



Report and Recommendation of the President to the Board of Directors

Project Number: 41908
November 2007

Proposed Equity Investment and Loan People's Republic of China: Central and Western Airports Development Project

In accordance with ADB's public communications policy (PCP, 2005), this abbreviated version of the RRP excludes confidential information and ADB's assessment of project or transaction risk as well as other information referred to in paragraph 126 of the PCP.

Asian Development Bank

CURRENCY EQUIVALENTS

(as of 28 September 2007)

Currency Unit	–	yuan (CNY)
CNY1.00	=	\$0.13
\$1.00	=	CNY7.52

ABBREVIATIONS

ADB	–	Asian Development Bank
CAAC	–	General Administration of Civil Aviation of China
CFS	–	complementary financing scheme
DMC	–	developing member country
DSCR	–	debt service coverage ratio
EBITDA	–	earnings before interest, tax, depreciation, and amortization
EIA	–	environmental impact assessment
EMDP	–	ethnic minority development plan
EMP	–	environmental management plan
EMS	–	environmental management system
EPB	–	environmental protection bureaus
ESD	–	Environment and Social Division
FIRR	–	financial internal rate of return
FTK	–	freight ton kilometers
HAG	–	HNA Airport Group Company, Limited
HMIA	–	Hainan Meilan International Airport
HNA	–	HNA Group Company, Limited
IPO	–	initial public offering
IRR	–	internal rate of return
ISO	–	International Standards Organization
JAL	–	Japan Airlines
LZA	–	Lanzhou Zhongchuan Airport
MBA	–	master's in business administration
MDG	–	Millennium Development Goal
MTS II	–	Medium Term Strategy II
NDRC	–	National Development and Reform Commission
NGO	–	nongovernment organization
OCR	–	ordinary capital resources
PRC	–	People's Republic of China
PSOD	–	Private Sector Operations Department
RPK	–	revenue passenger kilometer
SASAC	–	State-owned Asset Supervision and Administration Commission
SEPA	–	State Environmental Protection Agency
SPIA	–	Sanya Phoenix International Airport Co., Ltd
SSMF	–	social safeguards management framework
TA	–	technical assistance
YSA	–	Yichang Sanxia Airport

WEIGHTS AND MEASURES

Ha	–	hectare
M	–	meter
m ²	–	square meter
Km ²	–	square kilometer
T	–	ton

NOTES

- (i) The fiscal year (FY) ends on 31 December. FY before a calendar year denotes the year in which the fiscal year ends.
- (ii) In this report, “\$” refers to US dollars.

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CONTENTS

	Page
I. THE PROPOSAL	1
II. BACKGROUND AND RATIONALE	1
A. The Airport Sector	1
B. ADB Operations, Strategy and Sector Policy	3
III. THE PROJECT	4
A. Project Description	4
B. Implementation Arrangements	4
C. Environmental Aspects and Social Dimensions	4
D. Development Impact	5
E. Development Effectiveness	6
IV. THE PROPOSED ASSISTANCE	6
A. Equity Investment	6
B. Loan	6
C. Justification	7
D. Anticorruption and Combating Money Laundering and the Financing of Terrorism	8
V. ASSURANCES	8
VI. RECOMMENDATION	8
Appendix	
1. Design And Monitoring Framework	10

I. THE PROPOSAL

1. I submit for your approval the following report and recommendation on (i) an equity investment of up to \$50 million equivalent in HNA Airport Group Company, Limited (HAG), and (ii) a loan to HAG consisting of two tranches: A Tranche, for up to CNY1.2 billion, funded by the Asian Development Bank (ADB), and B Tranche, for up to \$200 million, funded by commercial banks. The proceeds of the equity investment and loan will be applied for the financing of HAG's airport portfolio in the People's Republic of China (PRC). The design and monitoring framework is in Appendix 1.

II. BACKGROUND AND RATIONALE

A. The Airport Sector

1. Background

2. With a total area of 9.6 million square kilometers (km²), a population of 1.3 billion, and gross domestic product of \$2.67 trillion in 2006, the PRC remains the leading emerging market in Asia. With a sustained growth rate of 9.5% over the past 26 years, the economy of the PRC continues to benefit from the comparative advantage of lower labor costs, higher productivity levels and increased ease of global movement of goods and services. The civil aviation industry has benefited from this growth through increased demand for both cargo and passenger services. The Government of the PRC (the Government) recognizes the importance of infrastructure as a prerequisite for economic growth, and has focused on the development of land, sea and air transport.

2. Demand for Air Transportation

3. The PRC currently has the second largest civil aviation market in the world, after the United States. In 2006, the General Administration of Civil Aviation of China (CAAC) reported passenger transportation volume of 332 million person-times and cargo and postal transportation of 7.53 million tons (t), increasing by 16.7% and 19% respectively, over 2005 levels. Average annual passenger growth stood at 22.1%, and average annual cargo traffic growth at 22.0% over the past decade.

4. The demand for travel, for both work and leisure, is projected to increase at an unprecedented pace as a result of increased labor movement flexibility and disposable income growth. It is estimated that Chinese air passenger transportation throughput, measured in revenue passenger-kilometers (RPK),¹ will average 8.4% annually during 2007–2026, while the PRC's air cargo transportation turnover, measured in freight ton-kilometers (FTK),² will increase at an annual average of 10.5%.³

3. Development of Airport Sector

¹ RPK is a measure of airline passenger volume calculated by multiplying the number of revenue passengers carried on each flight stage by the flight stage distance.

² FTK is a measure of airline freight volume calculated by multiplying freight carried on each flight stage by the flight stage distance.

³ Research in China. 2007. *China Air Transportation and Airport Industry Report*. Beijing.

5. The PRC had 146 civil airports in operation in 2006. There were 7 airports with throughput capacity for 10 million passengers, 12 with capacity for 5–10 million, and 25 with capacity for 1–5 million.⁴ Seven of the top ten airports in the PRC have experienced double-digit growth rates over the past 20 years and continue to expand, both in scale and number.

6. During the 10th Five-Year Plan (2001–2005), CNY110 billion (\$13.25 billion) was invested in hub and regional airport construction in the PRC. The 11th Five-Year Plan (2006–2010) continues to reflect the Government's emphasis on development of the airport sector. It stipulates the construction and expansion of some 60 airports, mostly in the western region. Moreover, almost all existing airports need rehabilitation. It is estimated that about \$17.7 billion in capital expenditure is required for the civil airports in the 11th Five-Year Plan. It is projected that more than 237 civil airports will come into operation by 2010. From 2006 to 2020, CAAC estimates that the number of airports is projected to grow 11% annually.

4. Government Policies and Regulations

7. Before 2003, all civil airports were directly controlled by CAAC, and most of them were suffering losses. Since 2004, all civil airports (except those in Beijing and Tibet) have been transferred to provincial and/or municipal governments. Although the local governments can better plan and coordinate the development of airports together with other infrastructure facilities, the capital expenditure required to expand and/or rehabilitate airports is an additional burden on local fiscal budgets. This is especially the case in the central and western regions, where municipal and provincial governments are constrained by (i) their limited financial budgets and overall infrastructure needs, (ii) lack of direct access to multilateral or other external financing sources, and (iii) inability to meet the Government's counterpart funding requirements.

8. In 2002, the Provisions on Foreign Investment in Civil Aviation were promulgated, which allow for up to 25% foreign ownership, with approval from the National Development and Reform Commission (NDRC) and CAAC. A majority of shares must remain with the domestic Chinese partner, however. In 2005, CAAC passed the Provision on Domestic Investments on Civil Aviation Industry and the Provision on Administration of Alliance, Reorganization or Restructuring of Civil Aviation, which detail the regulatory framework for participation of domestic private sector investment in civil aviation.

5. Tariff and Price

9. The current airport pricing mechanism is enacted by CAAC with approval from NDRC. CAAC issues detailed pricing standards for landing fees, passenger processing and ground handling fees. Overall, the airport tariff structure does not take into consideration the capital intensive nature of airports and is biased towards airports with larger passenger and cargo volumes. The charges are based on a uniform formula used by CAAC, regardless of differences in operational and capital expenditures. Because the fee received is directly correlated with aggregate passenger throughput, smaller airports with lower throughput often have difficulties with long-term profitability and operational sustainability.

10. Under a new CAAC pricing proposal, it is very likely that the overall charges will increase, with charges on domestic routes increasing substantially. Almost all airports will benefit from the

⁴ CAAC. 2007. *Civil Aviation Sector Overview*. Beijing.

reform plan, especially small and medium-sized airports that derive all their business from domestic routes.

5. Constraints in Private Sector Participation

11. The operation of civil airports requires special knowledge and sector-specific experience that most local governments lack, reducing the efficiency of airports. Private sector participation, accompanied by funding and experience, is clearly needed in development of the airport sector in the PRC, especially in the central and western regions. However, experienced foreign operators are focusing on investments in hub or large airports in the coastal region, so as to create synergies with their existing operations and minimize investment risks. As a result, potential investors and/or operators for medium and small airports are likely to be from domestic market.

12. Local investors and/or operators are typically relatively new and have limited financial resources, limiting their capacity to develop a large number of projects. Moreover, the local financing market, especially for the central and western PRC, is unfavorable to the private sector. Long-term private sector financing, which is desperately needed in the airport sector, is nearly nonexistent, limiting local private sector participation, especially in small and medium airports, and restricting mobilization of resources for the sector. Consequently, priority needs to be given to dedicated and qualified local sponsors of airport infrastructure development in the PRC, particularly in the central and western regions. This can be achieved through equity investments and long-term local currency debt—with which ADB has extensive experience in other, similar sectors—which can in turn mobilize other financing.

B. ADB Operations, Strategy and Sector Policy

13. ADB's country strategy for the PRC⁵ is based on five development objectives: (i) promoting equitable and inclusive growth, (ii) making markets work better, (iii) improving the environment, (iv) promoting regional cooperation, and (v) private sector development and operations. This is consistent with priorities highlighted in ADB's Medium-Term Strategy II 2006–2008 (MTS II),⁶ including (i) catalyzing investment to improve the investment climate and expand private sector operations, (ii) strengthening inclusiveness through increasing investment to support rural development and social development interventions, and (iii) promoting regional cooperation and integration. In the PRC, ADB is enhancing its focus on achieving a better development balance between rural and urban areas, and between coastal and inland regions. The emphasis on infrastructure projects in rural areas and less-developed central and western regions has increased.

14. The PRC has been steadily transforming into a market economy, which has become the basis and driving force for economic growth and job creation. In addition to ADB's policy advice to the Government on private sector development, ADB also provides project-based financial assistance. ADB's private sector operations in the PRC have focused on the infrastructure and energy sectors, the financial sector, and environmental improvements. In the infrastructure and energy sectors, ADB prioritizes pioneering projects with innovative contractual and financial structuring to encourage private sector participation, enhance management expertise, and improve corporate governance. As agreed with the Government, ADB private sector operations will identify and support viable projects that are located in the less-developed central and

⁵ ADB. 2006. *Country Strategy and Program Update (2007–2008): People's Republic of China*. Manila.

⁶ ADB. 2006. *Medium-Term Strategy II 2006–2008*. Manila.

western regions, and explore the possibility of using proceeds of CNY-denominated bonds for lending to local borrowers.

III. THE PROJECT

A. Project Description

15. The Project, which allows for both loan and equity participation by ADB, will support HAG's expansion and capital expenditure plan to privatize, rehabilitate, expand, upgrade, and/or operate medium and small airports in the PRC's central and western regions. The Project aims to (i) enhance the development of efficient medium and small airports in the central and western PRC through private sector participation; (ii) ease the financial constraints being faced by provincial and/ or municipal governments through mobilization of private sector capital; and (iii) support regional economic growth and equitable economic development of the country. Proceeds from the ADB loan and equity participation will be channeled through HAG to the portfolio airports in the central and western PRC.

B. Implementation Arrangements

1. Privatization

16. HAG procures the ownership and management rights to all its portfolio airports through privatization, so both new and existing portfolio airports generate revenue and cash flow. HAG has its own team to conduct pre-privatization evaluation and negotiation, with support from external professionals. The pre-privatization evaluation is typically very comprehensive, covering legal, engineering, operational and financial aspects. Each privatization structure is unique, but all transactions are well documented and approved by various government agencies, including the State-owned Assets Supervision and Administration Commission (SASAC) and CAAC. The privatization agreements define the rights and obligations of HAG and local governments, with implementation closely monitored by various government agencies.

C. Environmental Aspects and Social Dimensions

1. Environmental Safeguards

17. HAG and its portfolio airports abide by national and provincial environmental laws related to airport operations. HAG conducts environmental impact assessments for all of its projects and applies for all required permits when implementing projects and operating project facilities. Where environmental impacts related to construction and operation of airport terminal and associated facilities exist, these are rendered "not significant" through implementation of appropriate monitoring and mitigation measures.

18. The Project is classified as category FI in accordance with ADB's *Environmental Assessment Guidelines* (2003) under ADB's *Environment Policy* (2002). Due diligence was conducted on the environmental, safety, and health aspects of HAG's current operations to ensure compliance with ADB's safeguard policies. HAG's environmental management is considered satisfactory and in line with ADB's and local policies. In addition, HAG will ensure that environmental monitoring for all future operations of each subsidiary company is undertaken in accordance with ADB's *Environment Policy*. HAG is establishing environment management systems (EMSs), including environmental assessment and review procedures satisfactory to ADB. HAG will also ensure it complies with the PRC's environmental laws and

regulations. HAG will periodically confirm with ADB its compliance with ADB's and the PRC's environmental requirements, and make reports on these matters available to ADB.

2. Land Acquisition, Resettlement, and Indigenous Peoples

19. The Project is classified as category A with respect to ADB's *Involuntary Resettlement Policy* (1995) and category B with respect to ADB's *Policy on Indigenous Peoples* (1998). Due diligence was conducted on the social aspects of HAG's current operations. With respect to HAG's planned expansion, land acquisition and resettlement activities could have substantial impact, which cannot be identified at this stage. HAG has expressed the intention to avoid involuntary resettlement or adverse impacts on ethnic minorities if at all possible, and/or to adopt measures to minimize land acquisition or other activities that would lead to involuntary resettlement. In the event of involuntary resettlement or any adverse impacts on ethnic minorities as a result of HAG's investment, HAG will ensure that resettlement plans and/or ethnic minority development plans are prepared and implemented consistent with the requirements of ADB's *Involuntary Resettlement Policy* and *Policy on Indigenous Peoples*, and in accordance with the Social Safeguards Management Framework.

D. Development Impact

20. The Project serves as an important catalyst for the overall economic growth of the PRC's less-developed central and western regions. Airport facilities with inadequate passenger and cargo capacity and service constitute the major aviation infrastructure bottleneck in the central and western PRC. Through assistance to HAG in increasing airport capacity and improving airport efficiency in the central and western PRC, the Project will directly benefit the people in the area by (i) providing direct access to and from markets in both the PRC's relatively developed coastal regions and in other countries, (ii) improving aviation safety and level of service, (iii) reducing the cost and duration of long distance travel, and (iv) creating more employment demand and opportunities. According to an estimate by the International Civil Aviation Organization, every \$100 of output from air transport generates triple that much demand, and 100 air transport jobs induce 610 jobs in other industries.

21. The Project promotes private sector participation in airport development in the PRC, thereby increasing the amount of available private capital in the civil aviation sector, which is a focus for improving the country's long-distance transportation. HAG, a local private sector developer based in a relatively advanced coastal region, will transfer its financial resources, successful experience and good practice to the less-developed central and western PRC in a sustainable manner through privatization of loss-making airports. The privatization of these airports will ultimately eliminate airport subsidies now being made by local governments, freeing up local government resources for other critical expenditures related to social concerns and health.

22. The Project will have a positive impact on the development of local capital markets through its use of locally raised funds. If the Project is implemented, and subject to Government approval, ADB will issue its second CNY-denominated bond (Panda Bond) to fund the Project, thereby assisting the Government to further improve the bond market in the PRC. The Project will also increase the efficiency of the local financing market. ADB's CNY-denominated loan will catalyze risk participation by international commercial banks, which otherwise could not finance a project requiring CNY financing due to a lack of CNY funding capacity. The Project establishes an excellent platform for international commercial banks, which have the risk appetite to provide long-term local currency loans, but limited capacity to do so.

E. Development Effectiveness

23. The development effectiveness of the Project is assessed in terms of private sector development, business success, and economic sustainability as per the guidelines for implementing the *Good Practice Standards for Evaluation of Private Sector Investment Operations* prepared by the Evaluation Cooperation Group of multilateral development banks. HAG will be in a position to comfortably fund the privatization, expansion, rehabilitation, improvement and operation of airports in the central and western PRC, thereby improving capacity and enhancing service. The increase in passenger and cargo traffic volume in its portfolio airports will lead to increased revenue and reinforce HAG's financial sustainability and continuous operations. On a broader level, the development effectiveness is reflected in the increased capacity and enhanced service levels in HAG's portfolio airports in the central and western PRC. The impact of this can be observed by assessing the quantity and quality of the related aeronautical operations in the area.

IV. THE PROPOSED ASSISTANCE

A. Equity Investment

24. The proposed equity investment is to subscribe ordinary shares in HAG⁷ at a cost of up to \$50 million, from ADB's ordinary capital resources (OCR). The terms and conditions, including valuation, representations, warranties, covenants, etc, of ADB's equity investment will be similar to other equity investment to HAG at about the same time.

25. The proposed ADB equity investment constitutes a critical and integral part of ADB assistance for HAG and the Project. Although HAG has already achieved significant success and established sound reputation in the sector, HAG is at the starting point of its planned expansion and IPO. HAG has been actively seeking strategic investors to ensure its continued growth in the rapidly expanding sector. ADB is expected to assist HAG to enhance its good corporate governance and improve its environmental and social management system.

26. The proposed equity investment will be documented appropriately, and all contractual and financial arrangements should be satisfactory to ADB. The disbursement will be subject to comprehensive conditions precedent, including all necessary governmental, creditor, and shareholder approvals and consents.

B. Loan

27. The proposed ADB loan will comprise an A Tranche funded by ADB and a B Tranche funded by commercial banks.

28. The A Tranche is for up to CNY1.2 billion, or about \$160 million equivalent. The A Tranche will be funded from ADB's OCR without government guarantee, but with a 50% risk participation from international commercial banks to cover up to CNY600 million of ADB's risk exposure under the A Tranche.

⁷ ADB may structure the proposed equity investment through an offshore special purpose company to be set up together with other investors. This is in line with international practice.

29. The A Tranche will be funded through the proceeds of a CNY-denominated bond issued by ADB. The A Tranche will have an interest rate to be determined in accordance with procedures applicable to ADB local currency loans.

30. The B Tranche of up to \$200 million will be funded by international commercial banks under terms and conditions to be mutually agreed upon between HAG and the participating commercial banks, with the concurrence of ADB.

31. The proposed loan will be documented in loan agreements, which will contain standard terms and conditions that apply to loans to private sector borrowers without government guarantee. The terms of the loan will include financial and operational covenants and reporting requirements.

C. Justification

32. ADB's assistance for the Project is justified on the basis of its development impacts and demonstration effects. It supports the Government's development plan and ADB's operational strategies. ADB's participation in the Project will produce substantial added value.

- (i) The Project is in line with the Government's Western Region Development Strategy to enhance economic development and reduce poverty in the central and western PRC, which is the key theme of the 11th Five-Year Plan. The strategy aims to reduce development disparities between the western and coastal regions. The Project is also in line with the civil aviation policy in Government's 11th Five-Year Plan, which has accorded priority to the development of airport infrastructure in the central and western regions.
- (ii) The Project supports the Government's strategy of encouraging private sector participation in the airport sector, given the substantial investment required to expand and improve airport facilities and the limited self-financing capacity of local governments. The Project is expected to free the resources of local governments from local airport investment and operations, making them available for other critical expenditures related to social concerns and health.
- (iii) The Project is fully in line with ADB's country strategy and program in the PRC. ADB is focusing its activities on promoting equitable and inclusive growth, with a strong emphasis on infrastructure projects in rural areas and less-developed central and western regions. The Project will substantially impact the balance of development between coastal and inland regions.
- (iv) The Project will be the first airport project supported by ADB in the PRC, and will be ADB's first long-term local currency financing in the transportation sector, where such financing is desperately needed. It complements ADB's existing public operations in the PRC's transportation sector (mainly in the road subsector) by easing a major transportation sector constraint: airport capacity and efficiency.
- (v) The Project reflects the infrastructure focus of ADB's non-sovereign operations in the PRC. In the infrastructure sector, ADB prioritizes pioneering projects with innovative contractual and financial structuring to encourage private sector participation, enhance management expertise, and improve corporate governance. The Project will enable HAG, a local private sector airport developer,

to transfer its financial resources, successful experience, and good practice to the less developed central and western PRC in a sustainable manner through privatization of loss-making airports, which are essential infrastructure facilities for economic growth. ADB will assist HAG to mobilize long-term local currency financing, which is not currently available in the market, by easing the concerns of private equity investors, who will co-invest with ADB in HAG.

- (vi) The Project will have positive impacts on the development of the local capital market and local financing market. The CNY-denominated A Tranche will be funded by a CNY-denominated bond issued by ADB, the issuance of which will assist the Government to improve the bond market in the PRC. The loan will also catalyze financing from international commercial banks, including those with the risk appetite, but limited capacity, to provide long-term local currency loans.
- (vii) ADB's assistance will play an important role in the total financial plan by satisfying funding requirements and mobilizing additional funds from international banks and private equity investors, but will also assist in attracting private sector investors by enhancing the institutional capacity of HAG. With potential board representation throughout the period that ADB holds shares, ADB will support HAG in (i) strengthening its institutional capacity, (ii) enhancing corporate governance, and (iii) developing a formal environmental and social management system for HAG's continued growth. ADB's participation in the Project will be viewed as demonstrational and catalytic, and is expected to establish more confidence in HNA's upcoming IPO and future private sector participation in airport projects in the PRC.

D. Anticorruption and Combating Money Laundering and the Financing of Terrorism

33. HAG was advised of ADB's *Anticorruption Policy* (1998, as amended to date) and the *Combating of Money Laundering and the Financing of Terrorism Policy* (2003). Consistent with its commitment to good governance, accountability, and transparency, ADB will require HAG to institute, maintain, and comply with internal procedures and controls following international best practice standards for the purpose of preventing corruption, money laundering, or the financing of terrorism, and covenant with ADB to refrain from engaging in such activities. The loan and equity documentation between ADB and HAG will allow ADB to investigate any violation or potential violation of these undertakings.

V. ASSURANCES

34. Consistent with the *Agreement Establishing the Asian Development Bank*, the Government will be requested to confirm that it has no objection to the proposed assistance to HAG. No funding will be disbursed until ADB receives such confirmation. ADB will enter into finance documents acceptable to ADB following the approval of the proposed financing by ADB's Board of Directors.

VI. RECOMMENDATION

35. I am satisfied that the proposed equity investment and loan would comply with the Articles of Agreement of the Asian Development Bank (ADB) and recommend that the Board approve

- (i) the equity investment in HNA Airport Group Company, Limited for an amount up to \$50,000,000 to be provided from ADB's ordinary capital resources; and
- (ii) the loan, to HNA Airport Group Company, Limited, consisting of (a) an A Tranche in an amount of up to CNY1,200,000,000 funded by ADB and supported by a 50% risk participation from international commercial banks rated A or above, to be provided from ADB's ordinary capital resources without government guarantee; an interest rate to be determined based on the procedures applicable to ADB local currency loans for private sector operations; and (b) a B Tranche for an amount of up to \$200,000,000 to be funded by commercial banks under terms and conditions to be mutually agreed upon between HAG and the participating commercial banks with the concurrence of ADB, subject to ADB's arrangement fee and annual administration fee to be approved by ADB's Pricing and Credit Enhancement Committee,

for the Central and Western Airports Development Project, and on such other terms and conditions as are substantially in accordance with those set forth in this report and as may be reported to the Board.

Haruhiko Kuroda
President

16 November 2007

DESIGN AND MONITORING FRAMEWORK

Design Summary	Performance Targets/Indicators	Data Sources/Reporting Mechanisms	Assumptions and Risks
<p>Impact</p> <p>1. Economic Growth</p> <ul style="list-style-type: none"> • Equitable and inclusive economic growth in the PRC, particularly in the less-developed central and western PRC, due to improved civil aviation infrastructure. <p>2. Private Sector Development</p> <ul style="list-style-type: none"> • Expanded private sector participation in the airport sector in the PRC. • Increased domestic and international commercial investment and lending to private airports in the PRC. • Improved local bond market and finance market for mobilizing more capital for private sector projects. 	<ul style="list-style-type: none"> • Annual economic growth sustains at over 8% in the central and western PRC. • Average annual increase of 10% in passenger and cargo throughput of civil airports in the PRC over the next 5 years, particularly in the central and western PRC. • The service quality of airports meets CAAC standards. • 20% increase in the number of privatized airports in the PRC over the next 5 years. • Private sector investment in the airport sector increases by at least 30% over the next 5 years. • Deepening of local currency financing, with larger volume and longer tenor, for private airports and other private sector business. • Increased use of the local bond market to fund private sector airport projects. 	<ul style="list-style-type: none"> • Government reports and statistics • Press • CAAC reports • Government reports and statistics • Annual research reports on civil aviation and banking • Press 	<p>Assumptions</p> <p>Other businesses related to the airport sector, such as airlines, also grow at comparable rates.</p> <p>Assumptions</p> <p>HAG is operationally and financially successful.</p> <p>Risks</p> <p>Macroeconomic outlook may deteriorate.</p>
<p>Outcome</p> <ul style="list-style-type: none"> • The people in the central and western PRC will benefit from having (i) direct and convenient access to and from the markets in the relatively developed coastal area of the PRC and in other countries, (ii) improved safety and level of service, (iii) reduced costs and time of long-distance travel and shipping, and (iv) more job opportunities. 	<ul style="list-style-type: none"> • HAG's portfolio airports enhance passenger and cargo throughput. • The aggregated capacity of HAG's portfolio airports expands, with at least 10% more flights for the newly acquired airports and more routes. • HAG will directly and indirectly create job opportunities in the central and western PRC. 	<ul style="list-style-type: none"> • CAAC reports and statistics • HAG reports • Press 	<p>Assumptions</p> <p>HAG's expansion is implemented as planned.</p> <p>There is no negative change in the regulatory framework.</p> <p>HAG services its debt as required.</p>

Design Summary	Performance Targets/Indicators	Data Sources/Reporting Mechanisms	Assumptions and Risks
<ul style="list-style-type: none"> HAG is operationally and financially successful. 	<ul style="list-style-type: none"> The passenger and cargo businesses meet CAAC safety and service standards. HAG operates efficiently, creating value for its stakeholders through dividend payouts and/or capital gains. 		
<p>Outputs</p> <ul style="list-style-type: none"> HAG acquires more airports through privatization. HAG turns around loss-making airports after privatization. HAG transports more passengers and cargo than prior to privatization. HAG further increases profitability and strengthens cash flow. HAG performs all activities in an environmentally and socially sustainable manner. 	<ul style="list-style-type: none"> HAG acquires at least 3 more portfolio airports through privatization before 2010. Lanzhou Zhongchuan Airport starts to make a profit in 2008. Newly privatized airports make a profit within 3 years of privatization. The growth of passenger and cargo throughputs of newly privatized airports is faster than the growth before privatization. HAG doubles its net profit and operating cash flow before its planned IPO in 2010. HAG is in compliance with ADB safeguard policies. 	<ul style="list-style-type: none"> HAG reports HAG's audited financial statements 	<p>Assumptions</p> <p>HAG and its portfolio airports are in compliance with relevant national laws, local regulatory requirements, and ADB policies.</p> <p>Risks</p> <p>Delay in expansion.</p>
<p>Activities with Milestones</p> <p>Development plan for 2007–2010</p> <ol style="list-style-type: none"> Privatization of loss-making airports in the central and western PRC Rehabilitation of existing portfolio airports in the central and western PRC Expansion of existing portfolio airports' capacity Improvement of profitability and efficiency of portfolio airports 			<p>Inputs</p> <ul style="list-style-type: none"> Funding from ADB and other co-financers. HAG's experience, management, financial resource and existing operations.

ADB = Asian Development Bank, CAAC = General Administration of Civil Aviation of China, HAG = HNA Airport Group Company, Limited, IPO = initial public offering, PRC = People's Republic of China.