	2005	2004
Aggregate face value - discounted interest: 1.478% to 1.488% and 1.250% to 1.288% in the years ended December 31, 2005 and 2004, respectively	\$ 850,000,000	\$ 900,000,000
Less: Unamortized discount	<u>884,613</u>	<u>373,655</u>
	<u>\$ 849,115,387</u>	<u>\$ 899,626,345</u>

## 13. BONDS

	<u>December 31</u>	
	2005	2004
<b>Current</b>		
Second issue of unsecured bonds in 2001	\$ 1,200,000,000	\$ 900,000,000
Issue of secured bonds in 2002	600,000,000	600,000,000
First issue of unsecured bonds in 2003	<u>1,200,000,000</u>	<u>-</u>
	<u>\$ 3,000,000,000</u>	<u>\$ 1,500,000,000</u>
<b>Noncurrent</b>		
Second issue of unsecured bonds in 2001	\$ -	\$ 1,200,000,000
Issue of secured bonds in 2002	800,000,000	1,400,000,000
Issue of secured bonds in 2003	2,800,000,000	4,000,000,000
Second issue of unsecured domestic convertible bonds	7,016,500,000	8,275,600,000
Third issue of unsecured domestic convertible bonds	<u>10,000,000,000</u>	<u>-</u>
	<u>\$ 20,616,500,000</u>	<u>\$ 14,875,600,000</u>

The third issue of unsecured domestic convertible bonds with an aggregate face value of \$10,000,000,000 was on August 8, 2005. These bonds will mature on August 7, 2010 at an annual interest rate of zero. The bond repayment terms, conversion features and other conditions are summarized as follows:

- a. The holders may demand a lump-sum payment for the bonds upon maturity.
- b. On August 7, 2008, the holders can require the Company to redeem their bonds at 99.7% of face value.
- c. The Company may redeem the bonds piecemeal between September 8, 2005 and June 28, 2010 under certain conditions.
- d. Between September 8, 2005 and July 28, 2010 (except for the period between the ex-dividend date and the date of dividend declaration on record), holders may convert the bonds to common stock of the Company. The initial conversion price was set at \$18.25, and the conversion price will be subject to adjustment if there is capital injection by cash, stock dividend distribution, or issuance of stock as employee stock bonus. The conversion price was at \$16.50 on December 31, 2005.
- e. As of December 31, 2005, the bonds had not been converted into any shares of common stock of the Company.

The second issue of unsecured domestic convertible bonds with an aggregate face value of \$10,000,000,000 was on February 24, 2004. These bonds will mature on February 23, 2009 at an annual interest rate of zero. The bond repayment terms, conversion features and other conditions are summarized as follows:

- a. The holders may demand a lump-sum payment for the bonds upon maturity.
- b. On February 23, 2007, the holders can require the Company to redeem their bonds at 99.7% of face value.
- c. The Company may redeem the bonds piecemeal between August 24, 2004 and January 14, 2009 under certain conditions.
- d. Between August 24, 2004 and February 13, 2009 (except for the period between the ex-dividend date and the date of dividend declaration on record), holders may convert the bonds to common stock of the Company. The initial conversion price was set at \$17.50, and the conversion price will be subject to adjustment if there is capital injection by cash, stock dividend distribution, or issuance of stock as employee stock bonus. The conversion price was \$15.00 on December 31, 2005.
- e. As of December 31, 2005, the bonds with aggregate face value of \$2,983,500,000 had been converted into 181,392,000 shares of common stock of the Company.

On May 20 to 23, 2003 (four business days), secured bonds with aggregate face values of \$1,200,000,000, \$1,200,000,000 and \$1,600,000,000 were issued as Type A, B and C bonds, respectively, and durations of 3, 4 and 5 years, respectively. The bonds are repayable in lump sum payment on maturity. The interest rates for Type A bonds and Type B bonds are 1.45% and 1.6%, respectively, and the interests are calculated and payable annually. The interest rate for Type C bonds is 4% minus floating interest rate, and the interest is calculated semiannually and payable annually. The guarantor institutions are Bank of Taiwan and Chiaotung Bank.

Secured bonds with aggregate face value of \$2,000,000,000 were issued on May 15 to 28, 2002 (ten business days). The bonds will mature on May 28, 2007 at an annual interest rate of 2.84%. The consecutive annual repayments of the principal start on May 28, 2005 annually at the percentage of 30%, 30% and 40%. The guarantor institutions are Land Bank and Taipei Fubon Bank.

The second issue of unsecured bonds, with an aggregate face value of \$3,000,000,000, was made between July 18, 2001 and August 6, 2001 (fourteen business days). The bonds will mature on August 6, 2006 at annual interest rates of 4.9%. The interests are payable annually. The consecutive annual repayments of the principal start on August 6, 2004 annually at the percentage of 30%, 30% and 40%.

#### 14. LONG-TERM LOANS

	<u>December 31</u>	
	<b>2005</b>	<b>2004</b>
Bank loans	\$ 113,156,463,054	\$ 92,987,480,703
Commercial paper, net of unamortized discount of \$42,240,397 and \$46,950,389 in the years ended December 31, 2005 and 2004, respectively	12,805,759,603	14,485,049,611
Less: Current portion	<u>20,627,781,085</u>	<u>15,083,694,067</u>
	<u>\$ 105,334,441,572</u>	<u>\$ 92,388,836,247</u>

Bank loans (New Taiwan dollars, Japanese yen and U.S. dollars) bear interest at the rates ranging from 0.5893% to 4.9563% and from 0.5972% to 3.3140% in the years ended December 31, 2005 and 2004, respectively. They are repayable either quarterly or semiannually or through a lump sum payment upon maturity in September 2017.

The Company has notes issuance facilities (NIF) obtained from certain financial institutions. The NIF, with various maturities until October 2014, were used by the Company to guarantee commercial paper it issued. The commercial paper was issued at discount rate of 1.290% to 2.299% and 1.4962% to 2.1566% in the year ended December 31, 2005 and 2004, respectively.

## 15. LONG-TERM CAPITAL LEASE OBLIGATIONS

	<u>December 31</u>	
	<u>2005</u>	<u>2004</u>
Capital lease obligations	\$ 11,156,284,311	\$ 12,107,997,247
Less: Current portion	<u>1,368,537,697</u>	<u>1,239,617,047</u>
	<u>\$ 9,787,746,614</u>	<u>\$ 10,868,380,200</u>

As of December 31, 2005, the Company was leasing certain aircraft and related parts from certain foreign companies under capital lease agreements expiring on various dates until February 2019.

Future minimum rental payments on flight equipment are summarized as follows:

<b>Period</b>	<b>Amount</b>
2006	\$ 1,368,537,697
2007	1,471,888,615
2008	1,583,057,977
2009	1,702,638,211
2010	1,290,148,337

Total rentals from 2011 onwards is \$3,744,385,000, and if discounted at the 2.015% interest rate of a one-year time deposit, the present value would be \$3,388,912,000.

## 16. PENSION PLAN

The Labor Pension Act took effect on July 1, 2005. The employees who were hired before June 30, 2005 and at work on July 1, 2005 could choose the pension scheme either under the Labor Standards Law or under this Act. The Act allows the employees to retain their seniority earned before its enforcement. The employees who were hired after July 1, 2005 can only choose to adopt the pension plan regulated in the Labor Pension Act.

The defined contribution pension plan pursuant to the Labor Pension Act requires the Company to contribute at the rate of no less than 6% of the employees' salaries to the individual's pension account under the custody of the Bureau of Labor Insurance. The Company recognized pension cost of \$29,507,000 for the second half year of 2005.

The pension plan, which is stipulated under the Labor Standard Law, is a defined benefit pension plan. Under the plan, the pension paid was based on the service years accumulated and the monthly average salaries earned by retired employees. The Company makes monthly contributions to a pension fund based on the 10% of the employees' salaries. The fund is administered by a pension fund committee and deposited in the committee's name in the Central Trust of China. As of December 31, 2005 and 2004, the contributions deposited in the Central Trust of China amounted to \$1,559,316,000 and \$1,289,412,000, respectively.

Pension information of the defined benefit pension plan is summarized as follows:

	<b>2005</b>	<b>2004</b>
a. Net periodic pension cost		
Service cost	\$ 272,172,883	\$ 275,829,176
Interest cost	240,291,515	229,293,945
Projected return on plan assets	(23,078,222)	(21,771,737)
Amortization of net transition obligation	307,511,000	307,511,000
Amortization of prior service cost	59,135,597	59,135,597
Amortization of pension gains or losses	<u>88,194,270</u>	<u>53,620,041</u>
	<u>\$ 944,227,043</u>	<u>\$ 903,618,022</u>
	<u><b>December 31</b></u>	
	<b>2005</b>	<b>2004</b>
b. Reconciliation of the fund status of the plan and accrued pension cost:		
Benefit obligation:		
Vested benefit obligation	\$ (4,257,769,512)	\$ (3,943,290,451)
Non-vested benefit obligation	(2,716,945,177)	(2,449,898,528)
Accumulated benefit obligation	(6,974,714,689)	(6,393,188,979)
Additional benefits based on future salaries	<u>(1,053,403,185)</u>	<u>(978,042,488)</u>
Projected benefit obligation	(8,028,117,874)	(7,371,231,467)
Fair value of plan assets	<u>1,559,316,321</u>	<u>1,289,412,041</u>
Funded status	(6,468,801,553)	(6,081,819,426)
Unrecognized net transition obligation	1,537,551,000	1,845,062,000
Unrecognized prior service cost	473,084,771	532,220,368
Unrecognized net actuarial loss	2,291,390,932	1,619,065,851
Additional liability	<u>(3,248,623,518)</u>	<u>(3,018,305,731)</u>
Accrued pension cost	<u>\$ (5,415,398,368)</u>	<u>\$ (5,103,776,938)</u>
	<b>2005</b>	<b>2004</b>
c. Actuarial assumptions		
Discount rate used in determining present values	3.7%	3.7%
Future salary increase rate	2.0%	2.0%
Expected rate of return on plan assets	3.7%	3.7%

## 17. STOCKHOLDERS' EQUITY

As of June 10, 2005 and June 11, 2004, the appropriation of earnings in 2004 and 2003 had been resolved by the stockholders, respectively, as follows:

	<b>Appropriations</b> <b>(in Thousands of</b>		<b>Dividend per Share</b>	
	<b>New Taiwan Dollars)</b>		<b>2004</b>	<b>2003</b>
	<b>2004</b>	<b>2003</b>	<b>2004</b>	<b>2003</b>
Legal reserve	\$ 418,274	\$ 177,945		
Special reserve	1,335,981	194,184		
Cash dividends	636,108	284,893	\$ 0.20	\$ 0.10
Stock dividends	3,180,542	1,424,464	1.00	0.50
Stock bonus for employees	<u>145,708</u>	<u>84,440</u>		
	<u>\$ 5,716,613</u>	<u>\$ 2,165,926</u>		

The above appropriations were the same as those proposed by the board of directors.

The second issue of unsecured domestic convertible bonds with aggregate face value of \$214,000,000 had been converted into 14,267,000 shares of common stock of the Company in fourth quarter in 2005. Under the related regulation, the Company can issue the shares first and then apply to the authorities to register the capital increase. The Company had completed the registration of capital increase dated on January 6, 2006.

Capital surplus from the issue of stock in excess of par value, stock issuance to effect a merger, reissuance of treasury stock and donation may be distributed as stock dividend or used to offset a deficit. But capital surplus from equity-method investees should not be used for any purpose.

The Company's Articles of Incorporation provide that the following should be appropriated from annual net income (less any deficit): (a) 10% as legal reserve and (b) special reserve equivalent to a debit balance of any stockholders' equity account. From the remainder, the Company should also appropriate at least 3% bonus to employees. Of the final remainder, at least 50% should be distributed to stockholders as both cash and stock dividends (cash dividend should not exceed 30% of the total dividends) or stock dividend only. In determining the amount of cash dividends to be distributed, the board of directors should take into account future cash requirements of the Company, primarily cash requirements for future aircraft acquisitions. Distribution of earnings generated in prior years should also comply with the foregoing guidelines. All earnings appropriations should be made and approved by the stockholders in the following year and given effect in the financial statements of that year.

The Company's special reserve appropriation from the current year's net income or the unappropriated earnings should be equal to the debit balance of any stockholders' equity account (other than deficit and the balance of treasury stocks), such as the debit balances of unrealized loss on investments in shares of stock, cumulative translation adjustments and unrecognized pension cost. When the sum of the debit balances decreases, a portion of the special reserve equal to the amount of the decrease becomes available for distribution.

Under the regulations of the Securities and Futures Commission (known as Securities and Futures Bureau now), a special reserve is appropriated from the balance of the retained earnings at an amount equal to the carrying value of the treasury stock held by subsidiaries in excess of the market value on the balance sheet date. The special reserve may be reversed when the market value recovers.

As of March 7, 2006, the date of the audit report, the appropriation of earnings in 2005 had not been resolved by the board of directors. The resolution on this appropriation will be announced through the Market Observation System on the Web site of the Taiwan Stock Exchange.

Under a resolution, the stockholders approved the board of directors' proposal on the appropriation of earnings in 2004 and declared \$145,708,000 as bonus for employees in the form of stocks (0.5% of the Company's outstanding common stocks as of December 31, 2004). Had the entire bonus for employees been distributed and recorded as expense, the 2004 basic earnings per share would have decreased from \$1.25 to \$1.21.

Under the Company Law, legal reserve should be appropriated until the reserve equals the Company's paid-in capital. This reserve may be used to offset a deficit. Also, when the reserve exceeds 50% of the Company's paid-in capital and there were no retained earnings, the Company may distribute the portion of the reserve exceeding 50% of paid-in capital as dividends and bonus<sup>[f7]</sup>, or if there was no deficit at the balance sheet date, the portion of the reserve exceeding 25% of paid-in capital may be capitalized into common stock.<sup>[f8]</sup>

Under the Income Tax Law, ROC resident stockholders are entitled to income tax credit upon the distribution of dividends appropriated from earnings generated since January 1, 1998. The income tax credit is based on a creditable tax ratio determined on the date of dividend distribution.

## 18. TREASURY STOCK

(In Thousands of Shares)

Reason	Shares at Beginning of Year	Shares Increase During the Year	Shares at End of Year
<u>2005</u>			
Company shares held by its subsidiaries reclassified from investment in shares of stock to treasury stock	<u>3,503</u>	<u>352</u>	<u>3,855</u>
<u>2004</u>			
Company shares held by its subsidiaries reclassified from investment in shares of stock to treasury stock	<u>3,336</u>	<u>167</u>	<u>3,503</u>

The above shares increase during the year refers only to stock dividends.

The shares reclassified as treasury stock amounted to \$36,554,000 and \$35,493,000 for the years ended December 31, 2005 and 2004, respectively. The market values of the treasury stocks as of December 31, 2005 and 2004 were \$57,327,000 and \$59,138,000, respectively.

The shares of the Company held by its subsidiaries were treated as treasury stock. The subsidiaries can exercise stockholders' right on these treasury stocks except to participate in new shares as investments in shares of stock. However, under the amended Business Law, the subsidiaries will no longer have voting rights effective June 22, 2005.

## 19. INCOME TAXES

- a. The reconciliation of the income tax expense on income before income tax expense at statutory income tax rate and income tax expense - current is as follows:

	<b>2005</b>	<b>2004</b>
Income tax expense on income before income tax at statutory rate (25%)	\$ 103,558,988	\$ 1,000,708,351
Add (deduct) tax effects of:		
Permanent differences	(204,880,637)	(204,864,092)
Temporary differences	<u>147,682,786</u>	<u>(26,421,298)</u>
Income tax expense - current	<u>\$ 46,361,137</u>	<u>\$ 769,422,961</u>

- b. Income tax consisted of the following:

Income tax expense - current	\$ 46,361,137	\$ 769,422,961
Tax on unappropriated retained earnings	-	543,373,555
Investment income tax credit	(46,361,137)	(1,057,386,897)
Net changes in deferred income tax expense (benefit):		
Allowance for loss on inventories	(3,819,480)	(100,444)
Equity in net loss of domestic equity-method investees	-	276,753,472
Equity in net income of foreign equity-method investees	5,339,417	18,216,111
Depreciation difference between accounting and tax on properties	(319,760,614)	(44,344,762)
Reversal (allowance) for loss on idle assets	55,491,241	(79,494,521)
Accrued expense of frequent-flyer program	(3,722,812)	(8,716,323)
Provision for pension cost	(20,325,911)	(63,257,922)
Unrealized foreign exchange gain (loss)	114,315,753	(72,914,371)
Difference between accounting and tax on interest	16,926,515	18,789,936
Investment income tax credits	(1,287,328,353)	(291,446,464)
Provision (reversal) of valuation allowance	1,255,290,857	(210,375,968)
Adjustment of prior years' tax	<u>(43,363,026)</u>	<u>21,587,854</u>
Income tax benefit	<u>\$ (230,956,413)</u>	<u>\$ (179,893,783)</u>

- c. Deferred income tax assets (liabilities) as of December 31, 2005 and 2004 consisted of the following:

	<u>December 31</u>	
	<b>2005</b>	<b>2004</b>
Current		
Allowance for loss on inventories	\$ 12,376,199	\$ 8,556,719
Accrued expenses for frequent-flyer program	44,981,897	41,259,085
Unrealized foreign exchange loss	<u>131,935,383</u>	<u>246,251,136</u>
Deferred income tax assets	<u>\$ 189,293,479</u>	<u>\$ 296,066,940</u>

(Continued)

	<b>December 31</b>	
	<b>2005</b>	<b>2004</b>
Noncurrent		
Investment income tax credit	\$ 2,750,748,171	\$ 1,224,396,704
Provision for pension cost	541,546,833	521,220,922
Difference between accounting and tax on interest	194,938,906	211,865,421
Allowance for loss on idle properties	<u>234,813,424</u>	<u>290,304,665</u>
Deferred income tax assets	3,722,047,334	2,247,787,712
Less: Valuation allowance	<u>(1,843,001,275)</u>	<u>(587,710,418)</u>
Deferred income tax assets, net	1,879,046,059	1,660,077,294
Depreciation difference between accounting and tax on properties	(330,040,976)	(649,801,590)
Cumulative equity in the net gain of foreign equity-method investees	<u>(29,986,290)</u>	<u>(24,646,873)</u>
Deferred income tax assets - noncurrent, net	<u>\$ 1,519,018,793</u>	<u>\$ 985,628,831</u>

- d. Information on the imputation credit account (ICA) and creditable tax ratio is summarized as follows:

	<b>December 31</b>	
	<b>2005</b>	<b>2004</b>
Balance of ICA	<u>\$ 5,311,507</u>	<u>\$ 61,002,031</u>

The expected and actual creditable tax ratios for dividend distribution to each qualified stockholder of earnings generated up to December 31, 2005 and 2004 were 0.01% and 8.57%, respectively.

The actual creditable tax ratio to be used for distributing earnings generated as of December 31, 2005 will be determined on the date of dividend distribution. Thus, the expected creditable tax ratio may change depending on the ICA balance on the dividend distribution date.

- e. The unappropriated retained earnings as of December 31, 2005 and 2004 included earnings of \$4,346,093,000 and \$5,644,645,000 generated as of December 31, 1997, respectively.

The above deferred income taxes were computed at a tax rate of 25%.

- f. Unused investment income tax credits as of December 31, 2005 were as follows:

<b>Regulatory Basis of Tax Credits</b>	<b>Description of the Source of the Tax Credit</b>	<b>Total Amount of the Tax Credits</b>	<b>Remaining Tax Credits</b>	<b>Expiry Year</b>
Article 6 of the Statute for Upgrading Industries	R&D expenses, personnel	\$ 691,221,339	\$ 187,945,814	2006
	training expenses and	728,009,810	158,180,920	2007
	purchases of eligible	1,413,493,056	769,884,880	2008
	equipment	1,634,736,557	1,634,736,557	2009

The income tax returns through 2002 (except 2001) had been examined by the tax authorities. Other information on these returns is as follows:

- a. On the Company's 1997 income tax return, the tax authorities assessed the Company an additional income tax of \$25,498,000. The tax authorities contended that a portion of the interest expense claimed as income tax deduction by the Company should have been capitalized. In addition, the tax authorities reduced the portion of the income that the Company considered tax-exempt. Further, the Company is claiming that, under the Income Tax Law, an income tax of \$27,211,000 paid in foreign tax jurisdictions in 1997 should be credited against its income tax obligations.
- b. On the Company's 1998 income tax return, the tax authorities calculated an additional gain of \$1,313,088,000 from the securities trading by foreign investees and assessed a fine on the Company. The tax authorities contended that transfers from the reorganization of foreign investees are considered securities trading. The Company has appealed these assessments and expects a favorable outcome on those appeals. But for conservative purposes, the Company recognized in 2003 an additional income tax on the 1998 income tax return.
- c. On the Company's 1999 income tax return, the tax authorities reassessed and reduced by \$1,411,146,000 the loss carryforwards generated from 1998 because they determined that the additional gain on the securities trading by foreign investee was in violation of the income tax law in 1998. The Company is claiming that the assessment of its 1998 income tax return is unreasonable and has appealed the assessment.

## 20. PERSONNEL, DEPRECIATION AND AMORTIZATION EXPENSES

	<b>2005</b>		
	<b>Included in Operating Costs</b>	<b>Included in Operating Expenses</b>	<b>Total</b>
Personnel expenses			
Salaries	\$ 8,510,333,506	\$ 2,115,643,963	\$ 10,625,977,469
Labor and health insurance	374,546,663	243,755,939	618,302,602
Pension cost	802,921,877	211,735,331	1,014,657,208
Others	1,843,128,120	266,771,107	2,109,899,227
Depreciation	9,481,076,699	295,043,524	9,776,120,223
Amortization	27,862,408	91,616,375	119,478,783

	<b>2004</b>		
	<b>Included in Operating Costs</b>	<b>Included in Operating Expenses</b>	<b>Total</b>
Personnel expenses			
Salaries	\$ 7,704,691,254	\$ 2,368,150,038	\$ 10,072,841,292
Labor and health insurance	337,434,340	235,537,051	572,971,391
Pension cost	695,007,302	271,691,799	966,699,101
Others	1,864,536,699	326,853,666	2,195,151,317
Depreciation	7,713,322,049	291,829,268	8,005,151,317
Amortization	23,853,418	24,358,625	48,212,043

## 21. EARNINGS PER SHARE

Numerators and denominators used in calculating earnings per share (EPS) were as follows:

	Amount (as Numerator) (Thousand)		Shares (as Denominator) (Thousand)	Earnings Per Share	
	Pre-tax	After Tax		Pre-tax	After Tax
	<u>For the year ended December 31, 2005</u>				
Basic EPS					
Net income on common stock	\$ 414,276	\$ 645,232	3,475,693	\$ 0.12	\$ 0.19
Dilutive effect of potential common stock					
Second tranche of unsecured convertible bonds	-	-	691,033		
Diluted EPS	\$ 414,276	\$ 645,232	4,166,726	\$ 0.10	\$ 0.15
<u>For the year ended December 31, 2004</u>					
Basic EPS					
Net income on common stock	\$ 4,002,833	\$ 4,182,727	3,345,186	\$ 1.20	\$ 1.25
Dilutive effect of potential common stock					
Second tranche of unsecured convertible bonds	-	-	548,980		
Diluted EPS	\$ 4,002,833	\$ 4,182,727	3,894,166	\$ 1.03	\$ 1.07

## 22. RELATED-PARTY TRANSACTIONS

a. The related parties

<u>Related Party</u>	<u>Relationship with the Company</u>
Taiwan Air Cargo Terminal	Subsidiary
Cal-Asia Investment	Subsidiary
Mandarin Airlines	Subsidiary
Cal-Dynasty International	Subsidiary
Taoyuan International Airport Services	Subsidiary
China Pacific Catering Services	Subsidiary
Abacus Distribution Systems (Taiwan)	Subsidiary
Taiwan Airport Services	Subsidiary
China Pacific Laundry Services	Subsidiary
Hwa Hsia	Subsidiary
Yestrip Co., Ltd.	Subsidiary
Dynasty Holidays	Subsidiary
Global Sky Express	Subsidiary
Freighter Princess Ltd.	Subsidiary
Freighter Prince Ltd.	Subsidiary
Freighter Queen Ltd.	Subsidiary
ICAS Co., Ltd.	Equity-method investee
China Aircraft Service Ltd.	Equity-method investee (from November in 2005)
Kaohsiung Catering Services	Equity-method investee
Science Park Logistics Co.	Equity-method investee (from May in 2005)
Asian Compressor Technology Services	Equity-method investee
China Aviation Development Foundation	Major stockholder (65.63%)

b. Significant transactions with related parties:

	<b>2005</b>		<b>2004</b>	
	<b>Amount</b>	<b>%</b>	<b>Amount</b>	<b>%</b>
1) Revenues				
Mandarin Airlines	\$ 1,424,137,942	1.31	\$ 1,178,032,166	1.22
Global Sky Express	156,776,388	0.14	160,602,034	0.17
China Aviation Development Foundation	47,104,040	0.04	47,581,043	0.05
Taiwan Air Cargo Terminal	31,963,212	0.03	28,471,379	0.03
Others	<u>54,140,174</u>	<u>0.06</u>	<u>37,203,923</u>	<u>0.04</u>
	<u>\$ 1,714,121,756</u>	<u>1.58</u>	<u>\$ 1,451,890,545</u>	<u>1.51</u>
2) Costs				
China Pacific Catering Services Taoyuan International Airport Services	\$ 1,052,620,530	1.15	\$ 982,395,606	1.29
Mandarin Airlines	846,050,554	0.93	791,722,585	1.04
Taiwan Air Cargo Terminal	773,286,817	0.85	413,248,012	0.54
Hwa Hsia	249,291,890	0.27	226,970,153	0.30
Taiwan Airport Services	209,263,445	0.23	193,363,594	0.25
China Aviation Development Foundation	203,689,376	0.22	250,241,206	0.33
Kaohsiung Catering Services	103,955,648	0.11	106,134,077	0.14
China Pacific Laundry Services	93,826,277	0.10	91,053,103	0.12
Dynasty Holidays	63,310,048	0.07	60,883,959	0.08
Cal-Dynasty International	57,447,861	0.06	75,474,091	0.10
Cal Asia Investment	46,945,338	0.05	45,597,315	0.06
Asian Compressor Technology Services	30,190,193	0.03	24,117,886	0.03
Others	4,243,535	-	4,548,261	-
	<u>32,624,891</u>	<u>0.05</u>	<u>611,684</u>	<u>-</u>
	<u>\$ 3,766,746,403</u>	<u>4.12</u>	<u>\$ 3,266,361,532</u>	<u>4.28</u>
	<b>December 31</b>			
	<b>2005</b>		<b>2004</b>	
	<b>Amount</b>	<b>%</b>	<b>Amount</b>	<b>%</b>
3) Receivables: Related parties				
Mandarin Airlines	\$ 131,129,233	78.51	\$ 384,064,718	94.76
China Aviation Development Foundation	8,832,951	5.38	8,159,011	2.01
Global Sky Express	6,678,261	4.06	7,900,247	1.95
Taiwan Air Cargo Terminal	3,495,242	2.13	3,172,050	0.78
Others	<u>11,544,958</u>	<u>9.92</u>	<u>2,002,695</u>	<u>0.50</u>
	<u>\$ 161,680,645</u>	<u>100.00</u>	<u>\$ 405,298,721</u>	<u>100.00</u>

(Continued)

	<b>December 31</b>			
	<b>2005</b>		<b>2004</b>	
	<b>Amount</b>	<b>%</b>	<b>Amount</b>	<b>%</b>
4) Payables to related parties				
Mandarin Airlines	\$ 445,394,146	43.90	\$ 690,146,433	54.06
China Pacific Catering Services	242,683,917	24.03	245,183,885	19.20
Taoyuan International Airport Services	200,689,383	19.87	207,647,733	16.26
Taiwan Air Cargo Terminal	33,604,060	3.33	30,732,847	2.41
Hwa Hsia	22,214,152	2.20	22,680,375	1.78
China Aviation Development Foundation	20,124,159	1.99	15,616,466	1.22
Taiwan Airport Services	15,840,181	1.57	38,876,414	3.05
Kaohsiung Catering Services	12,854,161	1.27	15,384,117	1.20
Others	<u>18,452,332</u>	<u>1.84</u>	<u>10,430,792</u>	<u>0.82</u>
	<u>\$ 1,011,856,491</u>	<u>100.00</u>	<u>\$ 1,276,699,062</u>	<u>100.00</u>

5) Trading of marketable securities

The Company acquired all the investments in shares of Yestrip Co., Ltd. held by Abacus Distribution Systems (Taiwan) in November of 2005, and the amount is \$36,265,000.

6) Lease of property and equipment

In September 2002, in order to help Mandarin Airlines fly the passenger and cargo routes between Kaohsiung and Hong Kong, the Company rented out planes to Mandarin Airlines under a jointly operating agreement. Passenger fares, revenue and the cost of the routes were recognized at the percentages of seats sold every month; for cargo, the rent received is based on actual flights made. As of December 31, 2005 and 2004, the rentals received were \$1,292,241,000 and \$1,060,603,000.

The Company rented planes from Mandarin Airlines under an operating lease agreement from July 2003 to February 2008. The Company paid the rental by flight hours except the rentals of the 737-800 aircraft was at a fixed amount of US\$282,000 monthly. For the year ended 2005 and 2004, the Company had paid about \$622,612,000 and \$301,134,000, respectively.

7) Endorsement and guarantee

	<b>December 31</b>	
	<b>2005</b>	<b>2004</b>
Mandarin Airlines - bank loans, commercial paper and other guarantee	\$ -	\$ 1,087,500,000
China Pacific Laundry Services - bank loans	120,000,000	120,000,000
Asian Compressor Technology Services - bank loans	21,092,715	20,749,186
Freighter Queen Ltd.	427,785,817	419,390,543
Freighter Prince Ltd.	485,856,393	477,943,422
Freighter Princess Ltd.	645,157,525	703,378,859

These related party transactions were conducted under normal terms.

### 23. PLEDGED ASSETS

The following assets had been pledged or mortgaged as collateral for long-term loans and business affairs:

	<u>December 31</u>	
	<u>2005</u>	<u>2004</u>
Deposits (for business affairs in certificates of deposit)	\$ 6,894,800	\$ 14,514,200
Pledged certificates of deposit (for bank loans)	314,900,662	258,064,516
Properties - flight equipment (net)	<u>137,490,907,132</u>	<u>111,034,129,803</u>
	<u>\$ 137,812,702,594</u>	<u>\$ 111,306,708,519</u>

### 24. COMMITMENTS AND CONTINGENT LIABILITIES

- a. The Company leased certain flight equipment and hangar under various operating lease agreements expiring in various dates until October 2013. Lease deposits aggregated \$3,350,000,000.

Minimum rentals for future years are summarized as follows:

<b>Year</b>	<b>Amount</b>
2006	\$ 2,047,729,800
2007	1,881,026,342
2008	1,524,947,247
2009	820,184,162
2010	730,409,538

Rentals from 2011 and thereafter will aggregate \$1,179,651,000. The present value of these rentals, discounted using the 2.015% discounted interest rate of one-year time deposits, is \$1,058,562,000.

- b. In July 1999, the Company acquired thirteen 747-400F aircraft from the Boeing Co., which had delivered 12 planes as of December 31, 2005. The aggregate purchase price of the remaining aircraft for delivery is US\$213,836,000. As of December 31, 2005, the Company had paid about US\$43,777,000, which was included in "advance payments on equipment purchase contracts" in the properties section of the balance sheets.

In April 2004, the Company acquired two more 747-400F aircraft from the Boeing Co. The aggregate purchase price of the aircraft for delivery is US\$459,813,000. As of December 31, 2005, the Company had paid about US\$152,513,000, included in "advance payments on equipment purchase contracts" in the properties section of the balance sheets.

- c. In December 2002, the Company entered into an option contract with Airbus for the purchase of twelve A330 aircraft and purchase option of another six A330 aircraft. The Company exercised the purchase option on two planes in December 2003. Airbus had delivered eight planes as of December 31, 2005. The aggregate purchase price of the remaining six planes is US\$1,026,016,000. As of December 31, 2005, the Company had paid about US\$196,035,000, which was included in the "advance payments on equipment purchase contracts" in the properties section of the balance sheets.

- d. A case involving a dispute between the Company and the Civil Aeronautics Administration (CAA) on certain lease payments and interests incurred on advances on leased aircraft was filed with the Taipei District Court. CAA repudiated the terms of the original contracts and claimed additional interests imputed both on rentals for six planes under capital lease and on prepayments for another three planes, i.e., originally leased but were later acquired by the Company. The amount claimed was about \$1,100,000,000. The district court ruled that the Company should pay the additional interest, but the Company appealed this decision. On April 8, 2003, the Taiwan high court ruled that the Company should pay CAA only \$2,874,000 plus 5% interest from May 21, 1997 to the payment date. In addition, the Company has to pay 0.3% of the lawsuit fees. The ruling was abandoned by the supreme court, and the supreme court remanded the case to the Taiwan high court on July 20, 2004 for a retrial. The Company expects a favorable outcome on this case.
- e. The Company entered into an operating lease agreement with the CAA for the use of six planes. Later, the CAA decided to dispose these planes at public auction. As a lessee, the Company was entitled to bid at the auction and subsequently won the bid in December 2003. The Company paid the purchase price in December 2003, before the delivery of the planes in January 2004. Afterwards, the CAA claimed that the Company should pay the residual lease payments between the last date of rental payment and the delivery date. The Company claimed these lease payments were already included in the purchase price. In May 2005, the CAA filed a lawsuit against the Company in Taiwan Taipei district court for the residual lease payments of \$380,570,000 and a late payment penalty of \$2,059,000. The Company declined to accept the ruling by Taiwan Taipei district court which required the Company pay the claimed amount. The Company argues that the lease agreement was originally a financing lease that entitled the Company to own those planes after it has fulfilled its obligation to pay all the lease payments. However, the CAA altered the lease agreement to an operating lease in response to their intention of selling those planes. The Company claimed that the CAA should return the excessive rentals collected in the period of lease agreement. Furthermore, such rentals rebated from the CAA can be used to offset the claims by the CAA. The previous ruling failed to clarify the characteristics of the lease agreement. The Company continues filing an appeal against the CAA in Taiwan High Court with more evidence and expects to have a favorable outcome.

## **25. FINANCIAL INSTRUMENTS**

### **a. Derivative financial instruments**

Forward exchange contracts and foreign-currency options are intended to hedge the Company's exposure to the adverse effect of exchange rate fluctuations on foreign-currency assets, liabilities and commitment. The currency swap contracts are intended to help the Company manage its currency positions. Interest rate swaps is used to hedge the risk arising from adverse movements of interest rates. The fuel price hedging contracts are to hedge against the volatility in fuel prices. The hedging strategy is to protect the Company from market risk by using instruments with fluctuations in their fair values that offset the changes in the fair values of the underlying exposures. The Company also periodically evaluates the effectiveness of the instruments.

The Company is exposed to credit risk if a counter-party defaults on its obligations. To manage this risk, the Company enters into derivative transactions only with known international and domestic financial institutions with good credit ratings. Contracts were also entered into with different financial institutions to minimize concentration of credit risk. Thus, no material losses resulting from counter-party defaults are anticipated.

The following table summarizes the aggregate contract (notional) amounts, credit risk and fair value of the Company's and a subsidiary, Mandarin Airlines's derivative financial instruments as of December 31, 2005 and 2004.

	December 31					
	2005			2004		
	Contract (Notional) Amount	Credit Risk	Fair Value	Contract (Notional) Amount	Credit Risk	Fair Value
<u>The Company</u>						
Forward exchange contracts	\$ 2,052,980,132	\$ 23,291,255	\$ 12,216,963	\$ -	\$ -	\$ -
Foreign-currency options						
- Buy	1,589,403,974	21,641,456	18,727,332	5,080,645,161	12,372,438	12,372,438
- Sell	1,690,181,391	-	(7,859,349)	10,923,562,387	-	(502,787,986)
Interest rate swaps	53,245,051,636	8,703,086	(1,251,398,204)	113,996,724,336	247,088,317	(1,442,180,263)
Fuel price hedging contracts	24,963,079,470	839,608,285	839,571,795	19,456,774,194	978,936,413	781,960,180
<u>Mandarin Airlines</u>						
Interest rate swaps	-	-	-	883,870,968	-	(20,719,712)
Fuel price hedging contracts	114,238,411	2,376,599	2,376,599	-	-	-

The fair value of each contract is calculated by using quotes from financial institutions.

The contract amount is used to calculate the amounts to be settled by the counter-parties; thus, it is neither the actual delivery amount nor the cash requirement of the Company. The derivative financial instruments held or issued by the Company are likely to be sold at reasonable market prices. The Company does not expect significant cash flow requirements upon contract maturity.

The gain or loss from derivative transactions is listed below.

	2005	2004
<u>The Company</u>		
Forward exchange contracts		
Foreign exchange gain	\$ 53,654,005	\$ 14,336,637
Reduction (addition) of advance payments on equipment purchase contracts	25,451,787	(1,523,213)
Reduction of fuel cost	31,647,107	-
Foreign-currency options		
Foreign exchange gain (loss)	916,032	(247,003,571)
Addition of advance payments on equipment purchase contracts	160,291,211	64,630,689
Reduction of fuel cost	5,815,409	-
Currency swap		
Reductional interest expense	5,770,984	-
Reduction of advance payments on equipment purchase contracts	53,922,247	-
Interest rate swaps - additional interest expense	774,664,857	578,360,112
Fuel price hedging contracts - reduction of fuel cost	2,035,054,458	2,646,122,668
<u>Mandarin Airlines</u>		
Interest rate swap - additional interest expense	10,700,402	36,920,648
Fuel price hedging contracts - reduction of fuel cost	3,918,057	7,195,012

b. Fair value of financial instruments as of December 31, 2005 and 2004

	<b>December 31</b>			
	<b>2005</b>		<b>2004</b>	
	<b>Carrying Amount</b>	<b>Fair Value</b>	<b>Carrying Amount</b>	<b>Fair Value</b>
Financial assets				
Fair value equal to carrying value	\$ 26,146,103,134	\$ 26,146,103,134	\$ 25,372,582,788	\$ 25,372,582,788
Short-term investments	4,823,118,380	4,898,231,908	3,508,718,329	3,636,533,186
Financial liabilities				
Fair value equal to carrying value	152,163,639,846	152,163,639,846	133,557,916,974	133,557,916,974
Bonds	23,616,500,000	23,700,566,600	16,375,600,000	17,220,439,778

The methods and assumptions used in estimating fair values are as follows:

- 1) The carrying values of some financial instruments reported in the balance sheets approximate fair values because of the short-term maturities of these instruments or the present receipts and payments approximate their carrying value. This assumption applies to cash and cash equivalents, receivables, receivable from related parties, other receivables, pledged certificates of deposit, deposits-in and -out, other financial assets - noncurrent, short-term loans, commercial paper, accounts payable, payable to related parties, accrued expenses, loans and debts - current portion, capital lease obligations - current portion, loans and debts, capital lease obligations and some other current liabilities.
- 2) Fair values of short-term investments and investment in shares of stock are based on quoted market price or on carrying amounts if quoted market prices are not available.
- 3) Fair values of bonds payable are based on quoted market prices.
- 4) Long-term loans and capital lease obligations - noncurrent are financial liabilities with floating interest. Thus, their carrying values represent fair values.

Only the fair values of some financial instruments were listed above; thus, the total of fair values listed above does not represent the Company's fair value.

## 26. ADDITIONAL DISCLOSURES

- a. Following are the additional disclosures required by the Securities and Futures Bureau for the Company and its investees:
  - 1) Financing provided: None.
  - 2) Endorsement/guarantee provided: Table 1 (attached).
  - 3) Marketable securities held: Table 2 (attached).
  - 4) Marketable securities acquired and disposed of at costs or prices of at least NT\$100 million or 20% of the paid-in capital: Table 3 (attached).
  - 5) Acquisition of individual real estates at costs or price of at least NT\$100 million or 20% of the paid-in capital: None.
  - 6) Disposal of individual real estates at cost or prices of at least NT\$100 million or 20% of the paid-in capital: None.
  - 7) Total purchase from or sale to related parties amounting to at least NT\$100 million or 20% of the paid-in capital: Table 4 (attached).

- 8) Receivables from related parties amounting to at least NT\$100 million or 20% of the paid-in capital: Table 5 (attached).
- 9) Names, locations, and related information of investees on which the Company exercises significant influence: Table 6 (attached).
- 10) Derivative financial transactions (please see Note 25).
- b. Investment in Mainland China: Table 7 (attached).

## 27. SEGMENT INFORMATION

### a. Industry

The Company mainly engages in air transportation services for passengers and cargo.

### b. Geographic area

Geographic area information in 2005 and 2004 is summarized as follows:

In Thousands of New Taiwan Dollars

	2005						Total
	America	Northeast Asia	Southeast Asia	Europe	Australia	Domestic	
Operating revenues	\$ 43,852,582	\$ 14,147,877	\$ 30,457,398	\$ 18,549,297	\$ 1,680,450	\$ -	\$ 108,687,604
Segment operating income	\$ 623,970	\$ 1,887,131	\$ 1,417,124	\$ (189,422)	\$ (384,074)	\$ -	\$ 3,354,729
Interest income							94,608
Equity in investees' net income							749,579
Other investment income							167,417
General income of the Company							985,576
Interest expense							(4,659,507)
General expense of the Company							(278,126)
Pretax income							\$ 414,276
Identifiable assets	\$ 273,611	\$ 45,926	\$ 147,543	\$ 20,102	\$ 2,167	\$ 188,341,112	\$ 188,830,461
Investments in shares of stock							9,568,291
General assets							46,580,939
Total assets							\$ 244,979,691
	2004						Total
	America	Northeast Asia	Southeast Asia	Europe	Australia	Domestic	
Operating revenues	\$ 38,236,090	\$ 11,276,740	\$ 28,456,117	\$ 16,713,669	\$ 1,492,446	\$ -	\$ 96,175,062
Segment operating income	\$ 2,105,081	\$ 3,217,442	\$ (2,784,982)	\$ 2,496,705	\$ 586,907	\$ -	\$ 5,621,153
Interest income							72,860
Equity in investees' net income							487,738
Other investment income							131,802
General income of the Company							1,246,317
Interest expense							(2,560,970)
General expense of the Company							(996,067)
Pretax income							\$ 4,002,833
Identifiable assets	\$ 323,771	\$ 37,462	\$ 152,777	\$ 8,641	\$ 2,172	\$ 150,016,351	\$ 150,541,174
Investments in shares of stock							7,068,066
General assets							59,698,693
Total assets							\$ 217,307,933

c. Major customers

The primary customers are the public; therefore, there is no customer with sales that are at least 10% of the Company's total sales.

d. Foreign sales revenue

Because of the business nature that is mainly to provide international air transportation services, the Company doesn't have to disclose foreign sales revenues.

**TABLE 1****CHINA AIRLINES, LTD. AND INVESTEES**

**ENDORSEMENT/GUARANTEE PROVIDED  
FOR THE YEAR ENDED DECEMBER 31, 2005  
(Amounts in New Taiwan Dollars, Unless Stated Otherwise)**

No.	Endorsement/ Guarantee Provider	Counter-party		Limits on Each Counter-party's Endorsement/ Guarantee Amounts (Note 1)	Maximum Balance for the Period	Ending Balance	Value of Collaterals Property, Plant, or Equipment	Ratio of Accumulated Amount of Collateral to Net Equity of the Latest Financial Statement (%)	Maximum Collateral/Guarantee Amounts Allowable (Note 2)
		Name	Nature of Relationship						
0	China Airlines	China Pacific Laundry Services	55% subsidiary	\$ 10,833,868,751	\$ 120,000,000	\$ 120,000,000	\$ -	-	\$ 27,084,671,878
		Asian Compressor Technology Services	Subsidiary held by each stockholder proportionately, who provided an endorsement/ guarantee within joint investment arrangements	10,833,868,751	21,162,791	21,092,715	-	-	27,084,671,878
		Mandarin Airlines	93.99% subsidiary	10,833,868,751	490,000,000	-	-	-	27,084,671,878
		Freighter Queen Ltd.	100% subsidiary	10,833,868,751	429,207,033	427,785,817	-	1	27,084,671,878
		Freighter Prince Ltd.	100% subsidiary	10,833,868,751	487,470,534	485,856,393	-	1	27,084,671,878
		Freighter Princess Ltd.	100% subsidiary	10,833,868,751	696,571,966	645,157,525	-	1	27,084,671,878

Note 1: Based on the Company's guidelines, the maximum amount of guarantee to an individual counter-party is up to 20% of the Company's stockholders' equity.

Note 2: Based on the Company's guidelines, the allowable aggregate amount of collateral guarantee is up to 50% of the Company's stockholders' equity.

## CHINA AIRLINES, LTD. AND INVESTEEES

## MARKETABLE SECURITIES HELD

DECEMBER 31, 2005

(Amounts in New Taiwan Dollars, Unless Stated Otherwise)

Holding Company Name	Marketable Securities Type and Name	Relationship with the Company	Financial Statement Account	December 31, 2005				Note
				Shares/Units	Carrying Value	Percentage of Ownership	Market Value or Net Asset Value	
China Airlines	<u>Stock</u>							
	Taiwan Air Cargo Terminal	Subsidiary	Investments in shares of stock	135,000,000	\$ 1,764,771,295	54.00	\$ 1,764,771,295	-
	Cal-Asia Investment	Subsidiary	Investments in shares of stock	42,850,000	1,472,577,119	100.00	1,472,577,119	-
	Mandarin Airlines	Subsidiary	Investments in shares of stock	188,154,026	1,428,761,776	93.99	1,769,154,633	Note 1
	Cal-Dynasty International	Subsidiary	Investments in shares of stock	2,614,500	844,269,204	100.00	844,269,204	-
	Taoyuan International Airport Services	Subsidiary	Investments in shares of stock	34,300,000	837,402,173	49.00	837,402,173	-
	China Pacific Catering Services	Subsidiary	Investments in shares of stock	43,860,000	628,245,974	51.00	628,245,974	-
	Abacus Distribution Systems (Taiwan)	Subsidiary	Investments in shares of stock	22,450,008	427,426,104	93.93	427,426,104	-
	Taiwan Airport Services	Subsidiary	Investments in shares of stock	17,188,870	364,282,492	47.35	364,282,492	-
	China Aircraft Services Limited	Equity-method investee	Investments in shares of stock	28,400,000	252,983,716	20.00	206,226,553	Note 4
	Kaohsiung Catering Services	Equity-method investee	Investments in shares of stock	12,705,000	168,040,746	31.76	168,040,746	-
	Science Park Logistics Co.	Equity-method investee	Investments in shares of stock	13,293,000	153,127,612	28.48	146,041,073	Note 4
	Asian Compressor Technology Services	Equity-method investee	Investments in shares of stock	7,732,200	135,117,532	24.50	135,117,532	-
	China Pacific Laundry Services	Subsidiary	Investments in shares of stock	13,750,000	108,670,082	55.00	108,670,082	-
	Hwa Hsia	Subsidiary	Investments in shares of stock	50,000	82,956,113	100.00	94,182,005	Note 1
	Yestrip Co., Ltd.	Subsidiary	Investments in shares of stock	2,600,000	34,887,394	100.00	34,887,394	-
	Dynasty Holidays	Subsidiary	Investments in shares of stock	408	22,525,138	51.00	22,525,138	-
	Global Sky Express	Subsidiary	Investments in shares of stock	250,000	5,868,415	25.00	5,868,415	-
	Freighter Princess Ltd.	Subsidiary	Investments in shares of stock	1,000	35,088	100.00	35,088	-
	Freighter Prince Ltd.	Subsidiary	Investments in shares of stock	1,000	34,602	100.00	34,602	-
	Freighter Queen Ltd.	Subsidiary	Investments in shares of stock	1,000	32,895	100.00	32,895	-
	ICAS Co., Ltd.	Equity-method investee	Investments in shares of stock	6,750,000	-	48.21	7,677,451	Note 5
	Far Eastern Air Transport	-	Investments in shares of stock	44,703,017	374,317,312	7.61	219,938,844	-
	Trade-Van Information Services	-	Investments in shares of stock	11,825,925	92,320,048	5.98	118,732,287	-
	Abacus International Holdings Ltd. - unlisted common stock	-	Investments in shares of stock	1,359,368	297,946,451	13.59	1,663,692,720	Note 7
	Fat Capital Management	-	Investments in shares of stock	12,000,000	120,000,000	10.00	66,544,122	-
	Jardine Air Terminal Services	-	Investments in shares of stock	12,000,000	51,260,145	15.00	55,919,052	Note 3
	Chung Hua Express Co.	-	Investments in shares of stock	2,200,000	22,000,000	11.00	22,178,523	Note 3
	Regal International Advertising	-	Investments in shares of stock	592,500	5,925,000	6.58	3,133,769	Note 3
	Abacus International Holdings Ltd. - unlisted preferred stock	-	Investments in shares of stock	135,937	472,522	-	1,663,692,720	Note 7
	Chunghwa Telecom	-	Short-term investments	2,000,000	114,755,878	-	114,140,000	-
	France Telecom	-	Short-term investments	195,587	88,962,451	-	164,075,979	-
	<u>Mutual funds</u>							
	ABN Amro Bond Fund	-	Short-term investments	16,824,253.84	250,000,000	-	250,028,601	-
	Fuh-Hwa Bond Fund	-	Short-term investments	34,218,710.80	450,000,000	-	450,051,326	-
	NITC Bond Fund	-	Short-term investments	2,157,324.42	350,000,000	-	350,094,922	-
	Tlam Solomon Bond Fund	-	Short-term investments	34,783,516.09	400,000,000	-	400,048,696	-
	Barits Bond Fund	-	Short-term investments	20,847,926.90	250,000,000	-	250,056,290	-
	INVESCO Income Fund	-	Short-term investments	26,609,898.88	300,000,000	-	300,031,932	-
	Prudential Financial Bond Fund	-	Short-term investments	13,872,030.50	200,000,000	-	200,019,421	-
	Jin Sun Bond Fund	-	Short-term investments	22,281,308.95	300,000,000	-	300,073,528	-
	Truswell Bond Fund	-	Short-term investments	15,868,104.30	200,000,000	-	200,012,694	-
	Shinkong Chi-Shin Fund	-	Short-term investments	14,146,672.72	200,000,000	-	200,007,074	-
	Fubon Ju-I II Fund	-	Short-term investments	13,916,625.40	200,000,000	-	200,025,049	-
	Polaris Di-Po Fund	-	Short-term investments	27,438,104.20	300,000,000	-	300,032,926	-
	Sheng Hua 1699 Bond Fund	-	Short-term investments	8,161,333.24	100,000,000	-	100,000,000	-
	PCA Bond Fund	-	Short-term investments	6,519,754.90	100,000,000	-	100,000,000	-
	Mega Diamond Bond Fund	-	Short-term investments	17,619,903.44	200,000,000	-	200,015,858	-

(Continued)

Holding Company Name	Marketable Securities Type and Name	Relationship with the Company	Financial Statement Account	December 31, 2005				Note
				Shares/Units	Carrying Value	Percentage of Ownership	Market Value or Net Asset Value	
	KGI Victory Fund	-	Short-term investments	18,841,617.36	\$ 200,000,000	-	\$ 200,015,073	-
	Cathay Bond Fund	-	Short-term investments	17,573,302.60	200,000,000	-	200,028,117	-
	JF(Taiwan) Bond Fund	-	Short-term investments	13,287,932.90	200,000,000	-	200,024,583	-
	JF(Taiwan) First Bond Fund	-	Short-term investments	10,819,310.30	150,000,000	-	150,028,130	-
	KG 100% Principal Guaranteed Fund	-	Short-term investments	1,000,000.00	10,000,000	-	9,897,900	-
	Goldman Sachs Money Market Fund	-	Short-term investments	1,500,000.00	59,523,809	-	59,523,809	-
	<u>Bonds purchased under agreements to resell</u>							
	HSBC Australia	-	Cash and cash equivalents	-	33,112,555	-	33,112,555	-
	EIB	-	Cash and cash equivalents	-	33,112,554	-	33,112,554	-
Taiwan Air Cargo Terminal	<u>Mutual funds</u>							
	Jin Sun Bond Fund	-	Short-term investments	3,716,919.40	50,057,612	-	50,057,612	-
	NITC Taiwan Bond Fund	-	Short-term investments	14,473,671.60	201,184,035	-	201,184,035	-
	NITC Bond Fund	-	Short-term investments	627,321.10	101,802,923	-	101,802,923	-
	Fuh-Hwa Bond Fund	-	Short-term investments	18,430,525.40	242,401,956	-	242,401,956	-
	Fuh-Hwa Albatross Fund	-	Short-term investments	7,648,670.10	85,171,001	-	85,171,001	-
	Sheng Hua 5599 Bond Fund	-	Short-term investments	25,227,522.37	279,081,989	-	279,081,989	-
	Fuhwa Bond Fund	-	Short-term investments	6,547,516.58	82,630,314	-	82,630,314	-
	Fuhwa Advantage Bond Fund	-	Short-term investments	18,052,407.82	185,748,445	-	185,748,445	-
	Fuhwa Apex Bond Fund	-	Short-term investments	13,053,875.30	152,089,396	-	152,089,396	-
	Mega Diamond Bond Fund	-	Short-term investments	17,847,550.74	202,591,118	-	202,600,042	-
	Fubon Chi-Hsiang I Fund	-	Short-term investments	14,911,730.09	192,601,397	-	192,601,397	-
	Fubon Chi-Hsiang III Fund	-	Short-term investments	4,897,383.31	51,223,691	-	51,223,691	-
	Chung Hsing Pion Fund	-	Short-term investments	9,559,155.46	100,894,974	-	100,894,974	-
	Dresdner Bond Dam Fund	-	Short-term investments	8,818,991.96	100,793,141	-	100,793,141	-
	Cathay Capital Income Growth Bond Fund	-	Short-term investments	18,550,501.70	200,154,348	-	200,154,348	-
	Shinkong Chi-Shin Fund	-	Short-term investments	4,324,299.34	61,137,376	-	61,137,376	-
	Ta Chong Bond Fund	-	Short-term investments	7,831,834.90	100,577,990	-	100,577,990	-
Cal-Asia Investment	<u>Stock</u>							
	Xiamen International Airport Air Cargo Terminal Co., Ltd.	Equity-method investee	Investments in shares of stock	-	127,284,536	12.00	127,284,536	Note 2
	Xiamen International Airport Air Cargo Storage Co., Ltd.	Equity-method investee	Investments in shares of stock	-	52,210,265	12.00	8,700,861	Note 2 and Note 4
	Eastern United International Logistics	Equity-method investee	Investments in shares of stock	600,000	12,427,185	20.00	12,427,185	-
	Yangtze River Express Airlines Co., Ltd.	-	Advances for investments in shares of stock	-	1,176,767,318	-	-	Note 8
Mandarin Airlines	<u>Stock</u>							
	Mandarin Airlines Sweden AB	Subsidiary	Investments in shares of stock	1,000	-	100.00	-	-
	Mandarin Aircraft Trading Co., Ltd.	Subsidiary	Investments in shares of stock	1,000	-	100.00	-	-
	China Airlines, Ltd.	Parent company	Short-term investments	2,768,807	26,947,989	-	43,027,261	-
	France Telecom	-	Short-term investments	8,274	3,894,546	-	6,940,976	-
	<u>Mutual funds</u>							
	The Wan Pao Fund	-	Short-term investments	2,005,267.17	30,000,000	-	30,045,119	-
	Mega Diamond Bond Fund	-	Short-term investments	1,761,850.65	20,000,000	-	20,000,000	-
	<u>Government bond</u>							
	Central Government Bonds - 87B1	-	Cash and cash equivalent	67,563	6,756,294	-	8,910,837	-
	Central Government Bonds - 88A1	-	Cash and cash equivalent	300,000	30,000,000	-	32,574,990	-
	Central Government Bonds - 89A8	-	Cash and cash equivalent	232,437	23,243,706	-	24,235,137	-
	Central Government Bonds - 8914	-	Cash and cash equivalent	235,400	23,540,000	-	27,125,472	-
	Central Government Bonds - 92A2	-	Cash and cash equivalent	300,000	30,000,000	-	31,812,090	-
	Central Government Bonds - 92A7	-	Cash and cash equivalent	264,600	26,460,000	-	28,058,263	-
	Kaohsiung Government Bonds - 9402	-	Cash and cash equivalent	500,000	50,000,000	-	45,491,400	-
	Central Government Bonds - 94A2	-	Cash and cash equivalent	300,000	30,000,000	-	30,128,970	-

(Continued)

Holding Company Name	Marketable Securities Type and Name	Relationship with the Company	Financial Statement Account	December 31, 2005				Note
				Shares/Units	Carrying Value	Percentage of Ownership	Market Value or Net Asset Value	
Taoyuan International Airport Services	<u>Stock</u>							
	Taiwan Whi Lin Industry Co., Ltd.	Equity-method investee	Investments in shares of stock	4,275,000	\$ 43,567,162	26.07	\$ 43,567,162	-
	Tao Yao Co., Ltd.	Subsidiary	Investments in shares of stock	1,000,000	11,123,981	100.00	11,123,981	-
	Taiwan Air Cargo Terminal	Controlled by China Airlines	Investments in shares of stock	6,250,000	62,500,000	2.50	81,702,375	-
	<u>Mutual funds</u>							
	HSBC Taiwan Dragon Fund	-	Short-term investments	749,327.50	10,000,000	-	11,399,145	-
	ABN AMRO Aggressive Taiwan Bond Fund	-	Short-term investments	795,062.66	8,000,000	-	8,678,347	-
	ABN AMRO Income Fund	-	Short-term investments	8,538,667.97	133,000,000	-	133,087,948	-
	Barits Bond Fund	-	Short-term investments	4,099,077.40	48,000,000	-	49,165,564	-
	Fuhwa Bond Fund	-	Short-term investments	2,498,542.52	30,000,000	-	31,531,856	-
	Fuhwa Advantage Bond Fund	-	Short-term investments	4,184,558.16	41,908,350	-	43,056,593	-
	Sheng Hua 1699 Bond Fund	-	Short-term investments	5,075,777.78	60,000,000	-	62,192,998	-
	Mega Diamond Bond Fund	-	Short-term investments	882,036.45	10,000,000	-	10,012,613	-
	Ta Chong Bond Fund	-	Short-term investments	2,367,256.20	30,000,000	-	30,400,778	-
	JF(Taiwan) Bond Fund	-	Short-term investments	2,018,992.00	30,000,000	-	30,392,088	-
	JF (Taiwan) European Bond Fund	-	Short-term investments	3,000,000.00	30,030,000	-	29,996,700	-
	UPAMC Home Run Bond Fund	-	Short-term investments	1,498,666.20	20,000,000	-	20,752,331	-
	UPAMC James Bond Fund	-	Short-term investments	1,342,523.60	19,963,192	-	20,443,412	-
	TIIM High Yield Fund	-	Short-term investments	1,640,621.80	20,000,000	-	20,053,976	-
	Dresdner Bond Dam Fund	-	Short-term investments	875,457.43	10,000,000	-	10,005,691	-
	NITC Bond Fund	-	Short-term investments	123,313.69	20,000,000	-	20,011,591	-
	Fuh-Hwa Bond Fund	-	Short-term investments	760,745.50	10,000,000	-	10,005,477	-
	Transcend Fortune Fund	-	Short-term investments	833,340.30	10,000,000	-	10,005,000	-
ABN Amro Principal Guarantee Quantita Currency Note	-	Short-term investments	1,376,660.00	50,000,000	-	59,436,365	Note 6	
China Pacific Catering Services	<u>Mutual funds</u>							
	Fuhwa Classical Fund	-	Short-term investments	487,367.40	5,005,000	-	4,864,024	-
	CITC Safe Income Fund	-	Short-term investments	2,362,694.20	34,000,000	-	34,639,223	-
	The RSIT Enhanced Bond Fund	-	Short-term investments	1,880,948.27	20,165,429	-	20,470,736	-
HSBC BRIC Fund	-	Short-term investments	1,010,101.00	10,024,000	-	10,040,404	-	
Abacus Distribution Systems (Taiwan)	<u>Mutual funds</u>							
	Sheng Hua 5599 Bond Fund	-	Short-term investments	1,270,305.90	14,003,852	-	14,052,886	-
	Sheng Hua 1699 Bond Fund	-	Short-term investments	1,647,464.97	20,059,449	-	20,186,224	-
	TLAM B.B. Bond Fund	-	Short-term investments	1,097,825.40	12,000,000	-	12,245,693	-
	TLAM Solomon Bond Fund	-	Short-term investments	2,177,893.78	25,047,303	-	25,048,174	-
	Mega Diamond Bond Fund	-	Short-term investments	1,240,958.73	14,000,000	-	14,086,991	-
	NITC Bond Fund	-	Short-term investments	222,184.04	36,000,000	-	36,056,470	-
HSBC NTD Money Management Fund	-	Short-term investments	1,372,353.90	20,000,000	-	20,115,552	-	
Taiwan Airport Services	<u>Stock</u>							
	Taiwan Airport Service (Samoa)	Subsidiary	Investments in shares of stock	-	193,116,970	100.00	193,116,970	Note 2
	Taiwan Air Cargo Terminal	Controlled by China Airlines	Investments in shares of stock	6,250,000	62,500,000	2.50	81,702,375	-
	Titan V.C. Corp.	-	Investments in shares of stock	5,000,000	50,000,000	5.30	42,738,143	Note 3
	TransAsia Airways	-	Investments in shares of stock	2,814,660	26,400,000	0.60	31,395,078	-
	<u>Mutual funds</u>							
	CITC Safe Income Fund	-	Short-term investments	7,459,604.70	108,703,028	-	109,364,519	-
	TIIM High Yield Fund	-	Short-term investments	2,313,045.83	27,481,846	-	28,273,284	-
	CITC High Yield	-	Short-term investments	1,497,037.20	20,000,000	-	20,120,030	-
	Prudential Financial Return Fund	-	Short-term investments	6,769,257.94	93,658,303	-	94,096,747	-
Fuhwa Apex Bond Fund	-	Short-term investments	858,781.90	10,000,000	-	10,005,582	-	
Hwa Hsia	<u>Stock</u>							
	Hwa Shin Building Safeguard Co., Ltd.	Subsidiary	Investments in shares of stock	1,000,000	13,038,116	100.00	13,038,116	-
	China Airlines	Parent company	Short-term investments	1,086,571	11,225,890	-	16,885,313	-

(Continued)

Holding Company Name	Marketable Securities Type and Name	Relationship with the Company	Financial Statement Account	December 31, 2005				Note
				Shares/Units	Carrying Value	Percentage of Ownership	Market Value or Net Asset Value	
Yestrip Co., Ltd.	<u>Mutual funds</u>							
	CITC Safe Income Fund	-	Short-term investments	1,297,632.00	\$ 19,000,000	-	\$ 19,024,453	-
	CITC Cash ReserveVes	-	Short-term investments	866,663.80	10,000,000	-	11,647,875	-
	Fuh-Hwa Albatross Fund	-	Short-term investments	449,575.60	5,000,000	-	5,006,204	-
	<u>Mutual funds</u>							
	ABN AMRO Select Bond Fund	-	Short-term investments	1,445,131.15	16,021,880	-	16,155,699	-
Taiwan Airport Service (Samoa)	Sheng Hua 5599 Bond Fund	-	Short-term investments	906,035.10	10,000,000	-	10,023,104	-
	NITC Bond Fund	-	Short-term investments	18,513.50	3,000,000	-	3,004,408	-
	<u>Stock</u>							
	Xiamen International Airport Air Cargo Terminal Co., Ltd.	Equity-method investee	Investments in shares of stock	-	136,798,076	13.00	136,798,076	Note 2
	Xiamen International Airport Air Cargo Storage Co., Ltd.	Equity-method investee	Investments in shares of stock	-	56,318,796	13.00	9,425,933	Note 2 and Note 4

Note 1: Based on the ROC Statement of Financial Accounting Standards No. 30, "Accounting for Treasury Stocks," Company shares held by subsidiaries are reclassified from investment in shares of stocks to treasury stocks. In addition, the difference between the carrying value and net asset value of Mandarin Airlines is due to the difference between the investment acquisition cost and the Company's equity in the investee's net assets.

Note 2: The Company was established as a limited company.

Note 3: The subsidiary's financial statements as of and for the year ended December 31, 2005 were not audited.

Note 4: The difference between carrying value and net asset value was the difference between the investment acquisition cost and the Company's equity in the investee's net assets.

Note 5: The subsidiary's net asset value as of December 31, 2005 was not audited. The difference between carrying value and net asset value of ICAS Co., Ltd. was because the Company wrote off the carrying value to zero based on the resolution in the special stockholders' meeting held in August of 2005 liquidating ICAS Co., Ltd.

Note 6: Included 659,109 units recorded in euros and 717,551 units recorded in U.S. dollars.

Note 7: The net asset value of the subsidiary amounted to \$1,663,692,720 which included common stock and preferred stock.

Note 8: The subsidiary's financial statements as of and for the year ended December 31, 2005 were not audited and the carrying value was calculated at 25% of the net assets, the targeted percentage of ownership.

## CHINA AIRLINES, LTD. AND INVESTEEES

MARKETABLE SECURITIES ACQUIRED AND DISPOSED OF AT COSTS OR PRICES OF AT LEAST NT\$100 MILLION OR 20% OF THE PAID-IN CAPITAL  
FOR THE YEAR ENDED DECEMBER 31, 2005  
(Amounts in New Taiwan Dollars, Unless Stated Otherwise)

Company Name	Marketable Securities Type and Name	Financial Statement Account	Counter-party	Nature of Relationship	Beginning Balance		Acquisition		Disposal			Ending Balance		
					Shares/Units	Amount	Shares/Units	Amount	Shares/Units	Amount	Carrying Value	Gain (Loss) on Disposal	Shares/Units	Amount
China Airlines	<u>Stock</u>													
	Mandarin Airlines	Investments in shares of stock	Mandarin Airlines	Subsidiary	108,220,793	\$ 526,892,631	79,933,233	\$ 799,332,330	-	\$ -	\$ -	\$ -	188,154,026	\$ 1,428,761,776 (Note 1)
	China Aircraft Services Limited	Investments in shares of stock	Air China and Hutchison Whampoa Limited	Equity-method investee	-	-	28,400,000	251,736,111	-	-	-	-	28,400,000	252,983,716 (Note 2)
	<u>Mutual funds</u>													
	Ta Chong Bond Fund	Short-term investments	-	-	-	-	137,332,854.90	1,750,000,000	137,332,854.90	1,752,743,025	1,750,000,000	2,743,025	-	-
	Grand Cathay Bond Fund	Short-term investments	-	-	-	-	98,378,990.70	1,250,000,000	98,378,990.70	1,251,874,959	1,250,000,000	1,874,959	-	-
	Chung Hsing Pion Fund	Short-term investments	-	-	-	-	85,817,889.86	900,000,000	85,817,889.86	901,065,466	900,000,000	1,065,466	-	-
	The First Global Investment Trust Duo LI-2 Bond Fund	Short-term investments	-	-	-	3,515,160.90	50,000,000	129,171,665.10	1,850,000,000	132,686,826.00	1,902,557,501	1,900,000,000	2,557,501	-
	Jin Sun Bond Fund	Short-term investments	-	-	-	-	126,915,292.13	1,700,000,000	104,633,983.18	1,402,666,104	1,400,000,000	2,666,104	22,281,308.95	300,000,000
	Tiam Solomon Bond Fund	Short-term investments	-	-	-	17,647,110.73	200,000,000	218,793,574.11	2,500,000,000	201,657,168.75	2,304,631,532	2,300,000,000	4,631,532	34,783,516.09
	Hua Nan Kirin Bond Fund	Short-term investments	-	-	-	27,854,894.60	300,000,000	115,215,120.20	1,250,000,000	143,070,014.80	1,552,015,940	1,550,000,000	2,015,940	-
	Hua Nan Phoenix Bond Fund	Short-term investments	-	-	-	-	-	101,593,865.40	1,500,000,000	101,593,865.40	1,503,496,552	1,500,000,000	3,496,552	-
	Mega Diamond Bond Fund	Short-term investments	-	-	-	17,904,301.51	200,000,000	97,409,816.52	1,100,000,000	97,694,214.59	1,102,295,737	1,100,000,000	2,295,737	17,619,903.44
	FUHWa Bond Fund	Short-term investments	-	-	-	12,051,580.77	150,000,000	91,620,329.34	1,150,000,000	103,671,910.11	1,302,623,409	1,300,000,000	2,623,409	-
	TIIM Bond Fund	Short-term investments	-	-	-	-	-	136,897,580.13	1,900,000,000	136,897,580.13	1,902,588,997	1,900,000,000	2,588,997	-
	PCA Well Pool Fund	Short-term investments	-	-	-	-	-	142,463,921.40	1,750,000,000	142,463,921.40	1,751,109,514	1,750,000,000	1,109,514	-
	PCA Bond Fund	Short-term investments	-	-	-	-	-	6,519,754.90	100,000,000	-	-	-	-	6,519,754.90
	Prudential Financial Fund	Short-term investments	-	-	-	21,086,962.70	300,000,000	62,950,589.90	900,000,000	84,037,552.60	1,201,552,785	1,200,000,000	1,552,785	-
	Prudential Financial Bond Fund	Short-term investments	-	-	-	-	-	76,505,726.10	1,100,000,000	62,633,695.60	901,754,405	900,000,000	1,754,405	13,872,030.50
	NITC Bond Fund	Short-term investments	-	-	-	1,874,847.70	300,000,000	11,148,722.63	1,800,000,000	10,866,245.91	1,754,605,566	1,750,000,000	4,605,566	2,157,324.42
	Barits Bond Fund	Short-term investments	-	-	-	12,671,380.40	150,000,000	150,937,907.90	1,800,000,000	142,761,361.40	1,702,819,353	1,700,000,000	2,819,353	20,847,926.90
	Cathay Bond Fund	Short-term investments	-	-	-	-	-	97,132,271.30	1,100,000,000	79,558,968.70	901,599,018	900,000,000	1,599,018	17,573,302.60
	The Increment Fund	Short-term investments	-	-	-	-	-	117,468,431.24	1,750,000,000	117,468,431.24	1,752,016,073	1,750,000,000	2,016,073	-
	Sheng Hua 5599 Bond Fund	Short-term investments	-	-	-	-	-	27,410,277.03	300,000,000	27,410,277.03	300,254,916	300,000,000	254,916	-
	Sheng Hua 9966 Bonded Fund	Short-term investments	-	-	-	10,000,000.00	100,000,000	5,020,886.90	50,000,000	15,020,886.90	151,041,892	150,000,000	1,041,892	-
	Sheng Hua 1699 Bond Fund	Short-term investments	-	-	-	-	-	131,412,641.27	1,600,000,000	123,251,308.03	1,502,111,974	1,500,000,000	2,111,974	8,161,333.24
	UPAMC JAMES Bond Fund	Short-term investments	-	-	-	13,319,835.90	200,000,000	95,842,375.90	1,450,000,000	109,162,211.80	1,652,703,238	1,650,000,000	2,703,238	-
	ABN Amro Bond Fund	Short-term investments	-	-	-	-	-	108,281,545.84	1,600,000,000	91,457,292.00	1,352,749,436	1,350,000,000	2,749,436	16,824,253.84
	KGI Victory Fund	Short-term investments	-	-	-	-	-	118,220,755.72	1,250,000,000	99,379,138.36	1,051,069,265	1,050,000,000	1,069,265	18,841,617.36
	Fubon JU-I Fund	Short-term investments	-	-	-	-	-	48,140,745.90	750,000,000	48,140,745.90	751,548,855	750,000,000	1,548,855	-
	Fubon Ju-I II Fund	Short-term investments	-	-	-	-	-	45,322,882.40	650,000,000	31,406,257.00	450,508,549	450,000,000	508,549	13,916,625.40
	Truswell Premier Fund	Short-term investments	-	-	-	18,455,803.00	200,000,000	-	-	18,455,803.00	200,332,205	200,000,000	332,205	-
	Truswell Bond Fund	Short-term investments	-	-	-	-	-	127,732,391.00	1,600,000,000	111,864,286.70	1,402,563,351	1,400,000,000	2,563,351	15,868,104.30
	Fuh-Hwa Bond Fund	Short-term investments	-	-	-	-	-	68,470,281.80	900,000,000	34,251,571.00	450,432,135	450,000,000	432,135	34,218,710.80
	INVESCO Income Fund	Short-term investments	-	-	-	26,971,140.88	300,000,000	147,065,177.42	1,650,000,000	147,426,419.42	1,653,532,791	1,650,000,000	3,532,791	26,609,898.88
	INVESCO ROC Bond Fund	Short-term investments	-	-	-	-	-	13,688,785.46	200,000,000	13,688,785.46	200,266,931	200,000,000	266,931	-
	Transcend Fortune Fund	Short-term investments	-	-	-	-	-	67,071,980.30	800,000,000	67,071,980.30	801,184,174	800,000,000	1,184,174	-
	HSBC NTD Money Management Fund	Short-term investments	-	-	-	-	-	34,433,822.60	500,000,000	34,433,822.60	500,486,706	500,000,000	486,706	-
	Shinkong Chi-Shin Fund	Short-term investments	-	-	-	21,509,693.70	300,000,000	135,286,402.46	1,900,000,000	142,649,423.44	2,003,544,637	2,000,000,000	3,544,637	14,146,672.72
	NTS High Yield Fund	Short-term investments	-	-	-	-	-	6,098,490.62	100,000,000	6,098,490.62	100,043,299	100,000,000	43,299	-
UBS Taiwan Bond Fund	Short-term investments	-	-	-	13,836,425.77	200,000,000	13,812,631.65	200,000,000	27,649,057.42	400,377,487	400,000,000	377,487	-	
FOREVER Fund	Short-term investments	-	-	-	-	-	77,584,018.16	1,100,000,000	77,584,018.16	1,100,970,688	1,100,000,000	970,688	-	
JF (Taiwan) Bond Fund	Short-term investments	-	-	-	13,466,290.50	200,000,000	93,573,243.80	1,400,000,000	93,751,601.40	1,401,271,300	1,400,000,000	1,271,300	13,287,932.90	
JF (Taiwan) First Bond Fund	Short-term investments	-	-	-	-	-	21,648,227.80	300,000,000	10,828,917.50	150,133,195	150,000,000	133,195	10,819,310.30	
Polaris De-Li Fund	Short-term investments	-	-	-	10,211,792.60	150,000,000	-	-	10,211,792.60	150,267,549	150,000,000	267,549	-	
Polaris Di-Po Fund	Short-term investments	-	-	-	-	-	137,791,258.70	1,500,000,000	110,353,154.50	1,202,549,627	1,200,000,000	2,549,627	27,438,104.20	
Taiwan Air Cargo Terminal	<u>Mutual funds</u>													
	Jin Sun Bond Fund	Short-term investments	-	-	10,686,136.43	142,055,086	18,119,975.22	243,052,009	25,089,192.25	336,155,405	335,049,483	1,105,922	3,716,919.40	50,057,612
	NITC Taiwan Bond Fund	Short-term investments	-	-	14,473,671.60	198,507,853	28,947,343.20	401,017,677	28,947,343.20	401,017,677	398,341,495	2,676,182	14,473,671.60	201,184,035
	NITC Bond Fund	Short-term investments	-	-	627,321.10	100,442,891	1,254,642.20	202,917,675	1,254,642.20	202,917,675	201,557,643	1,360,032	627,321.10	101,802,923
	THE Increment Fund	Short-term investments	-	-	15,002,271.78	222,368,173	15,002,271.78	223,860,899	30,004,543.56	447,930,330	446,229,072	1,701,258	-	-
	UPAMC James Bond Fund	Short-term investments	-	-	12,734,373.00	191,428,189	-	-	12,734,373.00	192,370,532	191,428,189	942,343	-	-
	Fuh-Hwa Bond Fund	Short-term investments	-	-	14,613,032.10	189,494,494	36,861,050.80	483,300,762	33,043,557.50	433,300,762	430,393,300	2,907,462	18,430,525.40	242,401,956
	Fuh-Hwa ALBATROSS Fund	Short-term investments	-	-	7,648,670.10	83,806,478	15,297,340.20	169,655,916	15,297,340.20	169,655,916	168,291,393	1,364,523	7,648,670.10	85,171,001
	Sheng Hua 5599 Bond Fund	Short-term investments	-	-	25,227,522.35	275,434,089	50,455,044.75	556,362,733	50,455,044.75	556,362,733	552,714,833	3,647,900	25,227,522.37	279,081,989
	PCA Bond Fund	Short-term investments	-	-	15,874,263.80	240,626,853	2,035,309.40	31,042,742	17,909,573.20	272,106,653	271,669,595	437,058	-	-
	FUHWa Bond Fund	Short-term investments	-	-	6,547,516.52	81,529,021	13,095,033.13	164,716,529	13,095,033.07	164,716,529	163,615,236	1,101,293	6,547,516.58	82,630,314
	Fuhwa Advantage Bond Fund	Short-term investments	-	-	18,052,407.83	181,766,084	36,104,815.62	370,290,989	36,104,815.63	370,290,989	366,308,628	3,982,361	18,052,407.82	185,748,445
	Fuhwa APEX Bond Fund	Short-term investments	-	-	4,368,796.30	50,227,177	34,792,829.60	403,182,781	26,107,750.60	303,182,781	301,320,562	1,862,219	13,053,875.30	152,089,396
	Mega Diamond Bond Fund	Short-term investments	-	-	8,967,966.42	100,000,000	40,145,281.76	453,702,260	31,265,697.44	353,702,260	351,111,142	2,591,118	17,847,550.74	202,591,118
	Fubon JU-I III Fund	Short-term investments	-	-	100,000,000	8,405,763.20	100,000,000	100,847,303	16,811,526.40	201,859,168	200,847,303	1,011,865	-	-
	Fubon Chi-Hsiang I Fund	Short-term investments	-	-	7,858,916.79	100,000,000	36,876,273.48	473,850,300	29,823,460.18	383,850,300	381,248,903	2,601,397	14,911,730.09	192,601,397
	Fubon Chi-Hsiang III Fund	Short-term investments	-	-	-	-	9,794,766.61	102,233,890	4,897,383.30	51,223,691	51,010,199	213,492	4,897,383.31	51,223,691
	Chung Hsing Pion Fund	Short-term investments	-	-	4,801,736.31	50,000,000	19,118,310.94	201,246,941	14,360,891.79	151,246,941	150,351,967	894,974	9,559,155.46	100,894,974
	Waterland Balance Fund	Short-term investments	-	-	-	-	-	12,800,298.80	119,233,227	12,800,298.80				

Company Name	Marketable Securities Type and Name	Financial Statement Account	Counter-party	Nature of Relationship	Beginning Balance		Acquisition		Disposal			Ending Balance		
					Shares/Units	Amount	Shares/Units	Amount	Shares/Units	Amount	Carrying Value	Gain (Loss) on Disposal	Shares/Units	Amount
Mandarin Airlines	Cathay Bond Fund	Short-term investments	-	-	-	\$ -	19,473,876.40	\$ 220,147,166	19,473,876.40	\$ 220,881,402	\$ 220,147,166	\$ 734,236	-	\$ -
	Cathay Capital Income Growth Bond Fund	Short-term investments	-	-	-	-	37,101,003.40	400,154,348	18,550,501.70	200,154,348	200,000,000	154,348	18,550,501.70	200,154,348
	Shinkong Chi-Shin Fund	Short-term investments	-	-	-	-	25,710,759.90	361,350,529	21,386,460.56	301,350,529	300,213,153	1,137,376	4,324,299.34	61,137,376
	Ta Chong Bond Fund	Short-term investments	-	-	-	-	15,663,669.80	200,577,990	7,831,834.90	100,577,990	100,000,000	577,990	7,831,834.90	100,577,990
	<u>Mutual funds</u>													
	Shinkong Chi-Shin Fund	Short-term investments	-	-	-	-	11,424,117.88	160,000,000	11,424,117.88	160,108,216	160,000,000	108,216	-	-
	NTS High Yield Fund	Short-term investments	-	-	-	-	9,184,554.15	150,000,000	9,184,554.15	150,130,005	150,000,000	130,005	-	-
	The Increment Fund	Short-term investments	-	-	-	-	6,710,023.92	100,000,000	6,710,023.92	100,218,576	100,000,000	218,576	-	-
	Mega Diamond Bond Fund	Short-term investments	-	-	-	-	9,754,531.03	110,000,000	7,992,680.38	50,066,349	90,000,000	66,349	1,761,850.65	20,000,000
	<u>Government bond</u>													
Taiwan Airport Services	Central Government Bonds - 91A8	Cash and cash equivalent	-	-	-	-	1,600,000	160,000,000	1,600,000	160,417,729	160,000,000	417,729	-	-
	Central Government Bonds - 8914	Cash and cash equivalent	-	-	-	-	1,200,000	120,000,000	1,200,000	120,103,288	120,000,000	103,288	-	-
Taiwan Airport Services	<u>Mutual funds</u>													
	Prudential Financial Return Fund	Short-term investments	-	-	-	-	22,596,703.92	312,000,000	15,827,445.98	219,200,000	218,341,697	858,303	6,769,257.94	93,658,303
	The Rsit Enhanced Bond Fund	Short-term investments	-	-	8,323,499.90	89,061,109	4,001,050.49	43,000,000	12,324,550.39	132,704,606	132,061,109	643,497	-	-
	CITC Safe Income Fund	Short-term investments	-	-	-	-	8,923,887.20	130,000,000	1,464,282.50	21,400,000	21,296,972	103,028	7,459,604.70	108,703,028

Note 1: The amount is composed of the following:

- Equity of \$110,899,341 in the investees' net income for the year ended December 31, 2005;
- Reduction by \$7,806,593 due to the nonproportional subscription in investees' new shares;
- Reduction by \$1,061,751 on treasury stock due to the changes of the ownership percentage; and
- Capital surplus of \$505,818 resulting from cash dividends distributed by the parent company.

Note 2: The amount included equity of \$2,394,849 in investees' net income for the year ended December 31, 2005.

## CHINA AIRLINES, LTD. AND INVESTEEES

TOTAL PURCHASE FROM OR SALE TO RELATED PARTIES AMOUNTING TO AT LEAST NT\$100 MILLION OR 20% OF THE PAID-IN CAPITAL  
FOR THE YEAR ENDED DECEMBER 31, 2005  
(Amounts in New Taiwan Dollars, Unless Stated Otherwise)

Company Name	Related Party	Nature of Relationship	Transaction Details				Abnormal Transaction		Note/Accounts Payable or Receivable		Note	
			Purchase/ Sale	Amount	% to Total	Payment Terms	Unit Price	Payment Terms	Ending Balance	% to Total		
China Airlines	Taiwan Air Cargo Terminal	Subsidiary	Purchase	\$ 249,291,890	0.27	30 days	\$ -	-	\$ (33,604,060)	(2.51)	-	
	Taoyuan International Airport Services	Subsidiary	Purchase	846,050,554	0.93	40 days	-	-	(200,689,383)	(15.01)	-	
	China Pacific Catering Services	Subsidiary	Purchase	1,052,620,530	1.15	60 days	-	-	(242,683,917)	(18.15)	-	
	Mandarin Airlines	Subsidiary	Sale	(1,424,137,942)	(1.31)	2 months	-	-	131,129,233	1.39	-	
				Purchase	773,286,817	0.85	2 months	-	-	(445,394,146)	(33.31)	-
	Taiwan Airport Services	Subsidiary	Purchase	203,689,376	0.22	40 days	-	-	(15,840,181)	(1.18)	-	
	Hwa Hsia	Subsidiary	Purchase	209,263,445	0.23	2 months	-	-	(22,214,152)	(1.66)	-	
	Global Sky Express	Equity-method investee	Sale	(156,776,388)	(0.14)	30 days	-	-	6,678,261	0.07	-	
	China Aviation Development foundation	Parent company	Purchase	103,955,648	0.11	30 days	-	-	(20,124,159)	(1.50)	-	
Taiwan Air Cargo Terminal	Taoyuan International Airport Services	Controlled by China Airlines	Purchase	135,650,000	10.00	45 days	-	-	(25,635,000)	(29.00)	-	
	Taiwan Airport Services	Controlled by China Airlines	Purchase	151,805,000	11.00	45 days	-	-	(26,627,000)	(30.00)	-	
	China Airlines	Parent company	Sale	(249,291,890)	(11.00)	45 days	-	-	33,604,060	34.00	-	
Mandarin Airlines	China Airlines	Parent company	Purchase	1,424,137,942	29.52	2 months	-	-	(131,129,233)	(56.73)	-	
			Sale	(773,286,817)	(15.18)	2 months	-	-	445,394,146	50.38	-	
Taoyuan International Airport Services	China Airlines	Parent company	Sale	(846,650,554)	(36.98)	30 days	-	-	200,689,383	54.25	-	
China Pacific Catering Services	China Airlines	Parent company	Sale	(1,052,620,530)	(61.88)	60 days	-	-	242,683,917	72.40	-	
Taiwan Airport Services	China Airlines	Parent company	Sale	(203,689,376)	(23.96)	45 days	-	-	15,840,181	15.10	-	
	Taiwan Air Cargo Terminal	Controlled by China Airlines	Sale	(152,056,048)	(17.88)	45 days	-	-	27,262,872	25.99	-	
	Mandarin Airlines	Controlled by China Airlines	Sale	(122,018,791)	(14.35)	45 days	-	-	21,133,159	20.14	-	
Hwa Hsia	China Airlines	Parent company	Sale	(209,263,445)	(84.13)	2 months	-	-	22,214,152	85.06	-	
Global Sky Express	China airlines	Parent company	Purchase	156,776,388	67.63	30 days	-	-	(6,678,261)	(67.16)	-	

**CHINA AIRLINES, LTD. AND INVESTEES**

**RECEIVABLES FROM RELATED PARTIES AMOUNTING TO AT LEAST NT\$100 MILLION OR 20% OF THE PAID-IN CAPITAL**

**DECEMBER 31, 2005**

**(Amounts in New Taiwan Dollars, Unless Stated Otherwise)**

Company Name	Related Party	Nature of Relationship	Ending Balance	Turnover Rate	Overdue		Amounts Received in Subsequent Period	Allowance for Bad Debts
					Amount	Action Taken		
China Airlines	Mandarin Airlines	Subsidiary	\$ 131,129,233	5.53	\$ -	-	\$ 18,392,941	\$ -
Mandarin Airlines	China Airlines	Parent company	445,394,146	1.74	-	-	63,506,957	-
Taoyuan International Airport Services	China Airlines	Parent company	200,689,383	4.05	-	-	117,836,840	-
China Pacific Catering Services	China Airlines	Parent company	242,683,917	4.32	-	-	79,432,868	-

## CHINA AIRLINES, LTD. AND INVESTEEES

NAMES, LOCATIONS, AND RELATED INFORMATION OF INVESTEEES ON WHICH THE COMPANY EXERCISES SIGNIFICANT INFLUENCE  
FOR THE YEAR ENDED DECEMBER 31, 2005  
(Amounts in New Taiwan Dollars, Unless Stated Otherwise)

Investor Company	Investee Company	Location	Main Businesses and Products	Original Investment Amount		Balance as of December 31, 2005			Net Income (Loss) of the Investee	Investment Income (Loss)	Note
				Dec. 31, 2005	Dec. 31, 2004	Shares	Percentage of Ownership (%)	Carrying Value			
China Airlines	Taiwan Air Cargo Terminal	Taoyuan, Taiwan	Air cargo and storage	\$ 1,350,000,000	\$ 1,350,000,000	135,000,000	54.00	\$ 1,764,771,295	\$ 439,315,136	\$ 230,586,565	-
	Cal-Asia Investment	Territory of the British Virgin Islands	General investment	US\$ 42,850,000	US\$ 5,650,000	42,850,000	100.00	1,472,577,119	18,719,164	18,719,164	-
	Mandarin Airlines	Taipei, Taiwan	Air transportation and maintenance of aircraft	2,042,368,252	1,243,035,922	188,154,026	93.99	1,428,761,776	83,844,349	110,899,341	Note 2
	Cal-Dynasty International	Los Angeles, U.S.A.	A holding company, real estate, hotel services, lease of aircraft and serving as cargo agent	US\$ 26,145,000	US\$ 26,145,000	2,614,500	100.00	844,269,204	(1,301,292)	(1,301,292)	Note 1
	Taoyuan International Airport Services	Taoyuan, Taiwan	Airport services	147,000,000	147,000,000	34,300,000	49.00	837,402,173	196,012,959	94,996,947	-
	China Pacific Catering Services	Taoyuan, Taiwan	In-flight catering	438,600,000	438,600,000	43,860,000	51.00	628,245,974	248,759,581	126,747,948	-
	Abacus Distribution System (Taiwan)	Taipei, Taiwan	Sale and maintenance of hardware and software	90,000,000	90,000,000	22,450,008	93.93	427,426,104	112,736,828	103,418,464	-
	Taiwan Airport Services	Taipei, Taiwan	Airport services	12,289,100	12,289,100	17,188,870	47.35	364,282,492	47,299,621	22,259,117	-
	China Aircraft Services Limited	Hong Kong	Airport services	HK\$ 58,000,000	-	28,400,000	20.00	252,983,716	258,874,194	4,528,383	-
	Kaohsiung Catering Services	Kaohsiung, Taiwan	In-flight catering	115,500,000	115,500,000	12,705,000	31.76	168,040,746	91,709,264	27,752,242	-
	Science Park Logistics Co.	Tainan, Taiwan	Storage and customs of services	150,654,000	44,310,000	13,293,000	28.48	153,127,612	73,852,824	11,335,612	-
	Asian Compressor Technology Services	Taoyuan, Taiwan	Research, manufacture and maintenance of engines	77,322,000	77,322,000	7,732,200	24.50	135,117,532	73,752,115	18,061,317	-
	China Pacific Laundry Services	Taoyuan, Taiwan	Cleaning and leasing of the tower of airlines company, hotel, restaurant, and health club	137,500,000	137,500,000	13,750,000	55.00	108,670,082	4,645,273	2,554,900	-
	Hwa Hsia	Taoyuan, Taiwan	Cleaning of aircraft and maintenance of machine and equipment	50,000,000	50,000,000	50,000	100.00	82,956,113	20,081,661	19,601,191	Note 2
	Yestrip Co., Ltd.	Taipei, Taiwan	Travel business	36,264,643	-	2,600,000	100.00	34,887,394	6,375,065	(1,377,249)	-
	Dynasty Holidays	Tokyo, Japan	Travel business	JPY 20,400,000	JPY 20,400,000	408	51.00	22,525,138	(1,154,091)	(588,586)	-
	Global Sky Express	Taipei, Taiwan	Forwarding and storage of air cargo	2,500,000	2,500,000	250,000	25.00	5,868,415	7,310,378	1,745,025	-
	Freighter Princess Ltd.	Cayman Islands	Aircraft lease	US\$ 1,000	US\$ 1,000	1,000	100.00	35,088	-	-	-
	Freighter Prince Ltd.	Cayman Islands	Aircraft lease	US\$ 1,000	US\$ 1,000	1,000	100.00	34,602	-	-	-
	Freighter Queen Ltd.	Cayman Islands	Aircraft lease	US\$ 1,000	US\$ 1,000	1,000	100.00	32,895	-	-	-
ICAS Co., Ltd.	Taoyuan, Taiwan	Manufacture and retail of aircraft and its related parts	67,500,000	67,500,000	6,750,000	48.21	-	(67,786,672)	(40,360,311)	-	
Cal Asia Investment	Eastern United International Logistics	Hong Kong International Airport	Forwarding and storage of air cargo	HK\$ 1,500,000	HK\$ 1,500,000	600,000	20.00	12,427,185	18,586,660	3,717,332	-
	Xiamen International Airport Air Cargo Terminal Co., Ltd.	Xiamen International Airport	Forwarding and storage of air cargo	US\$ 3,254,526	US\$ 3,254,526	-	12.00	127,284,536	120,751,929	13,813,215	Note 3
	Xiamen International Airport Air Cargo Storage Co., Ltd.	Xiamen International Airport	Airport cargo and storage of customers monitor	US\$ 1,626,428	-	-	12.00	52,210,265	14,414,090	(1,791,640)	Note 3
	Yangtze River Express Airlines Co., Ltd.	Shanghai	Forwarding and storage of air cargo	US\$ 35,538,373	-	-	25.00	1,176,767,318	(100,373,421)	-	Note 3
Mandarin Airlines	Mandarin Airlines Sweden AB	Sweden	Aircraft leasing agency	337,000	337,000	1,000	100.00	-	-	-	-
	Mandarin Aircraft Trading Co., Ltd	Cyprus	Aircraft leasing agency	60,000	60,000	1,000	100.00	-	-	-	-
Taoyuan International Airport Services	Taiwan Whi Lin Industry Co., Ltd.	Taichung, Taiwan	Other machine manufacturing	49,477,500	49,477,500	4,275,000	26.07	43,567,162	4,867,366	1,242,890	-
	Tao Yao Co., Ltd.	Taoyuan, Taiwan	Manpower placement and machine installation	10,000,000	10,000,000	1,000,000	100.00	11,123,981	66,118	77,273	-
Taiwan Airport Services	Taiwan Airport Service (Samoa)	TrustNet Chabers, Loteman Centre, P.O. Box 1225, Apia, Samoa	Airport services and investment	US\$ 5,294,476	-	-	100.00	193,116,872	4,540,382	4,540,382	Note 3
Hwa Hsia	Hwa Shin Building Safeguard Co., Ltd.	Taoyuan, Taiwan	Building security and maintenance services	10,000,000	10,000,000	1,000,000	100.00	13,038,116	2,891,216	2,907,565	-
Taiwan Airport Service (Samoa)	Xiamen International Airport Air Cargo Terminal Co., Ltd.	Xiamen International Airport	Forwarding and storage of air cargo	US\$ 3,525,726	-	-	13.00	136,798,076	120,751,929	14,827,601	Note 3
	Xiamen International Airport Air Cargo Storage Co., Ltd.	Xiamen International Airport	Airport cargo and storage of customers monitor	US\$ 1,768,750	-	-	13.00	56,318,796	14,414,090	(1,958,252)	Note 3

Note 1: Represents the consolidated financial information of the foreign holding company disclosed in accordance with local regulations.

Note 2: Adopted the treasury stock method in recognizing investment income or loss.

Note 3: The investee was established as a limited company.

## CHINA AIRLINES, LTD. AND INVESTEEES

INVESTMENT IN MAINLAND CHINA  
FOR THE YEAR ENDED DECEMBER 31, 2005  
(Amounts in New Taiwan Dollars, Unless Otherwise Noted)

Investee Company Name	Main Businesses and Products	Total Amount of Paid-in Capital	Investment Type (e.g., Direct or Indirect)	Accumulated Outflow of Investment from Taiwan as of Jan. 1, 2005	Investment Flows		Accumulated Outflow of Investment from Taiwan as of Dec. 31, 2005	% Ownership of Direct or Indirect Investment	Investment Gain (Loss) (Note 2)	Carrying Value as of Dec. 31, 2005	Accumulated Inward Remittance of Earnings as of Dec. 31, 2005	Accumulated Investment in Mainland China as of Dec. 31, 2005	Investment Amounts Authorized by Investment Commission, MOEA	Upper Limit on Investment
					Outflow	Inflow								
Xiamen International Air Cargo Terminal Ltd.	Air cargo and storage of customers monitor	\$ 941,610,728 (RMB224,480,000)	Indirect (Note 1)	\$ 109,580,000 (US\$ 3,254,526)	\$ -	\$ -	\$ 109,580,000 (US\$ 3,254,526)	12%	\$ 13,813,215 (US\$ 429,591)	\$ 127,284,536 (US\$ 3,843,993)	\$ -			
Xiamen International Airport Air Cargo Storage Co., Ltd.	Air cargo and storage	53,487,023 (RMB 14,000,000)	Indirect (Note 1)	-	51,427,653 (US\$ 1,626,428)	-	51,427,653 (US\$ 1,626,428)	12%	(1,791,640) (US\$ -55,720)	52,210,265 (US\$ 1,576,750)	-	\$1,338,388,311 (US\$40,419,327)	\$1,491,721,854 (US\$45,050,000)	\$12,333,868,751 (Note 5)
Yangtze River Express Airlines Co., Ltd.	Air cargo and storage	2,050,861,362 (RMB500,000,000)	Indirect (Note 1)	-	1,176,767,318 (US\$35,538,373)	-	1,176,767,318 (US\$35,538,373)	25% (Note 4)	- (Note 3)	1,176,767,318 (US\$ 35,538,373)	-			

Note 1: The Company invested in Cal-Asia Investment, which, in turn, invested in Mainland China.

Note 2: The accrual basis is based on the financial statements audited by CPAs of the Company in ROC.

Note 3: Net income (loss) of the investee was not recognized for the year ended December 31, 2005.

Note 4: The targeted percentage of ownership at the completion of the investment.

Note 5: The limits based on the Investment Commission's regulation, "Investment or Technical Cooperation in Mainland China Adjudgment Rule," are as follows: 40% for NT\$5 billion investment, 30% for investments of over NT\$5 billion to NT\$10 billion, and 20% for investments of over NT\$10 billion.