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As of the year end of 2003, the Group operated 334 routes, of which 274 were domestic, 42 were international and 18 were Hong Kong regional. The Group operates the most extensive domestic route network among all Chinese airlines. In 2003, the Group operated an average of 4,118 landings and take-offs per week serving 94 destinations. Most of these cities served by the Group are located in commercial centres or rapidly developing economic regions in China. The Group's headquarters is located in Guangzhou, one of the gateway cities of China. Located in the rapidly developing Pearl River Delta region, Guangzhou is the transportation hub of Southern China.

In addition to its main route base in Guangzhou, the Group maintains 12 regional route bases in Zhengzhou, Wuhan, Changsha, Shenzhen, Haikou, Zhuhai, Xiamen, Fuzhou, Guilin, Shantou, Guiyang and Beihai. Most of its regional route bases are located in provincial capitals or major commercial centres in the PRC.

The Group operates a portion of its air transportation business through its subsidiaries, namely Xiamen Airlines Company Limited ("Xiamen Airlines"), Southern Airlines Group Shantou Airlines Company Limited, Guangxi Airlines Company Limited, Zhuhai Airlines Company Limited and Guizhou Airlines Company Limited (collectively, the "Airline Subsidiaries"). Each of the Airline Subsidiaries is 60%-owned by the Company.

As of 31 December, 2003, the Group operated a fleet of 132 aircraft, consisting primarily of Boeing 737-300, 737-500, 737-700, 737-800, 747-400, 757-200, 777-200, Airbus 320-200 and 319-100 aircraft. The average age of the Group's fleet was 7.82 years as of the year end of 2003.

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### CORPORATE INFORMATION

#### DIRECTORS

##### EXECUTIVE DIRECTORS

Yan Zhi Qing

(Chairman of the Board of Directors)

Liu Ming Qi (Vice Chairman of the Board of Directors)

Wang Chang Shun

(Vice Chairman of the Board of Directors, President)

Peng An Fa (Director)

Wang Quan Hua (Director)

Zhao Liu An (Director)

Zhou Yong Qian (Director)

Zhou Yong Jin (Director)

Xu Jie Bo (Director, Chief Financial Officer, Vice President)

Wu Rong Nan (Director)

##### INDEPENDENT NON-EXECUTIVE DIRECTORS

Simon To

Peter Lok

Wei Ming Hai

Wang Zhi

Sui Guang Jun

##### SUPERVISORS

Liang Hua Fu

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(Chairman of the Supervisory Committee)  
Gan Yu Hua (Supervisor)  
Li Qi Hong (Supervisor)

### COMPANY SECRETARY

Su Liang

### AUTHORISED REPRESENTATIVES

Xu Jie Bo  
Su Liang

### PRINCIPAL BANKERS

The Industrial & Commercial Bank of China  
Bank of China  
China Construction Bank  
Agricultural Bank of China

### LEGAL ADVISERS TO THE COMPANY

O'Melveny & Myers LLP  
Z&T Law Firm

### SHARE REGISTRAR

Hong Kong Registrars Limited  
Rooms 1901-5, 19th Floor  
Hopewell Centre  
183 Queen's Road East  
Hong Kong

The Bank of New York  
Investor Relations  
P.O. Box 11258  
Church Street Station  
New York, NY 10286-1258, U.S.A.

China Securities Depository and Clearing Corporation  
Limited Shanghai Branch  
727 Pu Jian Road, Shanghai  
PRC

### CORPORATE HEADQUARTERS

Baiyun International Airport  
Guangzhou  
PRC  
Website: [www.cs-air.com](http://www.cs-air.com)

### PLACE OF BUSINESS IN HONG KONG

Unit B1, 9th Floor  
United Centre  
95 Queensway  
Hong Kong

### INTERNATIONAL AUDITORS

KPMG

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Certified Public Accountants  
8th Floor, Prince's Building  
10 Chater Road  
Hong Kong

### PRC AUDITORS

KPMG Huazhen  
8/F, Office Tower E2  
Oriental Plaza  
No. 1 East Chang An Avenue  
Beijing  
PRC  
Postcode 100738

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### FINANCIAL HIGHLIGHTS

The Board of Directors of the Company hereby presents below the consolidated results of the Group for the year ended 31 December, 2003, prepared in accordance with International Financial Reporting Standards ("IFRS"), together with the comparative figures for the corresponding period in 2002. The following consolidated results should be read in conjunction with the financial statements and the Report of the International Auditors contained in this annual report (the "Annual Report").

#### Total Revenue

2003  
RMB' million

[PIE CHART]

|                                 |        |         |
|---------------------------------|--------|---------|
| HK regional passenger revenue   | 750    | (4.3%)  |
| International passenger revenue | 2,018  | (11.6%) |
| Cargo & mail                    | 1,955  | (11.1%) |
| Other revenue                   | 505    | (2.9%)  |
| Domestic passenger revenue      | 12,242 | (70.1%) |

#### Passenger Traffic Capacity (Available Seat Kilometres ("ASK"))

2003  
ASK million

[PIE CHART]

|               |        |         |
|---------------|--------|---------|
| HK regional   | 1,347  | (3.3%)  |
| International | 6,930  | (17.0%) |
| Domestic      | 32,590 | (79.7%) |

#### Passenger Traffic (Revenue Passenger Kilometres ("RPK"))

2003  
RPK million

[PIE CHART]

|               |       |         |
|---------------|-------|---------|
| HK regional   | 778   | (2.9%)  |
| International | 4,315 | (16.4%) |

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Domestic 21,294 (80.7%)

CONSOLIDATED PROFIT AND LOSS ACCOUNT

FOR THE YEAR ENDED 31 DECEMBER,

|                                | 2003<br>RMB'000 | 2002<br>RMB'000 | 2003<br>HK\$'000 | 2002<br>US\$'000 |
|--------------------------------|-----------------|-----------------|------------------|------------------|
| -----                          |                 |                 |                  |                  |
| Operating revenue:             |                 |                 |                  |                  |
| Passenger                      | 15,009,885      | 15,695,622      | 14,084,531       | 1,811,233        |
| Cargo and mail                 | 1,954,915       | 1,786,270       | 1,834,395        | 233,600          |
| -----                          |                 |                 |                  |                  |
| Other operating revenue        | 16,964,800      | 17,481,892      | 15,918,926       | 2,046,600        |
|                                | 505,323         | 536,728         | 474,170          | 60,000           |
| -----                          |                 |                 |                  |                  |
| Total operating revenue        | 17,470,123      | 18,018,620      | 16,393,096       | 2,111,233        |
| -----                          |                 |                 |                  |                  |
| Operating expenses:            |                 |                 |                  |                  |
| Flight operations              | 7,070,031       | 6,732,543       | 6,634,166        | 850,000          |
| Maintenance                    | 2,588,613       | 2,333,419       | 2,429,026        | 310,000          |
| Aircraft and traffic servicing | 2,767,488       | 2,511,284       | 2,596,874        | 330,000          |
| Promotion and sales            | 1,480,168       | 1,499,587       | 1,388,916        | 170,000          |
| General and administrative     | 1,053,319       | 1,060,010       | 988,383          | 120,000          |
| Depreciation and amortisation  | 2,037,971       | 1,839,871       | 1,912,331        | 240,000          |
| Other                          | 16,804          | 15,829          | 15,767           | 2,000            |
| -----                          |                 |                 |                  |                  |
| Total operating expenses       | 17,014,394      | 15,992,543      | 15,965,463       | 2,050,000        |
| -----                          |                 |                 |                  |                  |
| Operating profit               | 455,729         | 2,026,077       | 427,633          | 50,000           |
| =====                          |                 |                 |                  |                  |

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FINANCIAL HIGHLIGHTS (Cont'd)

Passenger Traffic (RPK)  
million

[BAR CHART]

2002 28,940  
2003 26,387

Passenger Capacity (ASK)  
million

[BAR CHART]

2002 44,245  
2003 40,867

Cost (Operating Cost Per ASK)

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RMB

[BAR CHART]

2002 0.36  
2003 0.42

|                                  | FOR THE YEAR ENDED 31 DECEMBER, |           |            |             |
|----------------------------------|---------------------------------|-----------|------------|-------------|
|                                  | 2003                            | 2002      | 2003       | 2003        |
|                                  | RMB'000                         | RMB'000   | HK\$'000   | US\$'000    |
| -----                            |                                 |           |            |             |
| Non-operating                    |                                 |           |            |             |
| income/(expenses):               |                                 |           |            |             |
| Share of associated              |                                 |           |            |             |
| companies' results               | 47,798                          | 36,988    | 44,851     | 5,775       |
| Share of jointly controlled      |                                 |           |            |             |
| entities' results                | (39,495)                        | (3,352)   | (37,060)   | (4,772)     |
| (Loss)/gain on sale              |                                 |           |            |             |
| of fixed assets                  | (22,217)                        | 170,740   | (20,848)   | (2,684)     |
| Interest income                  | 13,061                          | 52,618    | 12,256     | 1,578       |
| Interest expense                 | (823,725)                       | (959,193) | (772,943)  | (99,523)    |
| Exchange loss, net               | (164,443)                       | (175,451) | (154,304)  | (19,868)    |
| Other, net                       | 21,682                          | (9,328)   | 20,345     | 2,619       |
| -----                            |                                 |           |            |             |
| Total net non-operating expenses | (967,339)                       | (886,978) | (907,703)  | (116,875)   |
| -----                            |                                 |           |            |             |
| (Loss)/profit before taxation    |                                 |           |            |             |
| and minority interests           | (511,610)                       | 1,139,099 | (480,070)  | (61,813)    |
| Taxation credit/(expense)        | 324,277                         | (398,227) | 304,286    | 39,179      |
| -----                            |                                 |           |            |             |
| (Loss)/profit before minority    |                                 |           |            |             |
| interests                        | (187,333)                       | 740,872   | (175,784)  | (22,634)    |
| Minority interests               | (170,934)                       | (165,111) | (160,396)  | (20,652)    |
| -----                            |                                 |           |            |             |
| (Loss)/profit attributable to    |                                 |           |            |             |
| shareholders                     | (358,267)                       | 575,761   | (336,180)  | (43,286)    |
| -----                            |                                 |           |            |             |
| Basic (loss)/earnings per share  | RMB(0.09)                       | RMB0.17   | HK\$(0.09) | US\$(0.011) |
| =====                            |                                 |           |            |             |

Note: The above consolidated profit and loss account has been prepared in Renminbi ("RMB"), the national currency of the PRC. Translations of amounts from RMB into Hong Kong dollars ("HK\$") and United States dollars ("US\$") solely for the convenience of readers have been made at the rates of HK\$1.00 to RMB1.0657 and US\$1.00 to RMB8.2767, being the average of the buying and selling rates as quoted by the People's Bank of China at the close of business on 31 December, 2003. No representation is made that the RMB amounts could have been or could be converted into HK\$ or US\$ at these rates or at any other certain rates on 31 December, 2003 or on any other date.

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CHAIRMAN'S STATEMENT

[PHOTO OF YAN ZHI QING]  
Chairman

Dear Shareholders,

2003 was a year filled with difficult challenges for us. The outbreak of Severe Acute Respiratory Syndrome ("SARS") during 2003 in China and other parts of Asia caused an unprecedented adverse impact to our business. Nevertheless, the Group and our staff did not succumb to these difficult circumstances. With the recovery of the economy after the SARS epidemic was brought under control, together with the support of the government through implementation of a series of related policies, we once again were given the opportunities for development and achieved satisfactory performance in terms of safety and services quality.

During the first half of 2003, the Group encountered the most severe challenge due to the outbreak of SARS. The Group's air passenger business was severely Chairman affected as a result and recorded a significant drop in the number of passengers carried and passenger load factor for the period from April to June 2003, as compared to the corresponding period of the previous year. In terms of revenue tonne kilometres, there was a decrease of 40%, 83.5% and 61.5% respectively in April, May and June comparing to the corresponding period of the previous year. To minimise the negative impact of SARS, the Group took various timely measures to adjust its operating capacity, including reduction in the number of flights and suspension of certain routes to cope with the sharp decrease in demand for air transport caused by SARS. In addition, we also minimised controllable expenses through strictly controlling expenses to offset part of the negative impact.

In order to alleviate the operational pressure on the PRC's civil aviation industry caused by the SARS epidemic, the PRC government waived the levies of China Aviation Administration of China ("CAAC") Infrastructure Development Fund, sales tax and related supplementary charges for passenger transportation business for the period from 1 May to 31 December, 2003. These measures have significantly boosted the recovery of the Group's business.

While the Group was dealing with the challenges brought by the SARS epidemic, we continued to enhance the standards of our safety and services. As a result, we once again received the Golden Roc Cup, the highest award for flight safety in the civil aviation industry, and won the Five-star Diamond Award for flight services. These awards demonstrated the excellent performance of our colleagues in their effort to improve the standards of our safety and services.

In July 2003, the Group successfully issued 1,000,000,000 A Shares in the domestic market for listing and raised an aggregate proceeds of RMB2,700,000,000. Such proceeds have been applied to acquire the new model of Boeing 737 series and related flight equipment. The successful offering of A Shares was crucial to the realisation of our business goal, as it marked the entry of the Company into the PRC capital market. The successful fund raising exercise provides the Group with additional capital resources for future development, improves the Group's assets quality and strengthens its operating capacity, which in turn provides a solid foundation for the Group to compete efficiently in the ever increasingly competitive civil aviation market.

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CHAIRMAN'S STATEMENT (Cont'd)

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[PHOTO]

The injection of the airline transportation businesses of China Northern Airlines Company and Xinjiang Airlines Company into the Group by China Southern Air Holding Company ("CSAHC"), the controlling shareholder of the Company, is progressing as scheduled. Since 1 January, 2003, the three airlines have implemented a code sharing arrangement, whereby the flight code of CZ is used for the flights of the three airlines. The preparatory work for business integration and assets restructuring is making good progress. The proposed restructuring will provide the Group with opportunities for expanding its flight networks and enlarging its market share in the civil aviation industry.

[PHOTO]

In view of global and domestic economic development, we believe that there will be robust growth in the airlines market in the coming year. The global economy has shown a visible recovery in a new cycle of economic growth, which will stimulate rapid development of the global air transport business. China's macro economic development in 2004 will also help to maintain the growth momentum of China in its economic cycle. The direction and guidelines of the Government in economic development represent the principles of scientific development, pursuant to which China's economy will see integral, harmonious and sustainable growth whilst maintaining a stable and rapid pace of development. The stably increasing consumption will gradually replace the previously substantial investments as a stimulant to economic growth. China's air transportation industry has regained growth on all fronts after the SARS outbreak and the overall growth trend will gain further momentum in the coming year. The Group, as a major player in the PRC airlines market, will make its contributions to the growth of the domestic economy. Meanwhile, the implementation of the Closer Economic Partnership Arrangement between mainland China, Hong Kong and Macau, and the State policies on the overall development of the Western region and the revitalisation of the old industrial base of Northeast China will provide a perfect opportunity for the business growth of the Group.

[PHOTO]

With the approval of the State Council, the "Pricing Reform Plan for the Domestic Civil Aviation Industry" was adopted on 20 April, 2004. Pursuant to this Pricing Reform Plan, the pricing guidelines formulated by the government will be applied to the domestic air transport industry. Direct control by governmental pricing authorities over airfares for different flight routes will be changed to indirect control through the setting of basic rates and price ranges for air transport by such governmental pricing authorities. China's airlines will be able to determine their own airfares within the price ranges set by the governmental pricing authorities based on the changes in supply and demand of the market, and will adopt more flexible sales policies with an objective of maximising economic benefits. It is expected that as the reform in China's civil aviation industry continues to intensify, airline operators will gain a greater level of autonomy in managing their own business operations, and the Group will be able to achieve further business growth through fair and positive competition in a gradually regulated and orderly market.

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CHAIRMAN'S STATEMENT (Cont'd)

On the other hand, recent political instability in the Middle East and other uncertainties continue to hamper global economic growth. The continuing high jet fuel price is also a factor unfavorable to the growth of the air transport industry.



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Challenges come with opportunities. In this year, the Group will continue to ensure a high standard of safety in our service and expedite its progress in the restructuring of the airline-related businesses with CSAHC. The Group will further strengthen its market competitiveness and strive to maintain and increase its market share. The Group will strive to achieve the above objectives through the following measures:

1. In the middle of the year, the Group will be able to enhance its operating capacity, route coverage and flight networks after the official opening of the Guangzhou New Airport and the commencement of operation of terminal No. 1 in the Beijing Capital International Airport leased by the Group.
2. Consistent with the business policies that emphasise development in the domestic market and expansion into overseas market for further growth, the Group will build domestic transportation hubs, optimise its flight networks in China and at the same time, actively explore overseas and regional markets. We will increase our overseas market share by opening new routes including flights from Guangzhou to Paris and adjusting our international cargo flights during the year.
3. We will further promote the "China Southern" brand name and enhance brand value in terms of "Reliability, Punctuality and Convenience".
4. The Group's cargo operation will be advanced to a higher standard upon the commencement of operation of the Guangzhou New Airport and its new cargo transportation centre.
5. We will continue to strengthen our financial management and tighten cost controls.

Looking back on 2003, we and our counterparts in the air transport industry had been striving for growth and meeting challenges amid difficult market conditions. On behalf of the board, I would like to express our gratitude to our management and staff. If not for their team spirit and dedication, China Southern Airlines would not have managed to overcome these unprecedented difficulties. We are particularly grateful to our front line staff who have shown their professional attitude and devotion by bravely and diligently performing their duties in the dangerous situation during the SARS outbreak. Finally, I would like to express our sincere gratitude to our shareholders for their continuous trust and support.

YAN ZHI QING  
Chairman

Guangzhou, the PRC  
23 April, 2004

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MANAGEMENT DISCUSSION AND ANALYSIS

[PHOTO OF WANG CHANG SHUN]  
Vice President of the Board  
of Directors, President

The following discussion and analysis should be read in conjunction with the

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financial statements of the Group prepared under IFRS as set out in pages 39 to 98. The Group also prepares financial statements in accordance with PRC Accounting Rules and Regulations as set out in pages 99 to 182. IFRS differs in certain material respects from accounting principles generally accepted in the United States of America ("U.S. GAAP") and PRC Accounting Rules and Regulations. For a discussion of the material differences between IFRS, U.S. GAAP and PRC Accounting Rules and Regulations relating to the Group, see supplementary information on pages 183 to 188 of this Annual Report.

### OVERVIEW

In 2003, the Group encountered the most unprecedented challenges and difficulties. The outbreak of the SARS earlier this year severely hit the PRC aviation industry. From April to June 2003, the Group's passenger volume and passenger load factor dropped which caused the revenue passenger kilometres ("RPK") for April, May and June of 2003 to fall by 40%, 83.5% and 61.5% respectively, as compared to the same period in 2002. In order to minimise the negative impact of SARS, the Group implemented various measures to adjust its operating capacity, for example by reducing the number of flights and suspending certain routes, in response to the reduced air traffic demand caused by the negative impact of SARS. The SARS was effectively under control in the PRC in July 2003 and the domestic market started to recover in the third quarter of 2003. The Group gradually resumed all its suspended flights since July 2003.

In order to alleviate the financial pressure suffered by the PRC civil aviation industry as a result of the SARS epidemic, the PRC government waived the levies of the CAAC Infrastructure Development Fund, sales tax and related supplementary taxes on passenger revenue payable by the PRC airlines, during the period from 1 May, 2003 to 31 December, 2003.

Besides, the political tension in the Middle East, in particular the Iraq war in March 2003, led to a surge in oil prices which in turn caused an increase in the Group's jet fuel cost.

The Group conducts a portion of its airline operations through the Airline Subsidiaries. Operating results for the Airline Subsidiaries are included in each of the years presented in the consolidated financial statements. The Airline Subsidiaries, which derive substantially all of their operating revenue from passenger traffic, accounted for 26.8% and 28.8% of the Group's total operating revenue, and 34.5% and 38.7% of the Group's total passengers carried, in 2002 and 2003, respectively. Xiamen Airlines is the largest member of the Airline Subsidiaries, with operating revenue of RMB3,278 million and RMB3,460 million in 2002 and 2003, respectively, or 18.2% and 19.8% of the Group's total operating revenue.

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MANAGEMENT DISCUSSION AND ANALYSIS (Cont'd)

[PHOTO]

The Group's operating revenue is substantially dependent on the passenger and cargo traffic volume carried, which is subject to seasonal and other changes in traffic patterns, the availability of appropriate time slots for the Group's flights and alternative routes, the degree of competition from other airlines and alternate means of transportation, as well as other factors that may influence passenger travel demand and cargo and mail volume. In particular, the Group's airline revenue is generally higher in the second and third quarters than in the first and fourth quarters.

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[PHOTO]

Like most airlines, the Group is subject to a high degree of financial and operating leverage. A significant percentage of the Group's operating expenses is fixed costs that do not vary proportionally based on the Group's yields or the load factors. These fixed costs include depreciation expense, jet fuel costs, landing and navigation fees, financing costs, operating lease payments, aircraft maintenance costs and labour for flight crew, cabin crew and ground personnel. Thus, a minor change in the Group's yields or load factors would have a material effect on the Group's results of operations. In addition, certain of these expenses, primarily financing costs and operating lease payments, labour costs and depreciation do not vary based on the number of flights flown. Thus, the Group's operating results can also be substantially affected by minor changes in aircraft utilisation rates. The Group is and will continue to be highly leveraged with substantial obligations denominated in foreign currencies and, accordingly, the results of its operations are significantly affected by fluctuations in foreign exchange rates, particularly for the U.S. dollar and the Japanese yen. The Group recognised a net exchange loss of RMB175 million and RMB164 million in 2002 and 2003, respectively. These amounts represented mainly unrealised exchange differences resulting from the retranslation of the foreign currency borrowings as of the years ended 2002 and 2003.

A number of other external variables, including political and economic conditions in China, tend to have a major impact on the Group's performance. The Group's financial performance is also significantly affected by factors arising from operating in a regulated industry. As substantially all aspects of the Group's airline operations are regulated by the PRC government, the Group's operating revenues and expenses are directly affected by the PRC government's policies with respect to domestic airfares, jet fuel prices and landing and navigation fees, among others. The nature and extent of airline competition and the ability of Chinese airlines to expand are also affected by CAAC's control over route allocations. Any changes in the PRC government's regulatory policies, or any implementation of such policies could have a significant impact on the Group's future operations and its ability to implement its operating strategy.

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### MANAGEMENT DISCUSSION AND ANALYSIS (Cont'd)

#### CERTAIN FINANCIAL INFORMATION AND OPERATING DATA BY GEOGRAPHIC REGION

The following table sets forth certain financial information and operating data by geographic region for the years ended 31 December, 2002 and 2003:

|  | FOR THE YEAR END<br>DECEMBER 31, |        | 2003 vs 2002              |
|--|----------------------------------|--------|---------------------------|
|  | 2003                             | 2002   | % Increase/<br>(Decrease) |
| <hr style="border-top: 1px dashed black;"/>  |                                  |        |                           |
| TRAFFIC                                      |                                  |        |                           |
| Revenue passenger kilometres (RPK) (million) |                                  |        |                           |
| - Domestic                                   | 21,294                           | 22,092 | (3.6)                     |
| - Hong Kong regional                         | 778                              | 1,081  | (28.0)                    |
| - International                              | 4,315                            | 5,767  | (25.2)                    |
| <hr style="border-top: 1px dashed black;"/>  |                                  |        |                           |
| Total  | 26,387                           | 28,940 | (8.8)                     |

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|  |        |        |        |
|--|--------|--------|--------|
| =====                                    |        |        |        |
| Revenue tonne kilometres (RTK) (million) |        |        |        |
| - Domestic                               | 2,424  | 2,532  | (4.3)  |
| - Hong Kong regional                     | 78     | 108    | (27.8) |
| - International                          | 1,059  | 974    | 8.7    |
| -----                                    |        |        |        |
| Total                                    | 3,561  | 3,614  | (1.5)  |
| =====                                    |        |        |        |
| Passengers carried (thousand)            |        |        |        |
| - Domestic                               | 18,259 | 18,535 | (1.5)  |
| - Hong Kong regional                     | 1,019  | 1,369  | (25.6) |
| - International                          | 1,192  | 1,589  | (25.0) |
| -----                                    |        |        |        |
| Total                                    | 20,470 | 21,493 | (4.8)  |
| =====                                    |        |        |        |
| Cargo and mail carried (thousand tonne)  |        |        |        |
| - Domestic                               | 379    | 404    | (6.2)  |
| - Hong Kong regional                     | 12     | 14     | (14.3) |
| - International                          | 73     | 52     | 40.4   |
| -----                                    |        |        |        |
| Total                                    | 464    | 470    | (1.3)  |
| =====                                    |        |        |        |

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MANAGEMENT DISCUSSION AND ANALYSIS (Cont'd)

CERTAIN FINANCIAL INFORMATION AND OPERATING DATA BY GEOGRAPHIC REGION (cont'd)

|  | FOR THE YEAR END<br>DECEMBER 31, |        | 2003 vs 2002<br>% Increase/<br>(Decrease) |
|--|----------------------------------|--------|---|
|  | 2003                             | 2002   |   |
| -----                                      |                                  |        |   |
| CAPACITY                                   |                                  |        |   |
| Available seat kilometres (ASK) (million)  |                                  |        |   |
| - Domestic                                 | 32,590                           | 33,753 | (3.4)                                     |
| - Hong Kong regional                       | 1,347                            | 1,746  | (22.9)                                    |
| - International                            | 6,930                            | 8,746  | (20.8)                                    |
| -----                                      |                                  |        |   |
| Total                                      | 40,867                           | 44,245 | (7.6)                                     |
| =====                                      |                                  |        |   |
| Available tonne kilometres (ATK) (million) |                                  |        |   |
| - Domestic                                 | 3,772                            | 3,924  | (3.9)                                     |
| - Hong Kong regional                       | 150                              | 193    | (22.3)                                    |
| - International                            | 1,999                            | 1,798  | 11.2                                      |
| -----                                      |                                  |        |   |

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|       |       |       |     |
|-------|-------|-------|-----|
| Total | 5,921 | 5,915 | 0.1 |
|-------|-------|-------|-----|

LOAD FACTORS

|                                     |      |      |       |
|-------------------------------------|------|------|-------|
| Passenger load factor (RPK/ASK) (%) |      |      |       |
| - Domestic                          | 65.3 | 65.5 | (0.3) |
| - Hong Kong regional                | 57.8 | 61.9 | (6.6) |
| - International                     | 62.3 | 65.9 | (5.5) |
| Overall                             | 64.6 | 65.4 | (1.2) |

|                                   |      |      |       |
|-----------------------------------|------|------|-------|
| Overall load factor (RTK/ATK) (%) |      |      |       |
| - Domestic                        | 64.2 | 64.5 | (0.5) |
| - Hong Kong regional              | 52.2 | 55.8 | (6.5) |
| - International                   | 53.0 | 54.2 | (2.2) |
| Overall                           | 60.1 | 61.1 | (1.6) |

YIELD

|                      |      |      |       |
|----------------------|------|------|-------|
| Yield per RPK (RMB)  |      |      |       |
| - Domestic           | 0.57 | 0.55 | 3.6   |
| - Hong Kong regional | 0.96 | 0.98 | (2.0) |
| - International      | 0.47 | 0.42 | 11.9  |
| Overall              | 0.57 | 0.54 | 5.6   |

|                      |       |       |        |
|----------------------|-------|-------|--------|
| Yield per RTK (RMB)  |       |       |        |
| - Domestic           | 5.40  | 5.21  | 3.6    |
| - Hong Kong regional | 10.35 | 10.36 | (0.1)  |
| - International      | 2.90  | 3.25  | (10.8) |
| Overall              | 4.76  | 4.84  | (1.7)  |

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MANAGEMENT DISCUSSION AND ANALYSIS (Cont'd)

CERTAIN FINANCIAL INFORMATION AND OPERATING DATA BY GEOGRAPHIC REGION (cont'd)

|  | FOR THE YEAR END |      | 2003 vs 2002 |
|--|------------------|------|--------------|
|  | DECEMBER 31,     |      | % Increase/  |
|  | 2003             | 2002 | (Decrease)   |

FLEET

|   |     |     |      |
|---|-----|-----|------|
| Total number of aircraft in service at year end |     |     |      |
| - Boeing  | 108 | 102 | 5.9  |
| - Airbus  | 24  | 20  | 20.0 |
| Total   | 132 | 122 | 8.2  |

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### OVERALL UTILISATION RATE (HOURS PER DAY)

|          |     |     |        |
|----------|-----|-----|--------|
| - Boeing | 8.6 | 9.9 | (13.2) |
| - Airbus | 7.9 | 9.3 | (15.6) |
| Overall  | 8.5 | 9.8 | (13.8) |

### COST

|                                |      |      |      |
|--------------------------------|------|------|------|
| - Operating cost per ASK (RMB) | 0.42 | 0.36 | 16.7 |
| - Operating cost per ATK (RMB) | 2.87 | 2.70 | 6.3  |

### 2003 COMPARED WITH 2002

The Group recorded a net loss of RMB358 million for 2003, as compared to a net profit of RMB576 million for 2002. The Group's operating revenue decreased by RMB549 million or 3.0% from RMB18,019 million in 2002 to RMB17,470 million in 2003. Passenger load factor decreased by 0.8 percentage point from 65.4% in 2002 to 64.6% in 2003. Passenger yield (in passenger revenue per RPK) increased by 5.6% from RMB0.54 in 2002 to RMB 0.57 in 2003. Average yield (in traffic revenue per RTK) decreased by 1.7% from RMB4.84 in 2002 to RMB4.76 in 2003. Operating expenses increased by RMB1,021 million or 6.4% from RMB15,993 million in 2002 to RMB17,014 million in 2003. As operating revenue decreased while operating expenses increased, operating profit decreased by 77.5% from RMB2,026 million in 2002 to RMB456 million in 2003. The Group's net non-operating expenses increased by 9.1%, from RMB887 million in 2002 to RMB967 million in 2003, mainly due to a decrease in gain on disposal of fixed assets of RMB193 million, partly offset by a decrease in interest expense of RMB135 million. Overall, the Group recorded a net loss of RMB358 million in 2003, as compared to a net profit of RMB576 million in 2002.

### OPERATING REVENUE

Substantially all of the Group's operating revenue is attributable to airline operations. Traffic revenue in 2003 and 2002 accounted for 97.1% and 97.0% respectively of total operating revenue. Passenger revenue and, cargo and mail revenue accounted for 88.5% and 11.5% respectively of total traffic revenue in 2003. The balance of the Group's operating revenue is derived from commission income, income from general aviation operations, fees charged for ground services and for air catering services and net income from lease arrangements.

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### MANAGEMENT DISCUSSION AND ANALYSIS (Cont'd)

Operating revenue decreased by 3.0% from RMB18,019 million in 2002 to RMB17,470 million in 2003. This decrease was primarily due to a 4.4% fall in passenger revenue from RMB15,696 million in 2002 to RMB15,010 million in 2003 resulting from lower traffic volume caused by SARS. The total number of passengers carried decreased by 4.8% to 20.5 million passengers in 2003. RPKs decreased by 8.8% from 28,940 million in 2002 to 26,387 million in 2003, primarily as a result of a decrease in passengers carried. However, passenger yield increased by 5.6% from RMB0.54 in 2002 to RMB0.57 in 2003, mainly as the result of the exemption of CAAC Infrastructure Development Fund and sales tax during the period from 1 May, 2003 to 31 December, 2003.

Domestic passenger revenue, which accounted for 81.6% of the total passenger revenue in 2003, increased slightly by 0.1% from RMB12,234 million in 2002 to

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RMB12,242 million in 2003. Domestic passenger traffic in RPKs decreased by 3.6%, mainly due to a decrease in passengers carried. Passenger yield, however, increased from RMB0.55 in 2002 to RMB0.57 in 2003, mainly as the result of the aforesaid exemption of CAAC Infrastructure Development Fund and sales tax.

Hong Kong passenger revenue, which accounted for 5.0% of total passenger revenue, decreased by 28.9% from RMB1,055 million in 2002 to RMB750 million in 2003. For Hong Kong flights, passenger traffic in RPKs decreased by 28.0%, while passenger capacity in ASKs decreased by 22.9%, resulting in a 4.1 percentage point decrease in passenger load factor from 2002. Passenger yield decreased from RMB0.98 in 2002 to RMB0.96 in 2003 mainly due to slack in traffic volume.

International passenger revenue, which accounted for 13.4% of total passenger revenue, decreased by 16.2% from RMB2,407 million in 2002 to RMB2,018 million in 2003. For international flights, passenger traffic in RPKs decreased by 25.2%, while passenger capacity in ASKs decreased by 20.8%, resulting in a 3.6 percentage point fall in passenger load factor from 2002. Passenger yield increased by 11.9% from RMB0.42 in 2002 to RMB0.47 in 2003 mainly as the result of the aforesaid exemption of CAAC Infrastructure Development Fund and sales tax.

Cargo and mail revenue, which accounted for 11.5% of the Group's total traffic revenue and 11.1% of total operating revenue, increased by 9.5% from RMB1,786 million in 2002 to RMB1,955 million in 2003. The increase was primarily due to the full year effect of the opening of two international cargo routes to Los Angeles of the United States of America and Leige of Belgium in late 2002.

Other operating revenue decreased by 6.0% from RMB537 million in 2002 to RMB505 million in 2003. The decrease was primarily due to a decrease in aircraft short-term lease income of RMB46 million.

### OPERATING EXPENSES

Substantially all of the Group's operating expenses result from its airline operations. The vast majority of such expenses relate directly to flight operations, aircraft and traffic servicing, aircraft repair and maintenance and to depreciation and amortisation in respect of aircraft and flight equipment. Expenses associated directly with the Group's flight operations (collectively, "flight operations expenses") include fuel costs, operating lease payments, catering expenses, aircraft insurance, flight personnel payroll and welfare and training expenses. Expenses associated directly with repairs and maintenance in respect of the Group's aircraft (collectively, "repairs and maintenance expenses") include repairs and maintenance and overhaul charges, the costs of consumables and other maintenance materials and labour costs for maintenance personnel. Expenses associated directly with the Group's aircraft and traffic servicing operations (collectively "aircraft and traffic servicing expenses") include landing and navigation fees, rental payments and charges in respect of terminal and other ground facilities and labour costs for ground personnel. The balance of the Group's operating expenses result from promotional and marketing activities

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### MANAGEMENT DISCUSSION AND ANALYSIS (Cont'd)

(collectively, "promotional and marketing expenses") such as sales commissions, fees for use of the CAAC's reservation system, ticket-printing and sales office expenses, advertising and promotional expenses, and from general and administrative expenses, such as administrative salaries and welfare and other personnel benefits and office expenses.

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Total operating expenses in 2003 amounted to RMB17,014 million, representing an increase of 6.4% or RMB1,021 million over 2002, primarily due to the combined effect of increases in jet fuel costs, maintenance expenses and aircraft and traffic servicing expenses. Total operating expenses as a percentage of total operating revenue increased from 88.8% in 2002 to 97.4% in 2003.

Flight operations expenses, which accounted for 41.6% of total operating expenses, increased by 5.0% from RMB6,733 million in 2002 to RMB7,070 million in 2003, primarily as a result of increases in jet fuel costs and operating lease payments, partly offset by a decrease in catering expenses. Jet fuel costs, which accounted for 54.7% of flight operations expenses, increased by 9.9% from RMB3,519 million in 2002 to RMB3,867 million in 2003 mainly as a result of increased jet fuel prices. Operating lease payments increased by 8.4% from RMB1,417 million in 2002 to RMB1,536 million in 2003, primarily due to the full year effect of the addition of new operating leases in respect four Boeing 757-200 aircraft in late 2002 and four Airbus 319-100 aircraft and three Boeing 737-700 aircraft during 2003. Catering expenses decreased by 18.4% from RMB625 million in 2002 to RMB510 million in 2003, primarily reflecting a tighter cost controls exercised by the Group. Aircraft insurance costs decreased by 23.4% from RMB256 million in 2002 to RMB196 million in 2003, primarily because of a reduction in the rate of aircraft insurance premiums prescribed by the PRC insurance company. Labour costs for flight personnel decreased by 6.8% from RMB781 million in 2002 to RMB728 million in 2003, largely due to a decrease in flight hours.

Maintenance expenses which accounted for 15.2% of total operating expenses, increased by 11.0% from RMB2,333 million in 2002 to RMB2,589 million in 2003. The increase was primarily attributable to an 11.3% increase in aircraft maintenance and repair charges from RMB2,135 million in 2002 to RMB2,377 million in 2003, mainly as the result of the effect of fleet expansion in recent years.

Aircraft and traffic servicing expenses, which accounted for 16.3% of total operating expenses, increased by 10.2% from RMB2,511 million in 2002 to RMB2,767 million in 2003. The increase primarily resulted from an 8.9% rise in landing and navigation fees from RMB2,354 million in 2002 to RMB2,563 million in 2003, due to an increase in the charge rate for domestic landing and navigation fees effective September 2002.

Promotional and marketing expenses, which accounted for 8.7% of total operating expenses, decreased by 1.3% from RMB1,500 million in 2002 to RMB1,480 million in 2003. The decrease was due to 9.3% decrease in labour costs from RMB248 million in 2002 to RMB225 million in 2003, as fewer bonuses were given because of reduced sales volume in 2003.

General and administrative expenses, which accounted for 6.2% of the total operating expenses, decreased slightly by 0.7% from RMB1,060 million in 2002 to RMB1,053 million in 2003. This was mainly due to a decrease in scale of operations during SARS period.

Depreciation and amortisation, which accounted for 12.0% of total operating expenses, increased by 10.8% from RMB1,840 million in 2002 to RMB2,038 million in 2003. This increase was primarily as a result of the additions of aircraft during 2003.

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MANAGEMENT DISCUSSION AND ANALYSIS (Cont'd)

OPERATING PROFIT



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Operating profit decreased by 77.5% from RMB2,026 million in 2002 to RMB456 million in 2003. This was mainly because operating revenue decreased by RMB549 million or 3.0% from 2002 while operating expenses increased by RMB1,021 million or 6.4% over the same period.

### NON-OPERATING INCOME/(EXPENSES)

Interest expense decreased by 14.1% from RMB959 million in 2002 to RMB824 million in 2003, mainly reflecting the combined effect of scheduled debt repayments and the replacement of certain RMB denominated bank loans with US\$ denominated bank loans with lower interest rates.

Interest income decreased by 75.2% from RMB53 million in 2002 to RMB13 million in 2003. This was mainly attributable to a decrease in average cash balances.

The Group recorded a net loss on sale of fixed assets of RMB22 million in 2003, mainly resulting from retirement of two old Boeing 737-200 aircraft.

During 2003, the Group recorded a net exchange loss of RMB164 million predominantly due to its Japanese yen denominated borrowings as a result of the Japanese yen appreciation. Such amount comprised mostly unrealised translation loss.

### TAXATION

On 17 October, 2003, the Company's registered address was moved to Guangzhou Economic & Technology Development Zone. In accordance with the Rules and Regulations for Implementation of Income Tax for Foreign Investment Enterprises and Foreign Enterprises of the PRC and a taxation approval document "Guangzhou Municipal State Tax Bureau Suo De Shui Zi Que 020043", the Company is entitled to enjoy the preferential tax policy implemented in the Guangzhou Economic & Technology Development Zone effective from 1 October, 2003. As a result, the Company's income tax rate has been changed to 15% from 33% beginning from that date.

The Group recorded an income tax credit of RMB324 million for 2003 compared to an income tax expense of RMB398 million for 2002. As a result of the reduction in income tax rate, the Company's net deferred taxation liability balance brought forward from 31 December, 2002 of RMB507 million was reduced by RMB392 million and a net deferred tax credit of RMB392 million was recognised in 2003 for such reduction in income tax rate accordingly.

### MINORITY INTERESTS

Minority interests increased by 3.6% from RMB165 million in 2002 to RMB171 million in 2003, primarily reflecting the net profits earned by certain of the Group's airline subsidiaries for the year.

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### MANAGEMENT DISCUSSION AND ANALYSIS (Cont'd)

#### LIQUIDITY, FINANCIAL RESOURCES AND CAPITAL STRUCTURE

As at 31 December, 2003, the Group's borrowings totalled RMB18,460 million, representing a decrease of RMB815 million from RMB19,275 million last year. Such borrowings were denominated, to a larger extent, in United States dollars and, to a smaller extent, in Japanese yen and Renminbi, with a significant portion being fixed interest rate borrowings. Of such borrowings, RMB8,395 million,

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RMB1,716 million, RMB1,601 million, RMB1,660 million and RMB5,088 million will be repayable in 2004, 2005, 2006, 2007, 2008 and thereafter respectively. As at 31 December, 2003, cash and cash equivalents of the Group totalling RMB2,080 million, of which 22.2% were denominated in foreign currencies, decreased by 44.8% from RMB3,771 million last year. Net debts (total borrowings net of cash and cash equivalents) increased by 5.7% to RMB16,380 million.

As at 31 December, 2003, the Group's shareholders' equity amounted to RMB11,896 million, representing an increase of RMB2,283 million from RMB9,613 million last year. The increase was mainly due to the issuance of 1,000,000,000 A shares with an issue price of RMB2.70 per share by way of public offering in July 2003 in the PRC.

Net debt/equity ratio of the Group at 31 December, 2003 was 1.38 times, as compared to 1.61 times last year.

### FINANCIAL RISK MANAGEMENT POLICY

In the normal course of business, the Group is exposed to fluctuations in foreign currencies and jet fuel prices. The Group's exposure to foreign currencies was as a result of its debt which are denominated in foreign currencies. Depreciation or appreciation of the RMB against foreign currencies affects the Group's results significantly because the Group's foreign currency payments generally exceed its foreign currency receipts. The Group is not able to hedge its foreign currency exposure effectively other than by retaining its foreign currency denominated earnings and receipts to the extent permitted by the State Administration of Foreign Exchange, or subject to certain restrictive conditions, by entering into forward foreign exchange contracts with certain authorised PRC banks.

The Group is required to procure a majority of its jet fuel consumption domestically at PRC spot market prices. There are currently no effective means available to manage the Group's exposure to the fluctuations in domestic jet fuel prices.

### CHARGES ON ASSETS

As at 31 December, 2003, certain aircraft of the Group with an aggregate carrying value of approximately RMB14,576 million (2002: RMB14,783 million) were mortgaged under certain loan and lease agreements. Details of charges are set out in notes 10, 21 and 22 to the consolidated financial statements.

### COMMITMENTS AND CONTINGENCIES

At December 31, 2003, the Group had capital commitments of approximately RMB13,628 million. Of such amounts, RMB10,615 million related to the acquisition of aircraft and related flight equipment and RMB2,072 million related to the Group's facilities and equipment to be constructed and installed at the Guangzhou new airport. The remaining amount of RMB941 million related to the Group's other airports and office facilities and equipment, overhaul and maintenance bases and training facilities.

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### MANAGEMENT DISCUSSION AND ANALYSIS (Cont'd)

As at 31 December, 2003, the Group was committed to make a capital contribution of approximately RMB446 million to its jointly controlled entities.

Details of the capital and investing commitments are set out in note 29 to the

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consolidated financial statements.

Major contingent liabilities of the Group at 31 December, 2003 are set out in note 30 to the consolidated financial statements.

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### REPORT OF THE DIRECTORS

The Board of Directors of the Company hereby presents this report and the audited consolidated financial statements of the Group for the year ended 31 December, 2003.

#### PRINCIPAL ACTIVITIES, OPERATING RESULTS AND FINANCIAL POSITION

The Group is principally engaged in airline operations. The Group also operates certain airline related businesses, including aircraft maintenance and air catering operations. The Group is one of the largest airlines in China. In 2003, the Group ranked first among all Chinese airlines in terms of passenger traffic volume, number of scheduled flights per week, number of hours flown, number of routes and size of aircraft fleet. The Group has prepared the results of operations for the year ended 31 December, 2003, and the financial position of the Company and the Group as of that date in accordance with IFRS and PRC Accounting Rules and Regulations. See pages 39 to 182 of this Annual Report.

#### FIVE-YEAR SUMMARY

A summary of the results and the assets and liabilities of the Group prepared under IFRS for the five-year period ended 31 December, 2003 are set out on pages 189 and 190 of this Annual Report.

#### DIVIDENDS

No interim dividend was paid during the year ended 31 December, 2003 (2002: Nil).

The Board of Directors of the Company does not recommend the payment of a final dividend in respect of the year ended 31 December, 2003 (2002: Nil).

#### BANK LOANS AND OTHER BORROWINGS

Details of the bank loans and other borrowings of the Company and the Group are set out in notes 21 and 22 to the consolidated financial statements prepared under IFRS.

#### INTEREST CAPITALIZATION

For the year ended 31 December, 2003, RMB83,077,000 interest (2002: RMB64,186,000) was capitalised as the cost of construction in progress and fixed assets.

#### FIXED ASSETS

Fixed assets of the Company and the Group and movements of fixed assets during the year ended 31 December, 2003 are set out in note 10 to the consolidated financial statements prepared under IFRS.

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REPORT OF THE DIRECTORS (Cont'd)

### MAJOR CUSTOMERS AND SUPPLIERS

The percentage of turnover attributable to the Group's five largest customers in aggregate was less than 30% of the Group's total operating revenue (i.e. turnover) for the year ended 31 December, 2003.

The percentage of purchases attributable to the largest supplier and the five largest suppliers in aggregate represented approximately 60% and 72%, respectively, of the Group's total purchases (not including purchases of items which are of a capital nature) for the year ended 31 December, 2003.

At no time during the year ended 31 December, 2003 have any Directors, associates of Directors or shareholders of the Company owning, to the knowledge of the Directors, more than 5% of the Company's share capital and any interest in the Group's five largest customers or suppliers.

### TAXATION

Details of taxation of the Company and the Group are set out in note 7 to the consolidated financial statements prepared under IFRS.

### RESERVES

Movements in the reserves of the Company and the Group during the year are set out in note 26 to the consolidated financial statements prepared under IFRS.

### EMPLOYEES AND EMPLOYEES' PENSION SCHEME

As at 31 December, 2003, the Group had an aggregate of 17,569 employees (2002: 17,031). Details of the employees' pension schemes and other welfare are set out in note 28 to the consolidated financial statements prepared under IFRS.

### SUBSIDIARIES

Details of the principal subsidiaries of the Company are set out in note 36 to the consolidated financial statements prepared under IFRS.

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REPORT OF THE DIRECTORS (Cont'd)

### SHARE CAPITAL STRUCTURE

With the approval of the China Securities Regulatory Commission, the Company issued 1,000,000,000 A Shares of RMB1 each to public at an issue price of RMB2.7 each from 10 July to 17 July, 2003 and successfully raised gross share proceeds of RMB2.7 billion. The A Shares issued are listed on the Shanghai Stock Exchange since 25 July, 2003 (Abbreviation: Southern Airlines; stock code: 600029).

Owing to the issuance of A Shares, the Company's total share capital has increased from 3,374,178,000 shares to 4,374,178,000 shares. The share capital of the Company is set out below:

BEFORE ISSUANCE OF  
A SHARES

AFTER ISSUA  
A SHAR

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| TYPE OF SHARES                                | NUMBER OF SHARES | APPROXIMATE PERCENTAGE OF TOTAL SHARE CAPITAL (%) | NUMBER OF SHARES |
|---|------------------|---|------------------|
| 1. Unlisted shares State-owned shares         | 2,200,000,000    | 65.2  | 2,200,000,000    |
| 2. Listed shares                              |                  |   |                  |
| 1. Overseas listed foreign shares (H Shares)  | 1,174,178,000    | 34.8  | 1,174,178,000    |
| 2. Domestic listed ordinary shares (A Shares) | -                | -   | 1,000,000,000    |
| Total share capital                           | 3,374,178,000    | 100   | 3,374,178,000    |

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REPORT OF THE DIRECTORS (Cont'd)

SUBSTANTIAL SHAREHOLDERS

As at 31 December, 2003, to the knowledge of the Directors, chief executive and Supervisors of the Company, the interests and short positions of the following persons other than the Directors, chief executives or Supervisors in the shares and underlying shares of the Company as recorded in the register of the Company required to be kept under section 336 of the Securities and Futures Ordinance (the "SFO") or otherwise persons who have an interest of 10% or more in the Company's shares are as follows:

| NAME OF SHAREHOLDER    | TYPE OF SHAREHOLDING | TYPE OF SHARE      | NUMBER OF SHARE HELD | % OF THE TOTAL ISSUED H SHARES OF THE COMPANY | % OF THE TOTAL ISSUED SHARE CAPITAL OF THE COMPANY |
|------------------------|----------------------|--------------------|----------------------|---|--|
| CSAHC                  | Direct holding       | State-owned Shares | 2,200,000,000        | -   | 50.30%   |
| HKSCC Nominees Limited | Direct holding       | H Shares           | 1,149,955,998        | 97.94%  | 26.29%   |

Note:

Based on the information available to the Directors, chief executive and Supervisors of the Company (including such information as was available on the website of the Hong Kong Stock Exchange) and so far as the Directors, chief executive and Supervisors are aware, as at 31 December, 2003:

- Among the 1,149,955,998 H Shares held by HKSCC Nominees Limited, Li Ka-Shing Unity Trustcorp Limited had an interest in an aggregate of 193,877,000 H Shares of the Company (representing approximately 16.51 %

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of its then total issued H Shares) in the capacity as beneficiary of a trust.

2. Among the 1,149,955,998 H Shares held by HKSCC Nominees Limited, J.P. Morgan Chase & Co. had an interest in an aggregate of 139,239,800 H Shares of the Company (representing approximately 11.86% of its then total issued H Shares). Out of the 139,239,800 H Shares, J.P. Morgan Chase & Co. had an interest in a lending pool comprising 19,849,000 H Shares of the Company (representing approximately 1.69% of its then total issued H Shares). According to the information as disclosed in the website of the Hong Kong Stock Exchange and so far as the Directors, chief executive and Supervisors are aware, J.P. Morgan Chase & Co. held its interest in the Company in the following manners:
- (a) 19,849,000 H Shares in a lending pool, representing approximately 1.69% of the Company's then total issued H Shares, were held by J.P. Morgan Chase Bank, which was 100% held by J.P. Morgan Chase & Co.;
  - (b) 3,856,800 H Shares, representing approximately 0.33% of the Company's then total issued H Shares, were held in the capacity as beneficial owner by J.P. Morgan Whitefriars Inc., which was ultimately 100% held by J.P. Morgan Chase & Co.;
  - (c) 115,138,000 H Shares, representing approximately 9.81% of the Company's then total issued H Shares, were held in the capacity as investment manager by JF Asset Management Limited, which was approximately 99.99% held by J.P. Morgan Fleming Asset Management (Asia) Inc., which was ultimately 100% held by J.P. Morgan Chase & Co.; and
  - (d) 396,000 H Shares, representing approximately 0.03% of the Company's then total issued H Shares, were held in the capacity as beneficial owner by J.P. Morgan Securities Ltd., which was approximately 90% held by J.P. Morgan Holdings (UK) Limited, which was ultimately 100% held by J.P. Morgan Chase & Co..

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REPORT OF THE DIRECTORS (Cont'd)

3. Among the 1,149,955,998 H Shares held by HKSCC Nominees Limited, Morgan Stanley International Incorporated had an interest in an aggregate of 111,121,932 H Shares of the Company (representing approximately 9.46% of its then total issued H Shares). According to the information as disclosed on the website of the Hong Kong Stock Exchange and so far as the Directors, chief executive and Supervisors are aware, Morgan Stanley International Incorporated which was (or its directors were) accustomed to act in accordance with the directors of Morgan Stanley, held its indirect interest in the Company as at 31 December, 2003 in the manner as follows:
- (a) 743,322 H Shares, representing approximately 0.06% of the Company's then total issued H Shares, were held by Morgan Stanley Dean Witter Hong Kong Securities Limited, which was ultimately 100% held by Morgan Stanley Asia Pacific (Holdings) limited, which, in turn, was 90% held by Morgan Stanley International Incorporated;

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- (b) 108,670,000 H Shares, representing approximately 9.25% of the Company's then total issued H Shares, were held by Morgan Stanley Investment Management Company, which was ultimately 100% held by Morgan Stanley Asia Pacific (Holdings) Limited, which, in turn, was 90% held by Morgan Stanley International incorporated;
- (c) 292,600 H Shares, representing approximately 0.02% of the Company's then total issued H Shares, were held by Morgan Stanley Asset & Investment Trust Management Co, Limited, which was 100% held by Morgan Stanley International Incorporated;
- (d) 714,000 H Shares, representing approximately 0.06% of the Company's then total issue H Shares, were held by Morgan Stanley & Co International Limited, which was ultimately 100% held by Morgan Stanley Group (Europe), which, in turn, was approximately 98.30% held by Morgan Stanley International Limited, in which Morgan Stanley International Incorporated held 100% control; and
- (e) 702,000 H Shares, representing approximately 0.06% of the Company's then total issued H Shares, were held by Morgan Stanley Capital (Luxembourg) S.A., which was approximately 93.75% held by Morgan Stanley International Incorporated.

According to the information as disclosed on the website of the Hong Kong Stock Exchange and so far as the Directors, chief executive and Supervisors are aware, as at 31 December, 2003, Morgan Stanley Dean Witter Hong Kong Securities Limited also had a short position in 616,000 H Shares of the Company (representing approximately 0.05% of its then total issued H Shares).

- 4. Among the 1,149,955,998 H Shares held by HKSCC Nominees Limited, 96,938,500 H Shares, representing approximately 8.26% of the Company's then total issued H Shares, were held by Space Dragon Limited as beneficial owner, which was 100% held by Cheung Kong Investment Company Limited.
- 5. Among the 1,149,955,998 H Shares held by HKSCC Nominees Limited, 96,938,500 H Shares, representing approximately 8.26% of the Company's then total issued H Shares, were held by Choicewell Limited as beneficial owner, which was ultimately 100% held by Hutchison Whampoa Limited.

Save as disclosed above, as at 31 December 2003, to the knowledge of the Directors, chief executive and Supervisors of the Company, no other person (other than the Directors, chief executives or Supervisors) had an interest or short positions in the shares or underlying shares of the Company as recorded in the register of the Company required to be kept under section 336 of the SFO or otherwise had an interest of 10% or more in the Company's shares.

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REPORT OF THE DIRECTORS (Cont'd)

### PARTICULARS OF SHAREHOLDERS

The total number of shareholders of the Company as at 31 December, 2003 was 152,747, of which 150,147 were shareholders of A Shares and 2,600 were shareholders of H Shares.

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Particulars of shareholdings of the Company's ten largest shareholders as at the end of the reporting period are as follows:

### SHAREHOLDINGS OF TEN LARGEST SHAREHOLDERS:

| NO. | NAME OF SHAREHOLDERS   | INCREASE/DECREASE DURING THE YEAR | SHAREHOLDINGS AT THE END OF THE YEAR | PERCENTAGE (%) | TYPE OF SHARES | NUMBER OF PLEDGED OR FROZEN SHARES |
|-----|------------------------|-----------------------------------|--------------------------------------|----------------|----------------|------------------------------------|
| 1.  | CSAHC                  | -                                 | 2,200,000,000                        | 50.30          | Unlisted       | -                                  |
| 2.  | HKSCC NOMINEES LIMITED | 314,000                           | 1,149,955,998                        | 26.29          | listed         | Unknown                            |
| 3.  | Huaxia Growth          | 59,000,000                        | 59,000,000                           | 1.35           | Listed         | Unknown                            |
| 4.  | Huaxia Return          | 56,865,741                        | 56,865,741                           | 1.30           | Listed         | Unknown                            |
| 5.  | Xinghua Fund           | 30,160,190                        | 30,160,190                           | 0.69           | Listed         | Unknown                            |
| 6.  | Yinfeng Fund           | 25,697,368                        | 25,697,368                           | 0.59           | Listed         | Unknown                            |
| 7.  | Xinghe Fund            | 24,536,588                        | 24,536,588                           | 0.56           | Listed         | Unknown                            |
| 8.  | Anxin Fund             | 21,001,852                        | 21,001,852                           | 0.48           | Listed         | Unknown                            |
| 9.  | Fenghe Value           | 20,940,086                        | 20,940,086                           | 0.48           | listed         | Unknown                            |
| 10. | Yuyuan Fund            | 15,007,147                        | 15,007,147                           | 0.34           | Listed         | Unknown                            |

### PURCHASE, SALE OR REDEMPTION OF SHARES

Neither the Company nor any of its subsidiaries purchased, sold or redeemed any shares of the Company during 2003.

### USE OF PROCEEDS FROM H SHARE OFFERING AND A SHARE OFFERING

As stated in the 2002 Annual Report of the Company, as of 31 December, 2002, the Company had RMB40 million remaining from the proceeds of the initial public offering of the H Shares of the Company. As at 31 December, 2003, the RMB40 million has been used for the development of the Company's computerised accounting system and flights controlling system in accordance with the disclosure in the Prospectus of the Company dated July 1997.

The proceeds from the issue of A Shares have been used for the purchases of Boeing 737-800 aircraft in accordance with the disclosure in the Prospectus for Offering of the A Shares. There has been no change in the use of proceeds.

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REPORT OF THE DIRECTORS (Cont'd)

### PRE-EMPTIVE RIGHTS

Neither the Articles of Association of the Company nor the laws of the PRC provide for any pre-emptive rights requiring the Company to offer new shares to existing shareholders in proportion to their existing shareholdings.

### COMPLIANCE WITH THE CODE OF BEST PRACTICE

In the opinion of the Directors of the Company, the Group has complied with the Code of Best Practice set out in Appendix 14 of the Listing Rules issued by The Stock Exchange of Hong Kong Limited ("the Hong Kong Stock Exchange") throughout



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the year ended 31 December, 2003.

DIRECTORS, SUPERVISORS AND SENIOR ADMINISTRATIVE OFFICERS,

Directors, Supervisors and Senior Administrative Officers of the Company in 2003 were as follows:

| NAME            | AGE | POSITION   | NUMBER OF<br>SHARES OF THE<br>COMPANY HELD |
|-----------------|-----|--|--|
| Yan Zhi Qing    | 62  | Chairman of the Board of Directors                 | 0  |
| Liu Ming Qi     | 60  | Vice Chairman of the Board of Directors            | 0  |
| Wang Chang Shun | 47  | Vice Chairman of the Board of Directors, President | 0  |
| Peng An Fa      | 56  | Director   | 0  |
| Wang Quan Hua   | 50  | Director   | 0  |
| Zhao Liu An     | 56  | Director   | 0  |
| Zhou Yong Qian  | 59  | Director   | 0  |
| Zhou Yong Jin   | 61  | Director   | 0  |
| Xu Jie Bo       | 39  | Director, Chief Financial Officer, Vice President  | 0  |
| Wu Rong Nan     | 62  | Director   | 0  |
| Simon To        | 53  | Independent Non-Executive Director                 | 100,000 H Shares                           |
| Peter Lok       | 68  | Independent Non-Executive Director                 | 0  |
| Wei Ming Hai    | 40  | Independent Non-Executive Director                 | 0  |
| Wang Zhi        | 62  | Independent Non-executive Director                 | 0  |
| Sui Guang Jun   | 43  | Independent Non-executive Director                 | 0  |
| Liang Hua Fu    | 62  | Chairman of the Supervisory Committee              | 0  |
| Gan Yu Hua      | 76  | Supervisor   | 0  |
| Li Qi Hong      | 56  | Supervisor   | 0  |
| Jiang Ping      | 54  | Vice President                                     | 0  |
| Li Kun          | 44  | Vice President                                     | 0  |
| Yuan Xin An     | 47  | Vice President                                     | 1,000 A Shares                             |
| Zheng En Ren    | 59  | Vice President                                     | 0  |
| Hao Jian Hua    | 54  | Vice President                                     | 0  |
| Su Liang        | 42  | Company Secretary                                  | 0  |

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REPORT OF THE DIRECTORS (Cont'd)

On 13 May, 2003, Mr. Liu Ming Qi, Mr. Peng An Fa, Mr. Wang Quan Hua, Mr. Zhao Liu An, Mr. Zhou Yong Qian, Mr. Wang Zhi and Mr. Sui Guang Jun respectively were appointed as Directors of the Company at the Shareholders' meeting of the Company.

On 13 May, 2003, Mr. Wang Shao Xi and Mr. Zhang Rui Ai tendered their resignations to the Company as Directors of the Company due to retirement. Their resignations were approved at the Shareholders' meeting of the Company.

On 30 July, 2003, the Board of Directors resolved to appoint Mr. Hao Jian Hua and Mr. Xu Jie Bo as Vice Presidents of the Company. On the same day, Mr. Yang Guang Hua resigned as Vice President of the Company due to work arrangement.

Biographical details of the Board of Directors, Senior Administrative Officers

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and members of the Supervisory Committee are set out on pages 191 to 195 of this Annual Report.

### INTERESTS AND SHORT POSITIONS OF DIRECTORS AND SUPERVISORS IN THE COMPANY AND ASSOCIATED CORPORATIONS

As at 31 December, 2003, the interests and short positions of the Directors and Supervisors of the Company in the shares, underlying shares and debentures (as the case may be) of the Company or its associated corporations (within the meaning of Part XV of the SFO) which were notified to the Company and the Hong Kong Stock Exchange pursuant to SFO (including interests or short positions which are taken or deemed to have under such provisions of the SFO), or recorded in the register maintained by the Company pursuant to section 352 of the SFO or which were notified to the Company and the Hong Kong Stock Exchange pursuant to the "Model Code for Securities Transactions by Directors of the Listed Companies" in schedule 10 of the Listing Rules are as follows:

| NAME     | THE COMPANY/<br>ASSOCIATED CORPORATION | TYPES OF INTEREST              | TYPE OF SHARES | NUMBER OF SHARES HELD | % TO THE TOTAL ISSUED SHARE CAPITAL OF THE COMPANY | % TO THE TOTAL ISSUED DOMESTIC SHARES OF THE COMPANY | % TO THE TOTAL ISSUED H SHARES OF THE COMPANY |
|----------|--|--------------------------------|----------------|-----------------------|--|--|---|
| Simon To | the Company                            | Interest of spouse<br>(Note 1) | H Shares       | 100,000               | 0.002%   | -  | 0.009%  |

Note 1: The spouse of Mr. Simon To is the owner of these 100,000 H Shares of the Company and accordingly, Mr. Simon To, is taken to be interested in these 100,000 H Shares by virtue of the SFO.

Save as disclosed above, as at 31 December, 2003, none of the Directors or Supervisors of the Company has interests or short positions in the shares, underlying shares and/or debentures (as the case may be) of the Company or its associated corporations (within the meaning of Part XV of the SFO) which were notified to the Company and the Hong Kong Stock Exchange pursuant to SFO (including interests or short positions which are taken or deemed to have under such provisions of the SFO), or recorded in the register maintained by the Company pursuant to section 352 of the SFO or which were notified to the Company and the Hong Kong Stock Exchange pursuant to the "Model Code for Securities Transactions by Directors of the Listed Companies" in schedule 10 of the Listing Rules.

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REPORT OF THE DIRECTORS (Cont'd)

### SERVICE CONTRACTS OF THE DIRECTORS AND SUPERVISORS

All Directors and Supervisors of the Company have entered into service contracts with the Company for a term of three years commencing on 16 April, 2001. The service contracts of Liu Ming Qi, Peng An Fa, Wang Quan Hua, Zhao Liu An, Zhou Yong Qian, Wang Zhi and Sui Guang Jun entered into on 13 May, 2003 will expire

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at the end of the term of the current session of the Board. Except for such service contracts, none of the Directors or Supervisors of the Company has entered or proposed to enter into any other service contracts with the Company or its subsidiaries. None of the Directors or Supervisors has entered into any service contracts with the Company which is not determinate by the Company within one year without payment of compensation, other than statutory compensation.

### INTERESTS OF DIRECTORS AND SUPERVISORS IN CONTRACTS

In 2003, none of the Directors and Supervisors of the Company had a material interest in any contract of significance to which the Company or any of its subsidiaries was a party.

### CONNECTED TRANSACTIONS

The Company enters from time to time into certain connected transactions with CSAHC and other connected persons. Such transactions fall within the definition of connected transactions as set out in Chapter 14 of the Listing Rules issued by the Stock Exchange of Hong Kong Limited ("the Hong Kong Stock Exchange"). The Hong Kong Stock Exchange has granted waivers to the Company in respect of compliance with certain provisions of Chapter 14 of the Listing Rules. Details of such transactions conducted during the year and/or the related agreements entered into between the Company and such parties for which waivers have been obtained are disclosed as follows:

#### (A) DE-MERGER AGREEMENT

The De-merger Agreement dated 25 March, 1995 (such Agreement was amended by Amendment No.1 dated 22 May, 1997) was entered into between the CSAHC and the Company for the purpose of defining and allocating the assets and liabilities between CSAHC and the Company. Under the De-merger Agreement, CSAHC and the Company have agreed to indemnify the other party against claims, liabilities and expenses incurred by such other party but relating to the businesses, assets and liabilities held or assumed by CSAHC or the Company (as the case may be) pursuant to the De-merger Agreement.

Neither the Company nor CSAHC has made any payments in respect of such indemnification obligations from the date of the De-merger Agreement up to the date of this report.

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REPORT OF THE DIRECTORS (Cont'd)

#### (B) CONNECTED BUSINESS TRANSACTIONS

The Company and CSAHC and their respective subsidiaries were a single group prior to the restructuring of CSAHC in 1995 in anticipation of the Company's global offering ("Restructuring"). As a result, certain arrangements between them have continued after the Restructuring and the listing of the Company's shares on the Hong Kong Stock Exchange and New York Stock Exchange. At present, the Company and CSAHC (or their respective subsidiaries) have entered into the following agreements:

- (a) Southern Airlines (Group) Import and Export Trading Company ("SAIETC"), a wholly-owned subsidiary of CSAHC

The Company and Southern Airlines have entered into an

agreement dated 22 May, 1997 for the import and export of aircraft, flight equipment, special vehicles for airline use, communication and navigation facilities, and training facilities for a term from 22 May, 1997 to 22 May, 2000 which was subsequently extended to 2006 by mutual agreement between the parties. The parties have mutually agreed that the agreement can be extended automatically.

For the year ended 31 December, 2003, the amount incurred by the Group for the import and export of the above equipment was RMB1, 154,553,000 inclusive of agency commission of 1.5% above the contract prices paid to SAIETC,

- (b) Southern Airlines Advertising Company, which is 90% owned by the Company and 10% owned by CSAHC ("CSAHC")

On 26 August, 2002, the Company had entered into a takeover agreement with CSAHC. As a result, the Company owns 90% and CSAHC owns 10% of Southern Airlines Advertising Company.

The Company and Southern Airlines Advertising Company have entered into an agreement dated 22 May, 1997 for the provision of advertising services for a term extending from 22 May, 1997 to 22 May, 2000. After extension of three years, the parties have mutually agreed to extend the agreement for another three years to 22 May, 2006.

For the year ended 31 December, 2003, the amount incurred by the Group to Southern Airlines Advertising Company for advertising services was RMB1,320,000.

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CHINA SOUTHERN AIRLINES COMPANY LIMITED 2003 ANNUAL REPORT

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REPORT OF THE DIRECTORS (Cont'd)

- (c) Southern Airlines Group Finance Company Limited ("SA Finance") which is 42% owned by CSAHC, 32% owned by the Company, 26% owned in aggregate by five subsidiaries of the Company

The company has entered into a financial agreement 22 May, 1997 with SA Finance for the provision of financial services such as deposit and loan facilities, credit facilities, financial guarantees and credit references for a term commencing from 22 May, 1997 to 22 May, 2000, As agreed by the parties, the agreement has been extended for six years to 22 May, 2006.

Under such agreement, (a) all funds that the Company deposits with SA Finance will be deposited by SA Finance with the Industrial and Commercial Bank of China, Bank of Communications, Bank of Agriculture, China Construction Bank, or other banks of similar creditworthiness; and (b) SA Finance will not at any time have outstanding loans in excess of the amount representing the aggregate of (i) deposits received from entities other than the Company, (ii) SA Finance's shareholders' equity and (iii) capital reserves.

The Group had short-term deposits placed with SA Finance at 31 December, 2003 amounting to RMB365,906,000 which earned interest at the rate of 1.98%-3.00% per annum.

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- (d) Shenzhen Air Catering Company Limited, which is 33% owned by CSAHC, and 67% owned by two independent third parties.

The Company and Shenzhen Air Catering Company Limited have entered into an agreement dated 23 May, 1997 for the sale and purchase of in-flight meals for flights originating or stopping at the airport in Shenzhen. Pursuant to such agreement, Shenzhen Air Catering Company Limited will supply in-flight meals to the Group from time to time during the term from 23 May, 1997 to 23 May, 1998. The parties have mutually agreed that the agreement can be extended automatically.

For the year ended 31 December, 2003, the amount incurred by the Group to Shenzhen Air Catering Company Limited for the provision of in-flight meals was approximately RMB28,199,000.

- (e) Guangzhou Aircraft Maintenance Engineering Company Limited ("GAMECO"), which is 50% owned by the Company and 50% owned by an independent third party

The Company and GAMECO have entered into an Aircraft Maintenance and Engineering Agreement for the provision of aircraft repair and maintenance services. On 17 May, 1996, the Company and GAMECO entered into an agreement regarding the fee arrangement for the provision of such repair and maintenance services (the "Fee Agreement"). Pursuant to the Fee Agreement and subsequent agreements, GAMECO charged the Company for expendables at cost plus 15%, and labor costs at US\$30.0 per hour during 2003.

For the year ended 31 December, 2003, the amount incurred by the Group for such repair and maintenance services was RMB587,252,000.

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REPORT OF THE DIRECTORS (Cont'd)

- (f) China Southern West Australian Flying College Pty Ltd (the "Australian Pilot College"), which is 65% owned by the Company and 35% owned by CSAHC

CSAHC and the Australian Pilot College entered into an agreement dated 7 October, 1993 for the provision of pilot training in Australia to the cadet pilots of CSAHC (the "Training Agreement"). The Training Agreement will remain in force unless terminated by either party upon 90 days' prior written notice to the other party. Pursuant to the De-merger Agreement, the Company has assumed all the interests, rights and obligations of CSAHC under the Training Agreement.

For the year ended 31 December, 2003, the amount paid by the Group to the Australian Pilot College for training services was RMB82,386,000.

- (g) Southern Airlines (Group) Economic Development Company, which is 61% owned by CSAHC and 39% owned by an independent third party

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The Company and Southern Airlines (Group) Economic development Company have entered into an agreement dated 22 May, 1997 for the provision of drinks, snacks, liquor, souvenirs and other products for a term extending from 22 May, 1997 to 22 May, 2007.

For the year ended 31 December, 2003, the amount paid by the Group to Southern Airlines (Group) Economic Development Company for the provision of drinks, snacks, liquor, souvenirs and other products was RMB42,849,000.

- (h) Guangzhou Nanland Air Catering Company Limited ("Nanland"), which is 51% owned by the Company and 49% owned by an independent third party

The Company and Nanland have entered into a catering agreement dated 22 May, 1999 for the sale and purchase of in-flight meals for flights originating or stopping at the airport in Guangzhou. Pursuant to such agreement, Nanland will supply in-flight meals to the Company from time to time during the term from 22 May, 1999 to 22 May, 2000. The agreement will then be automatically extended annually.

For the year ended 31 December, 2003, the amount paid by the Group to Nanland for the provision of in-flight meals was RMB70,194,000.

- (i) Ticket sales arrangements

The Group has entered into ticket agency agreements for the sale of the Group's air tickets with several subsidiaries of CSAHC (the "Agents"). The Agents charge commission on the basis of the rates stipulated by the CAAC and international Air Transport Association ("IATA"). The Agents charge a commission in the amount of 3% of the ticket price for domestic tickets and 5% to 12% of the ticket price for Hong Kong regional/ international tickets. The Group has other air ticket sales agents in China who also charge commission at the same rates. The Agents also act as air ticket sales agents for other Chinese airlines and charge the same rates of commission to such other airlines as those charged to the Group.

For the year ended 31 December, 2003, the aggregate amount of ticket sales of the Group conducted through the Agents was RMB143,016,000.

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REPORT OF THE DIRECTORS (Cont'd)

### (C) TRADEMARK LICENCE AGREEMENT

The Company and CSAHC have entered into a 10 year Trademark Licence Agreement dated 22 May, 1997 pursuant to which CSAHC acknowledges that the Company has the right to use the name "China Southern" and "China Southern Airlines" in both Chinese and English, and grants to the Company a renewable royalty free licence to use the kapok logo on a worldwide basis in connection with the Company's airline and airline-related businesses. Unless CSAHC gives written notice of termination three months before the expiration of the agreement, the agreement will be automatically extended for another 10-year term.

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### (D) LEASES

#### CSAHC

The Company as lessee and CSAHC as lessor have entered into the following lease agreements:

- (a) The Company and CSAHC have entered into a land lease agreement dated 22 May, 1997, in respect of the land used by the Company within Guangzhou Baiyun International Airport. The rental payment is RMB2,650,700 per year. The term of the lease is five years commencing 1 April, 1997 and is renewable by the parties thereafter (subject to mutual agreement with respect to rental terms).
- (b) The Company and CSAHC have separately entered into four lease agreements dated 22 May, 1997, in respect of office premises located at the east wing of the Guangzhou Railway Station on Guangzhou Huanshi Dong Road, office premises at Haikou Airport, office premises in Haikou City, and office premises at Tianhe Airport in Wuhan, Hubei Province. The aggregate rental payment under the four leases is RMB12,573,000 per year. The term of each lease is one year and is renewable by the parties thereafter (subject to mutual agreement with respect to rental terms).
- (c) The Company and CSAHC have entered into an indemnification agreement dated 22 May, 1997 in which CSAHC has agreed to indemnify the Company against any loss or damage caused by or arising from any challenge of, or interference with, the Company's right to use certain land and buildings.

Xinjiang Airlines Company ("Xinjiang Airlines"), a wholly owned subsidiary of CSAHC

The Company and Xinjiang Airlines have entered into an aircraft lease agreement dated 8 April, 2002, whereby Xinjiang Airlines wet leased a Boeing 757-200 aircraft, together with aircrew and other parts and equipment for the operation of the aircraft, including engine and such spare parts necessary for its maintenance during the term of the lease. The rental payment payable by the Company under the lease for year 2003 was RMB35,751,000.

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REPORT OF THE DIRECTORS (Cont'd)

### (E) COMPREHENSIVE SERVICES AND EMPLOYEE BENEFITS

The Company and CSAHC have entered into a comprehensive services agreement (the "Services Agreement") dated 22 May, 1997.

The Services Agreement provides that CSAHC shall sell or rent housing to eligible employees of the Group at lower than market price. As the housing is sold or rented below cost and the construction costs of the leased housing were originally paid by CSAHC, the Company shall pay CSAHC RMB85 million per year, payable quarterly in arrears, for a term of ten years from 1995 to 2004.

### (F) ONGOING CONNECTED TRANSACTIONS WITH CHINA NORTHERN AIRLINES COMPANY AND XINJIANG AIRLINES

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China Northern Airlines Company ("Northern Airlines"), a wholly owned subsidiary of CSAHC

Northern Airlines is principally engaged in commercial airline services in the PRC with its headquarters based in Shenyang, East Northern part of the PRC. Following the consolidation and restructuring among CSAHC, Northern Airlines and Xinjiang Airlines in 2002 (the "Consolidation and Restructuring"), Northern Airlines becomes a wholly owned subsidiary of CSAHC and therefore constitutes a connected person of the Company under the Listing Rules.

### Xinjiang Airlines

Xinjiang Airlines is principally engaged in commercial airline services in the PRC with its headquarters based in Urumqi, Xinjiang. Following the Consolidation and Restructuring, Xinjiang Airlines becomes a wholly owned subsidiary of CSAHC and therefore constitutes a connected person of the Company under the Listing Rules.

#### (a) In-flight Meals Arrangement with Northern Airlines

Nanland has been providing and will provide in-flight meals to Northern Airlines. Pursuant to an agreement dated 23 June, 2000, Nanland has been providing in-flight meals to Northern Airlines from time to time for a period of one year. The agreement will then be automatically extended annually. For the year ended 31 December, 2003, the amount paid by Northern Airlines to Nanland for the provision of in-flight meals was approximately RMB4,657,000.

Pursuant to an agreement dated 30 October, 2001, Northern Airlines has been providing and will provide in-flight meals to the Group from time to time for a period of one year. The agreement will then be automatically extended annually.

For the year ended 31 December, 2003, the amount paid by the Group to Northern Airlines for the provision of in-flight meals was approximately RMB2,321,000.

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REPORT OF THE DIRECTORS (Cont'd)

#### (b) In-flight Meals Arrangement with Xinjiang Airlines

Pursuant to an agreement dated 24 March, 2001, Nanland has been providing and will provide inflight meals to Xinjiang Airlines from time to time for a period of one year. The agreement will then be automatically extended annually. For the year ended 31 December, 2003, the amount paid by Xinjiang Airlines to Nanland for the provision of in-flight meals was approximately RMB1,806,000.

Pursuant to an agreement dated 20 September, 1999, Xinjiang Airlines has been providing and will provide in-flight meals to the Group for a period of one year. The agreement will then be automatically extended annually. The amount paid by the Group to Xinjiang Airlines for the provision of in-flight meals for the year ended 31 December, 2003 was approximately RMB2,888,000.

#### (c) Ticket Sales Arrangement with Northern Airlines



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In accordance with the relevant requirement and industry practice, the Group has entered into ticket agency arrangement with Northern Airlines for the sale of the Group's air tickets by Northern Airlines and for the sale of Northern Airlines air tickets by the Group. The selling party charges a commission in the amount of 3% of the ticket price for domestic tickets and 5% to 12% of the ticket price for Hong Kong regional and international tickets. These commission rates are based on the rates stipulated by the CAAC and IATA. The amount of commission paid by Northern Airlines to the Group for the year ended 31 December, 2003 was approximately RMB3,083,000. The amount of commission paid by the Group to Northern Airlines for the year ended 31 December, 2003 was approximately RMB404,000.

The amounts payable under the above aforesaid transactions are based on the rates stipulated by the CAAC and IATA.

(d) Ticket Sales Arrangement with Xinjiang Airlines

The Group has entered into ticket agency arrangement with Xinjiang Airlines for the sale of the Group's air tickets by Xinjiang Airlines and for the sale of Xinjiang Airlines air tickets by the Group. The selling party charges a commission in the amount of 3% of the ticket price for domestic tickets and 5% to 12% of the ticket price for Hong Kong regional and international tickets. These commission sales are based on the rates stipulated by the CAAC and IATA. The amount of commission paid by Xinjiang Airlines to the Group for the year ended 31 December, 2003 was approximately RMB1,290,000. The amount of commission paid by the Group to Xinjiang Airlines for the year ended 31 December, 2003 was approximately RMB392,000.

The amounts payable under the above aforesaid transactions are based on the rates stipulated by the CAAC and IATA.

The Independent Non-Executive Directors of the Company have confirmed to the Board of Directors of the Company that they have reviewed the connected transactions described in (B) through (F) above and have concluded that:

- (a) The transactions have been entered into by the Group in the ordinary and usual course of its business;
- (b) The transactions have been entered into either (i) on normal commercial terms (by reference to transactions of a similar nature made by similar entities within the PRC) or (ii) (where there is no available comparison) on terms that are fair and reasonable so far as the shareholders of the Company are concerned;
- (c) The transactions have been performed either (i) in accordance with the terms of the agreement governing each such transaction or (ii) (where there is no such agreement) on terms no less favourable than terms available from third parties; and
- (d) The aggregate annual amount payable by the Group to CSAHC, and the aggregate annual amount payable by CSAHC to the Group, under the Ongoing Connected Transactions for In-Flight Meals and Ticket Sales for the year ended 31 December, 2003 have not exceeded the higher of HK\$10 million and

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3% of the consolidated net tangible assets of the Group as disclosed in its latest published audited accounts.

### WAIVER FOR ACQUISITIONS AND DISPOSALS OF AIRCRAFT

In March 2002, the Hong Kong Stock Exchange granted a waiver to allow the Company to use a new size test based on available tonne kilometres ("ATKs") to replace the normal net asset test and consideration test under Chapter 14 of the Listing Rules in respect of acquisitions and disposals of aircraft.

The Hong Kong Stock Exchange has granted the waiver on and subject to the following conditions:

1. Instead of the normal tests under Chapter 14 of the Listing Rules, the tests may be calculated by reference to the ATKs for aircraft being acquired or disposed of as compared to the Company's aggregate fleet ATKs.
2. The proposed method of calculation for the four tests will replace the net asset test and the consideration test only while the other two tests, namely, net profit and equity capital issued tests will continue to apply as set out in Chapter 14 of the Listing Rules.
3. The calculation of ATKs will be as follows: (i) fleet ATKs will be the aggregate actual ATKs for all aircraft in the Company's fleet for the last financial year as disclosed in the Company's annual report, (ii) ATKs for aircraft being disposed of will be based on actual ATKs of the aircraft for the previous two financial years; and (iii) ATKs for aircraft being acquired will be based on the historical operating data for the same type of aircraft. Where the aircraft to be acquired is a new type, the ATKs will be estimated based on other aircraft of similar size operated by the Company or the average for the Chinese civil aviation industry.

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### REPORT OF THE DIRECTORS (Cont'd)

4. The Company's ATKs figure will be disclosed in the Company's annual report and be reviewed by the Company's auditors which will report on an annual basis that the Company's ATKs are calculated correctly and consistently.
5. For the purposes of making the test as stated in paragraph 1 above, all acquisitions and disposals for the last 12 months will be aggregated, unless the acquisition or disposal has previously been reported as a notifiable transaction under these rules.
6. The thresholds for classifying a transaction as a discloseable, major or very substantial acquisition will be 30%, 50% and 100% (assuming that there are no circumstances which would make it a connected transaction or a share transaction).
7. Where the transaction is a discloseable transaction, disclosure will take the form of a press announcement complying with rule 14.14 of the Listing Rules and details of the transaction will be set out in the Company's next annual report and accounts. Where the transaction is a major transaction or a very substantial acquisition, the provisions of Chapter 14 of the Listing Rules will apply.
8. An option to acquire aircraft will not be treated as acquisition while the exercise of such an option will be treated as acquisition of aircraft.

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9. The waiver will only apply to acquisition/ disposal of aircraft, and acquisition or disposal of other types of assets by the Company will be subject to provisions under Chapter 14 of the Listing Rules.
10. The Company will disclose in its annual reports and interim reports the following information:
  - (a) Regarding future deliveries of aircraft, details of aircraft on order including the number and type; and the years in which such aircraft are scheduled to be delivered;
  - (b) The number and type of aircraft which are subject to options exercisable during a period of not less than 12 months from the end of the financial year or period to which the annual report relates; and
  - (c) Details of the waiver granted pursuant to the application.
11. The Company remains a subsidiary of the CSAHC. Should there be any change in control of the Company, the Hong Kong Stock Exchange will need to reconsider whether the waiver continues to be appropriate.

Regarding future deliveries of aircraft, details of aircraft on order and the years in which such aircraft are scheduled to be delivered, please refer to note 29 to the financial statements prepared under IFRS. One Boeing 757-200 aircraft and one Boeing 737-300 aircraft are subject to options exercisable in 2004.

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REPORT OF THE DIRECTORS (Cont'd)

### DONATIONS

During the year, the Group made donations for charitable purposes amounting to RMB2,106,000.

### DESIGNATED DEPOSITS AND OVERDUE TIME DEPOSITS

As at 31 December, 2003, the Group's deposits placed with financial institutions or other parties did not include any designated deposits, or overdue time deposits against which the Group failed to receive repayments.

### MATERIAL LITIGATION

The Group was not involved in any material litigation or dispute in 2003.

### AUDITORS

A resolution is to be proposed at the forthcoming Annual General Meeting of the Company for the reappointment of KPMG as the international auditors of the Company and of KPMG Huazhen as the PRC auditors of the Company.

By Order of the Board of Directors

YAN ZHI QING  
Chairman of the Board of Directors

Guangzhou, the PRC  
23 April, 2004

REPORT OF THE SUPERVISORY COMMITTEE

Dear Shareholders,

In 2003, the members of the Supervisory Committee of the Company (the "Supervisory Committee") faithfully carried out their duties, participated in all the board meetings of the Directors, monitored the financial position of the Company and the Directors and senior administrative officers of the Company in discharge of their duties and protected the legitimate rights and interests of the Company and all the Shareholders, based on the powers bestowed upon them by the Company Law and the Company's Articles of Association and in accordance with the Working Procedures for the Supervisory Committee of China Southern Airlines Company Limited and their sense of responsibility toward all the Shareholders.

I. PARTICULARS OF THE WORK OF THE SUPERVISORY COMMITTEE

The Supervisory Committee held a meeting on 14 March, 2003 during which it reviewed and approved the 2002 Report of the Supervisory Committee and concluded that the 2002 financial statements of the Company truly reflected the financial position and operating results of the Company, and that the audit opinions prepared by KPMG and KPMG Huazhen were both objective and fair.

II. THE SUPERVISORY COMMITTEE'S INDEPENDENT OPINION:

1. The Company's policy making process and its operation were in compliance with the laws and the Company established a relatively comprehensive internal control system. The Supervisory Committee was not aware of any actions of the Directors or senior administrative officers of the Company who, in carrying out their duties, violated laws, regulations, the Articles of Association of the Company or were prejudicial to the interests of the Company.
2. The Company's financial report for 2003 gave a true and fair view of its financial positions and operating results. The unqualified opinion expressed in the auditors' reports issued by KPMG and KPMG Huazhen gave an objective and fair view.
3. The Supervisory Committee was not aware of any insider dealings or acts which impaired the Shareholders' interests or caused loss of assets of the Company in the course of acquisition or disposal of assets.
4. The Supervisory Committee was of the opinion that the use of proceeds from the offering was in accordance with the disclosure in the prospectus and such use of proceeds had not been changed.
5. The Supervisory Committee was of the opinion that the connected transactions between the Company and its connected persons were conducted at fair market value without prejudice to the interests of the Company and its medium and minority Shareholders.

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presented by the Board of Directors of the Company, and appreciates the satisfactory results in terms of enhancement of safety and service standards achieved by the management of the Company in the face of challenges and difficulties during the SARS outbreak. The Supervisory Committee will continue to closely monitor the reorganization of CSAHC in 2004, and consider that an integration of corporate culture after the reorganization is crucial to the future development. The Supervisory Committee has every confidence in the Group's prospects.

By Order of the Supervisory Committee

LIANG HUA FU  
Chairman of the Supervisory Committee

Guangzhou, the PRC  
23 April, 2003

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REPORT OF THE INTERNATIONAL AUDITORS

[KPMG LOGO]

TO THE SHAREHOLDERS OF CHINA SOUTHERN AIRLINES COMPANY LIMITED  
(Established in the People's Republic of China with limited liability)

We have audited the financial statements on pages 40 to 98 which have been prepared in accordance with International Financial Reporting Standards promulgated by the International Accounting Standards Board.

### RESPECTIVE RESPONSIBILITIES OF DIRECTORS AND AUDITORS

The Company's directors are responsible for the preparation of financial statements which give a true and fair view. In preparing financial statements which give a true and fair view it is fundamental that appropriate accounting policies are selected and applied consistently, that judgements and estimates are made which are prudent and reasonable and that the reasons for any significant departure from applicable accounting standards are stated.

It is our responsibility to form an independent opinion, based on our audit, on those financial statements and to report our opinion solely to you, as a body, and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

### BASIS OF OPINION

We conducted our audit in accordance with Statements of Auditing Standards issued by the Hong Kong Society of Accountants. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Company's and the Group's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance as to whether the financial statements are free from material misstatement. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the

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financial statements. We believe that our audit provides a reasonable basis for our opinion.

### OPINION

In our opinion, the financial statements give a true and fair view of the state of affairs of the Company and of the Group as at 31 December, 2003 and of the Group's loss and cash flows for the year then ended and have been properly prepared in accordance with International Financial Reporting Standards promulgated by the International Accounting Standards Board and the disclosure requirements of the Hong Kong Companies Ordinance.

KPMG

Certified Public Accountants

Hong Kong, 23 April, 2004

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### CONSOLIDATED PROFIT AND LOSS ACCOUNT

For the year ended 31 December, 2003

(Prepared under International Financial Reporting Standards)

(Expressed in Renminbi)

|   | Note | 2003<br>RMB'000 | 2002<br>RMB'000 |
|---|------|-----------------|-----------------|
| <hr/>   |      |                 |                 |
| Operating revenue:                            |      |                 |                 |
| Traffic revenue                               |      | 16,964,800      | 17,481,000      |
| Other revenue                                 |      | 505,323         | 536,000         |
| <hr/>   |      |                 |                 |
| Total operating revenue                       | 3    | 17,470,123      | 18,018,000      |
| <hr/>   |      |                 |                 |
| Operating expenses:                           |      |                 |                 |
| Flight operations                             |      | 7,070,031       | 6,732,000       |
| Maintenance                                   |      | 2,588,613       | 2,333,000       |
| Aircraft and traffic servicing                |      | 2,767,488       | 2,511,000       |
| Promotion and sales                           |      | 1,480,168       | 1,499,000       |
| General and administrative                    |      | 1,053,319       | 1,060,000       |
| Depreciation and amortisation                 |      | 2,037,971       | 1,839,000       |
| Other   |      | 16,804          | 15,000          |
| <hr/>   |      |                 |                 |
| Total operating expenses                      | 4    | 17,014,394      | 15,992,000      |
| <hr/>   |      |                 |                 |
| Operating profit                              |      | 455,729         | 2,026,000       |
| <hr/>   |      |                 |                 |
| Non-operating income/(expenses):              |      |                 |                 |
| Share of associated companies' results        |      | 47,798          | 36,000          |
| Share of jointly controlled entities' results | 14   | (39,495)        | (3,000)         |
| (Loss)/gain on sale of fixed assets           | 5    | (22,217)        | 170,000         |
| Interest income                               |      | 13,061          | 52,000          |
| Interest expense                              | 4    | (823,725)       | (959,000)       |

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|  |   |           |        |
|--|---|-----------|--------|
| Exchange loss, net                                   |   | (164,443) | (175,  |
| Other, net   |   | 21,682    | (9,    |
| -----  |   |           |        |
| Total net non-operating expenses                     |   | (967,339) | (886,  |
| -----  |   |           |        |
| (Loss)/profit before taxation and minority interests | 4 | (511,610) | 1,139, |
| Taxation credit/(expense)                            | 7 | 324,277   | (398,  |
| -----  |   |           |        |
| (Loss)/profit before minority interests              |   | (187,333) | 740,   |
| Minority interests                                   |   | (170,934) | (165,  |
| -----  |   |           |        |
| (Loss)/profit attributable to shareholders           |   | (358,267) | 575,   |
| =====  |   |           |        |
| Basic (loss)/earnings per share                      | 9 | RMB(0.09) | RMB0   |
| =====  |   |           |        |

The notes on pages 47 to 98 form part of these financial statements.

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CONSOLIDATED BALANCE SHEET  
As at 31 December, 2003  
(Prepared under International Financial Reporting Standards)  
(Expressed in Renminbi)

|  | Note | 2003<br>RMB'000 | 2002<br>RMB'000 |
|--|------|-----------------|-----------------|
| -----                                    |      |                 |                 |
| NON-CURRENT ASSETS                       |      |                 |                 |
| Fixed assets                             | 10   | 28,535,907      | 26,920,829      |
| Construction in progress                 | 11   | 1,629,689       | 661,352         |
| Lease prepayments                        |      | 348,652         | 201,854         |
| Interest in associated companies         | 13   | 422,201         | 692,026         |
| Interest in jointly controlled companies | 14   | 731,323         | 461,962         |
| Other investments                        |      | 204,971         | 201,854         |
| Lease and equipment deposits             |      | 2,932,591       | 2,147,038       |
| Deferred expenditure                     | 15   | 248,853         | 283,303         |
| Long-term receivables                    |      | 6,380           | 12,034          |
| -----                                    |      |                 |                 |
|  |      | 35,060,567      | 31,582,252      |
| -----                                    |      |                 |                 |
| CURRENT ASSETS                           |      |                 |                 |
| Inventories                              | 17   | 543,777         | 545,700         |
| Trade receivables                        | 18   | 833,604         | 671,776         |
| Other receivables                        |      | 296,047         | 372,586         |
| Prepaid expenses and other assets        |      | 247,926         | 244,690         |
| Cash and cash equivalents                | 20   | 2,080,174       | 3,771,043       |

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|                                       |    |              |             |
|---------------------------------------|----|--------------|-------------|
|                                       |    | 4,001,528    | 5,605,795   |
| -----                                 |    |              |             |
| CURRENT LIABILITIES                   |    |              |             |
| Bank and other loans                  | 21 | 7,096,846    | 5,240,726   |
| Obligations under finance leases      | 22 | 1,297,855    | 1,566,698   |
| Amounts due to related companies      | 19 | 929,003      | 525,090     |
| Other liabilities                     |    | 1,019,811    | 646,989     |
| Accounts payable                      | 23 | 928,093      | 532,480     |
| Bills payable                         |    | 438,135      | 1,299,680   |
| Sales in advance of carriage          |    | 466,087      | 390,531     |
| Accrued expenses                      |    | 2,527,794    | 2,341,454   |
| Taxes payable                         |    | 89,954       | 78,145      |
|                                       |    |              |             |
|                                       |    | 14,793,578   | 12,621,793  |
| -----                                 |    |              |             |
| NET CURRENT LIABILITIES               |    | (10,792,050) | (7,015,998) |
| -----                                 |    |              |             |
| TOTAL ASSETS LESS CURRENT LIABILITIES |    | 24,268,517   | 24,566,254  |
| -----                                 |    |              |             |

The notes on pages 47 to 98 form part of these financial statements.

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CONSOLIDATED BALANCE SHEET (Cont'd)

As at 31 December, 2003

(Prepared under International Financial Reporting Standards)

(Expressed in Renminbi)

|  | Note | 2003<br>RMB'000 | 2002<br>RMB'000 |
|--|------|-----------------|-----------------|
| -----                                    |      |                 |                 |
| LONG TERM LIABILITIES AND DEFERRED ITEMS |      |                 |                 |
| Bank and other loans                     | 21   | 4,521,735       | 5,835,434       |
| Obligations under finance leases         | 22   | 5,543,084       | 6,631,751       |
| Provision for major overhauls            | 24   | 189,464         | 141,887         |
| Deferred credits                         |      | 46,554          | 48,095          |
| Deferred taxation                        | 16   | 398,305         | 779,234         |
|  |      |                 |                 |
|  |      | 10,699,142      | 13,436,401      |
| -----                                    |      |                 |                 |
|  |      | 13,569,375      | 11,129,853      |
| =====                                    |      |                 |                 |
| REPRESENTING:                            |      |                 |                 |
| SHARE CAPITAL                            | 25   | 4,374,178       | 3,374,178       |
| RESERVES                                 | 26   | 7,521,529       | 6,239,029       |



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|                      |            |            |
|----------------------|------------|------------|
| SHAREHOLDERS' EQUITY | 11,895,707 | 9,613,207  |
| MINORITY INTERESTS   | 1,673,668  | 1,516,646  |
|                      | 13,569,375 | 11,129,853 |

Approved and authorised for issue by the board of directors on 23 April, 2004

|                          |                             |                       |
|--------------------------|-----------------------------|-----------------------|
| YAN ZHI QING<br>Director | WANG CHANG SHUN<br>Director | XU JIE BO<br>Director |
|--------------------------|-----------------------------|-----------------------|

The notes on pages 47 to 98 form part of these financial statements.

[LOGO] CHINA SOUTHERN AIRLINES COMPANY LIMITED 2003 ANNUAL REPORT 43

BALANCE SHEET  
As at 31 December, 2003  
(Prepared under International Financial Reporting Standards)  
(Expressed in Renminbi)

|   | Note | 2003<br>RMB'000 | 2002<br>RMB'000 |
|---|------|-----------------|-----------------|
| <b>NON-CURRENT ASSETS</b>               |      |                 |                 |
| Fixed assets                            | 10   | 22,610,251      | 19,530,908      |
| Construction in progress                | 11   | 1,532,462       | 615,511         |
| Lease prepayments                       |      | 116,276         | 15,502          |
| Interest in subsidiaries                | 12   | 1,445,831       | 1,406,010       |
| Interest in associated companies        | 13   | 287,235         | 367,573         |
| Interest in jointly controlled entities | 14   | 563,736         | 474,042         |
| Other investments                       |      | 106,548         | 106,009         |
| Lease and equipment deposits            |      | 2,228,754       | 2,065,192       |
| Deferred expenditure                    | 15   | 240,514         | 272,636         |
|   |      | 29,131,607      | 24,853,383      |
| <b>CURRENT ASSETS</b>                   |      |                 |                 |
| Inventories                             | 17   | 213,219         | 118,134         |
| Trade receivables                       | 18   | 683,206         | 464,930         |
| Other receivables                       |      | 222,438         | 239,601         |
| Prepaid expenses and other assets       |      | 181,856         | 141,591         |
| Cash and cash equivalents               | 20   | 1,404,874       | 2,960,337       |
|   |      | 2,705,593       | 3,924,593       |

CURRENT LIABILITIES

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|                                       |    |             |             |
|---------------------------------------|----|-------------|-------------|
| Bank and other loans                  | 21 | 5,958,968   | 3,479,322   |
| Obligations under finance leases      | 22 | 1,297,855   | 1,566,698   |
| Amounts due to related companies      | 19 | 870,682     | 358,077     |
| Other liabilities                     |    | 854,057     | 411,218     |
| Accounts payable                      | 23 | 745,888     | 296,989     |
| Bills payable                         |    | 438,135     | 1,299,680   |
| Sales in advance of carriage          |    | 405,851     | 340,457     |
| Accrued expenses                      |    | 1,628,072   | 1,049,806   |
| Tax payable                           |    | 48,142      | 48,143      |
|                                       |    | 12,247,650  | 8,850,390   |
| NET CURRENT LIABILITIES               |    | (9,542,057) | (4,925,797) |
| TOTAL ASSETS LESS CURRENT LIABILITIES |    | 19,589,550  | 19,927,586  |

The notes on pages 47 to 98 form part of these financial statements.

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[LOGO]

BALANCE SHEET (Cont'd)

As at 31 December, 2003

(Prepared under International Financial Reporting Standards)

(Expressed in Renminbi)

|  | Note | 2003<br>RMB'000 | 2002<br>RMB'000 |
|--|------|-----------------|-----------------|
| NON-CURRENT LIABILITIES AND DEFERRED ITEMS |      |                 |                 |
| Bank and other loans                       | 21   | 3,670,499       | 4,628,372       |
| Obligations under finance leases           | 22   | 5,543,084       | 6,631,751       |
| Provision for major overhauls              | 24   | 130,992         | 63,389          |
| Deferred credits                           |      | 6,317           | 7,855           |
| Deferred taxation                          | 16   | 89,708          | 507,077         |
|  |      | 9,440,600       | 11,838,444      |
| NET ASSETS                                 |      | 10,148,950      | 8,089,142       |
| REPRESENTING:                              |      |                 |                 |
| SHARE CAPITAL                              | 25   | 4,374,178       | 3,374,178       |
| RESERVES                                   | 26   | 5,774,772       | 4,714,964       |
| SHAREHOLDERS' EQUITY                       |      | 10,148,950      | 8,089,142       |

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Approved and authorised for issue by the board of directors on 23 April, 2004

YAN ZHI QING  
Director

WANG CHANG SHUN  
Director

XU JIE BO  
Director

The notes on pages 47 to 98 form part of these financial statements.

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CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY  
For the year ended 31 December, 2003  
(Prepared under International Financial Reporting Standards)  
(Expressed in Renminbi)

|   | SHARE<br>CAPITAL<br>RMB'000 | SHARE<br>PREMIUM<br>RMB'000 | OTHER<br>RESERVES<br>RMB'000 |
|---|-----------------------------|-----------------------------|------------------------------|
| At 1 January, 2002  | 3,374,178                   | 3,813,659                   | 687,174                      |
| Land use rights adjustment<br>(Note 26 (f))                                     | -                           | (129,703)                   | -                            |
| Adjustments from adoption<br>of new PRC accounting<br>regulations (Note 26 (c)) | -                           | -                           | (185,540)                    |
| Dividend paid (Note 8)  | -                           | -                           | -                            |
| Profit for the year   | -                           | -                           | -                            |
| Appropriations to reserves  | -                           | -                           | 83,738                       |
| At 31 December, 2002  | 3,374,178                   | 3,683,956                   | 585,372                      |
| At 1 January, 2003  | 3,374,178                   | 3,683,956                   | 585,372                      |
| Issue of A shares (Note 25)   | 1,000,000                   | 1,640,767                   | -                            |
| Loss for the year   | -                           | -                           | -                            |
| Appropriations to reserves  | -                           | -                           | 24,969                       |
| At 31 December, 2003  | 4,374,178                   | 5,324,723                   | 610,341                      |

The notes on pages 47 to 98 form part of these financial statements.

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[LOGO]

CONSOLIDATED CASH FLOW STATEMENT  
For the year ended 31 December, 2003  
(Prepared under International Financial Reporting Standards)  
(Expressed in Renminbi)

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|  | Note   | 2003<br>RMB'000 |
|--|--------|-----------------|
| Cash inflows from operations                                 | 33 (a) | 3,074,718       |
| Interest received  |        | 13,061          |
| Interest paid  |        | (923,901)       |
| Income tax paid  |        | (35,129)        |
| Net cash inflows from operating activities                   |        | 2,128,749       |
| Investing activities:  |        |                 |
| Proceeds from sale of fixed assets                           |        | 57,077          |
| Proceeds from sale of investments                            |        | --              |
| Dividends received from associated companies                 |        | --              |
| Decrease/(increase) in long term receivables                 |        | 5,654           |
| Payment of lease and equipment deposits                      |        | (1,851,726)     |
| Refund of lease and equipment deposits                       |        | 1,066,086       |
| Capital expenditures   |        | (4,706,740)     |
| Purchase of investments in equity securities                 |        | (1,065)         |
| Investment in associated company                             |        | --              |
| Investments in jointly controlled entities                   |        | (2,999)         |
| Governmental subsidy for safety related capital expenditures |        | --              |
| Effect of acquisition of subsidiaries                        | 33 (c) | --              |
| Net cash used in investing activities                        |        | (5,433,713)     |
| Net cash outflows before financing activities                |        | (3,304,964)     |
| Financing activities:  |        |                 |
| Proceeds from A share issue, net of issuance costs           |        | 2,640,767       |
| Proceeds from bank and other loans                           |        | 8,913,992       |
| Repayment of bank and other loans                            |        | (8,371,362)     |
| Repayment of principal under finance lease obligations       |        | (1,555,390)     |
| Capital contribution received from minority shareholders     |        | 1,050           |
| Dividends paid to shareholders                               |        | --              |
| Dividends paid to minority shareholders                      |        | (14,962)        |
| Net cash inflows from financing activities                   |        | 1,614,095       |
| (Decrease)/Increase in cash and cash equivalents             |        | (1,690,869)     |
| Cash and cash equivalents at beginning of year               |        | 3,771,043       |
| Cash and cash equivalents at end of year                     |        | 2,080,174       |

The notes on pages 47 to 98 form part of these financial statements.

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NOTES TO THE FINANCIAL STATEMENTS  
(Prepared under International Financial Reporting Standards)  
(Expressed in Renminbi)

1 BACKGROUND OF THE COMPANY

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China Southern Airlines Company Limited (the "Company") and its subsidiary companies (collectively the "Group") are principally engaged in the provision of domestic, Hong Kong regional and international passenger, cargo and mail airline services, with flights operating primarily from the Guangzhou Baiyun International Airport, which is both the main hub of the Group's route network and the location of its corporate headquarters.

The Company was established in the People's Republic of China (the "PRC", "China" or the "State") on 25 March, 1995 as a joint stock limited company as part of the reorganisation (the "Reorganisation") of the Company's holding company, China Southern Air Holding Company ("CSAHC"). CSAHC is a state-owned enterprise under the supervision of the PRC central government.

The Company's H Shares and American Depositary Shares ("ADS") (each ADS representing 50 H Shares) are listed on the Stock Exchange of Hong Kong Limited and the New York Stock Exchange, respectively since July 1997. In July 2003, the Company issued 1,000,000,000 A shares which are listed on the Shanghai Stock Exchange.

### 2 PRINCIPAL ACCOUNTING POLICIES

#### (a) STATEMENT OF COMPLIANCE

The financial statements of the Group and the Company have been prepared in accordance with International Financial Reporting Standards ("IFRS") promulgated by the International Accounting Standards Board and the disclosure requirements of the Hong Kong Companies Ordinance. IFRS includes International Accounting Standards ("IAS") and related interpretations.

#### (b) BASIS OF PREPARATION

The financial statements of the Group and the Company are prepared on the historical cost basis as modified by the revaluation of certain fixed assets. The accounting policies have been consistently applied by the Group and the Company and are consistent with those used in the previous year.

#### (c) BASIS OF CONSOLIDATION

The consolidated financial statements of the Group include the financial statements of the Company and all of its subsidiaries made up to 31 December each year. Subsidiaries are those enterprises controlled by the Group. Control exists when the Group has the power, directly or indirectly, to govern the financial and operating policies of an enterprise so as to obtain benefits from its activities. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control effectively commences until the date that control effectively ceases.

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NOTES TO THE FINANCIAL STATEMENTS (Cont'd)  
(Prepared under International Financial Reporting Standards)  
(Expressed in Renminbi)

2 PRINCIPAL ACCOUNTING POLICIES (cont'd)

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### (c) BASIS OF CONSOLIDATION (cont'd)

The results of subsidiaries are included in the consolidated profit and loss account and the share attributable to minority shareholders is deducted from or added to the consolidated profit after taxation. Losses attributable to minority shareholders of partly owned subsidiaries are accounted for based on the respective equity owned by the minority shareholders up to the amount of the capital contribution and reserves attributable to the minority shareholders. Thereafter, all further losses are assumed by the Company.

All significant intercompany balances and transactions have been eliminated on consolidation.

### (d) INTEREST-BEARING BORROWINGS

Interest-bearing borrowings are recognised initially at cost, less attributable transaction costs. Subsequent to initial recognition, interest-bearing borrowings are stated at amortised cost with any difference between cost and redemption value being recognised in the profit and loss account over the period of the borrowings on an effective interest basis.

### (e) INVESTMENTS

#### (i) Investments in subsidiaries

Investments in subsidiaries in the Company's balance sheet are stated at cost less impairment losses (refer to accounting policy n).

#### (ii) Investments in associated companies and jointly controlled entities

An associated company is an entity in which the Group or the Company has significant influence, but not control or joint control, over its management, including participating in the financial and operating policy decisions.

A jointly controlled entity is an entity which operates under a contractual agreement between the Group or the Company and other parties, where the contractual agreement establishes the Group or the Company and one or more of the other parties share joint control over the economic activity of the entity.

The consolidated profit and loss account includes the Group's share of the results of its associated companies and jointly controlled entities for the year. In the consolidated balance sheet, the investments in associated companies and jointly controlled entities are stated at the Group's attributable share of net assets. When the Group's share of losses exceeds the carrying amount of the associated company or jointly controlled entity, the carrying amount is reduced to nil and recognition of further losses is discontinued except to the extent that the Group has incurred obligations in respect of the associated company or jointly controlled entity.

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(Prepared under International Financial Reporting Standards)  
(Expressed in Renminbi)

## 2 PRINCIPAL ACCOUNTING POLICIES (cont'd)

### (e) INVESTMENTS (cont'd)

The results of associated companies and jointly controlled entities are included in the Company's profit and loss account to the extent of dividends received and receivable, providing such dividends are in respect of a period ending on or before that of the Company and the Company's right to receive the dividend is established before 31 December each year. In the Company's balance sheet, investments in associated companies and jointly controlled entities are stated at cost, less impairment losses (refer to accounting policy n).

#### (iii) Other investments

Other investments are stated at cost less impairment losses (refer to accounting policy n). Other investments represent unquoted available-for-sale equity securities of companies established in the PRC. There is no quoted market price for such equity securities and accordingly a reasonable estimate of the fair value could not be made without incurring excessive costs.

### (f) FIXED ASSETS AND DEPRECIATION

Fixed assets are stated at cost or revalued amount less accumulated depreciation and impairment losses (refer to accounting policy n). Revaluations are performed periodically to ensure that the carrying amount does not differ materially from that which would be determined using fair value at the balance sheet date.

Depreciation is provided to write off the cost, or revalued amount where appropriate, of the fixed assets over their estimated useful lives on a straight line basis, after taking into account their estimated residual values, as follows:

|                                      | DEPRECIABLE LIFE | RESIDUAL VALUE |
|--------------------------------------|------------------|----------------|
| Buildings                            | 15 to 40 years   | Nil            |
| Owned & leased aircraft              | 8 to 15 years    | 28.75%         |
| Other flight equipment               |                  |                |
| - Jet engines                        | 8 to 15 years    | 3%             |
| - Others, including rotatable spares | 8 to 15 years    | Nil            |
| Machinery and equipment              | 5 to 10 years    | 3%             |
| Vehicles                             | 6 years          | 3%             |

No depreciation is provided in respect of construction in progress.

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NOTES TO THE FINANCIAL STATEMENTS (Cont'd)  
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2 PRINCIPAL ACCOUNTING POLICIES (cont'd)

(g) LEASED ASSETS

Flight equipment under finance leases is stated at an amount equal to lower of its fair value and the present value of minimum lease payments at inception of the lease, and is amortised on a straight line basis over the shorter of the lease term or estimated useful life of the asset to residual value. In cases where title to the asset will be acquired by the Group at the end of the lease, the asset is amortised on a straight line basis over the estimated useful life of the asset to its residual value.

Amounts payable in respect of finance leases are apportioned between interest charges and reductions of obligations based on the interest rates implicit in the leases. Interest charges are included in the profit and loss account to provide a constant periodic rate of charge over the lease term.

Gains on aircraft sale and leaseback transactions which result in finance leases are deferred and amortised over the terms of the related leases. Gains on other aircraft sale and leaseback transactions are recognised as income immediately if the transactions are established at fair value. Any excess of the sales price over fair value is deferred and amortised over the period the assets are expected to be used.

Operating lease payments are charged to the profit and loss account on a straight line basis over the terms of the related leases.

(h) CONSTRUCTION IN PROGRESS

Construction in progress represents office buildings, various infrastructure projects under construction and equipment pending installation, and is stated at cost. Cost comprises direct costs of construction as well as interest charges during the periods of construction and installation. Capitalisation of these costs ceases and the construction in progress is transferred to fixed assets when the asset is substantially ready for its intended use, notwithstanding any delays in the issue of the relevant commissioning certificates by the relevant PRC authorities.

(i) LEASE PREPAYMENTS

Lease prepayments represent the purchase costs of land use rights and are amortised on a straight line basis over the period of land use rights (Note 26).

(j) INVENTORIES

Inventories, which consist primarily of expendable spare parts and supplies, are stated at cost less any applicable provision for obsolescence, and are expensed when used in operations. Cost represents the average unit cost. Inventories held for disposal is stated at the lower of cost and net realisable value. Net realisable value represents estimated resale price.



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NOTES TO THE FINANCIAL STATEMENTS (Cont'd)  
(Prepared under International Financial Reporting Standards)  
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### 2 PRINCIPAL ACCOUNTING POLICIES (cont'd)

#### (k) TRADE AND OTHER RECEIVABLES

Trade and other receivables are stated at cost less impairment losses. Impairment losses are established based on evaluation of the recoverability of these accounts at the balance sheet date.

#### (l) DEFERRED EXPENDITURE

Custom duties and other direct costs in relation to modifying, introducing and certifying certain operating leased aircraft are deferred and amortised over the terms of the related leases.

Lump sum housing benefits payable to employees of the Group are deferred and amortised on a straight line basis over a period of 10 years, which represents the benefit vesting period of the employees.

#### (m) CASH AND CASH EQUIVALENTS

Cash and cash equivalents consist of cash in hand and balances with banks and other financial institutions with an original maturity within three months. For the purpose of the consolidated cash flow statement, cash and cash equivalents are presented net of bank overdrafts, if any.

#### (n) IMPAIRMENT LOSS

The carrying amounts of the Group's and the Company's assets, other than inventories (refer to accounting policy j) and deferred tax assets (refer to accounting policy u) are reviewed periodically in order to assess whether the recoverable amounts have declined below the carrying amounts. These assets are tested for impairment whenever events or changes in circumstances indicate that their recorded carrying amounts may not be recoverable. When such a decline has occurred, the carrying amount is reduced to the recoverable amount. The recoverable amount is the greater of the net selling price and the value in use. In determining the value in use, expected future cash flows generated by the asset are discounted to their present value. The amount of the reduction is recognised as an expense in the profit and loss account.

The Group and the Company assess at each balance sheet date whether there is any indication that an impairment loss recognised for an asset in prior years may no longer exist. An impairment loss is reversed if there has been a favourable change in the estimates used to determine the recoverable amount. A subsequent increase in the recoverable amount of an asset, when the circumstances and events that led to the write-down or write-off cease to exist, is recognised as income. The reversal is reduced by the amount that would have been recognised as depreciation had the write-down or write-off not occurred.

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### 2 PRINCIPAL ACCOUNTING POLICIES (cont'd)

#### (o) DEFERRED CREDITS

In connection with the acquisition or operating lease of certain aircraft and engines, the Group receives various credits. Such credits are deferred until the aircraft and engines are delivered, at which time they are either applied as a reduction of the cost of acquiring the aircraft and engines, resulting in a reduction of future depreciation, or amortised as a reduction of rental expense for aircraft and engines under operating leases.

#### (p) REVENUE RECOGNITION

Passenger, cargo and mail revenues are recognised when the transportation is provided. Ticket sales for transportation not yet provided are included in current liabilities as sales in advance of carriage. Revenues from airline-related business are recognised when services are rendered. Revenue is stated net of sales tax and contributions to the CAAC Infrastructure Development Fund.

Interest income is recognised as it accrues unless collectability is in doubt. Dividend income is recognised when the Group's right to receive the dividend is established.

Operating lease income is recognised on a straight line basis over the terms of the respective leases.

#### (q) TRAFFIC COMMISSIONS

Traffic commissions are expensed when the transportation is provided and the related revenue is recognised. Traffic commissions for transportation not yet provided are recorded on the balance sheet as a prepaid expense.

#### (r) MAINTENANCE AND OVERHAUL COSTS

Routine maintenance and repairs and overhauls in respect of owned aircraft and aircraft held under finance leases are expensed in the profit and loss account as and when incurred. In respect of aircraft held under operating leases, a provision is made over the lease term for the estimated cost of scheduled overhauls required to be performed on the related aircraft prior to their return to the lessors.

#### (s) TRANSLATION OF FOREIGN CURRENCIES

Foreign currency transactions during the year are translated into Renminbi at the applicable rates of exchange prevailing on the transaction dates.

Foreign currency monetary balances at the balance sheet date are translated into Renminbi at the exchange rates quoted by the People's Bank of China ruling at that date. Exchange differences are dealt with in the profit and loss account.

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NOTES TO THE FINANCIAL STATEMENTS (Cont'd)  
(Prepared under International Financial Reporting Standards)  
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### 2 PRINCIPAL ACCOUNTING POLICIES (cont'd)

#### (t) BORROWING COSTS

Borrowing costs are expensed in the profit and loss account as and when incurred, except to the extent that they are capitalised as being directly attributable to the acquisition or construction of an asset which necessarily takes a substantial period of time to get ready for its intended use.

#### (u) DEFERRED TAXATION

Deferred tax is provided using the balance sheet liability method on all temporary differences between the carrying amounts for financial reporting purposes and the amounts used for taxation purposes, except differences relating to the initial recognition of assets or liabilities which affect neither accounting nor taxable profit/loss.

The tax value of losses expected to be available for utilisation against future taxable income is recognised as a deferred tax asset and offset against the deferred tax liability attributable to the same legal tax unit and jurisdiction. Net deferred tax assets are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

#### (v) RETIREMENT BENEFITS

Contributions to retirement schemes and additional retirement benefits paid to retired employees are charged to the profit and loss account as and when incurred.

#### (w) FREQUENT FLYER AWARD PROGRAMMES

The Group maintains two frequent flyer award programmes, namely, the China Southern Airlines Sky Pearl Club and the Egret Mileage Plus, which provide travel awards to members based on accumulated mileage. The estimated incremental cost to provide free travel is recognised as an expense and accrued as a current liability as members accumulate mileage. As members redeem awards or their entitlements expire, the incremental cost liability is reduced accordingly to reflect the acquittal of the outstanding obligations.

Revenue from mileage sales to third parties under the frequent flyer award programmes is recognised when the related transportation services are provided.

#### (x) PROVISIONS

A provision is recognised in the balance sheet when the Group has a legal or constructive obligation as a result of a past event, and it is probable that an outflow of economic benefits will be required to settle the obligations. If the effect is material, provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability.

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)  
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2 PRINCIPAL ACCOUNTING POLICIES (cont'd)

(y) RELATED PARTIES

For the purposes of these financial statements, parties are considered to be related to the Group if the Group has the ability, directly or indirectly, to control the party or exercise significant influence over the party in making financial and operating decisions, or vice versa, or where the Group and the party are subject to common control or common significant influence. Related parties may be individuals or entities.

(z) SEGMENTAL REPORTING

The Group operates principally as a single business segment for the provision of air transportation services. The analysis of turnover and operating profit by geographical segment is based on the following criteria:

- (i) Traffic revenue from domestic services within the PRC (excluding Hong Kong) is attributed to the domestic operation. Traffic revenue from inbound / outbound services between the PRC and Hong Kong, and the PRC and overseas destinations is attributed to the Hong Kong regional operation and international operation respectively.
- (ii) Other revenue from ticket selling, general aviation and ground services, air catering and other miscellaneous services is attributed on the basis of where the services are performed.

(aa) USE OF ESTIMATES

The preparation of the financial statements of the Group and the Company in accordance with IFRS requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)  
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3 TURNOVER

Turnover comprises revenues from airline and airline-related business and is stated net of sales tax and contributions to the CAAC Infrastructure Development Fund. An analysis of turnover is as follows:

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|  | 2003<br>RMB' 000 | 2002<br>RMB' 000 |
|--|------------------|------------------|
| -----  |                  |                  |
| Traffic revenue                              |                  |                  |
| Passenger                                    | 15,009,885       | 15,695,622       |
| Cargo and mail                               | 1,954,915        | 1,786,270        |
| -----  |                  |                  |
|  | 16,964,800       | 17,481,892       |
| -----  |                  |                  |
| Other operating revenue                      |                  |                  |
| Commission income                            | 140,180          | 137,928          |
| General aviation income                      | 40,309           | 68,225           |
| Ground services income                       | 99,130           | 78,616           |
| Air catering income                          | 30,756           | 38,077           |
| Net income from lease arrangements (Note 10) | 69,121           | 51,682           |
| Rental income                                | 40,307           | -                |
| Aircraft lease income                        | -                | 46,640           |
| Other  | 85,520           | 115,560          |
| -----  |                  |                  |
|  | 505,323          | 536,728          |
| -----  |                  |                  |
|  | 17,470,123       | 18,018,620       |
| =====  |                  |                  |

Pursuant to various sales tax rules and regulations, the Group is required to pay sales tax to national and local tax authorities at the following rates:

| TYPES OF REVENUE        | APPLICABLE SALES TAX RATES  |
|-------------------------|---|
| Traffic revenue         | 3% (2002: 3%) of traffic revenue, except for the period from 1 May, 2003 to 31 December, 2003 during which passenger revenue was exempted from sales tax. All inbound international and Hong Kong regional flights are exempted from sales tax. |
| Other operating revenue | 3% (2002: 3%) of commission income, general aviation income and ground services income, and 3% to 5% (2002: 3% to 5%) of other operating revenue.   |

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NOTES TO THE FINANCIAL STATEMENTS (Cont'd)  
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3 TURNOVER (cont'd)

Sales tax incurred during the year ended 31 December, 2003, netted off against revenue, amounted to RMB205,925,000 (2002: RMB557,784,000). In addition, the Group is required to pay contributions to the CAAC Infrastructure Development Fund which are calculated at the rates of 5%

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and 2%, respectively (2002: 5% and 2%, respectively) of the domestic and international/Hong Kong regional traffic revenue, except for the period from 1 May, 2003 to 31 December, 2003 during which the Group was exempted from paying the contributions. Contributions to the CAAC Infrastructure Development Fund payable by the Group for the year ended 31 December, 2003 totalled RMB250,802,000 (2002: RMB798,386,000).

Pursuant to approval documents issued by the CAAC, the Group imposes a fuel surcharge on passengers carried by its domestic and Hong Kong regional flights at certain prescribed rates on ticket fares. The fuel surcharge forms part of the traffic revenue of the Group. For the year ended 31 December, 2003, the fuel surcharge revenue of the Group totalled approximately RMB740 million (2002: RMB554 million).

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NOTES TO THE FINANCIAL STATEMENTS (Cont'd)  
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4 (LOSS)/PROFIT BEFORE TAXATION AND MINORITY INTERESTS

|  | 2003<br>RMB' 000 | 2002<br>RMB' 000 |
|--|------------------|------------------|
| -----  |                  |                  |
| (Loss)/profit before taxation and minority interests is arrived at after charging: |                  |                  |
| Operating expenses   |                  |                  |
| Jet fuel   | 3,866,932        | 3,519,005        |
| Aircraft maintenance   | 2,376,635        | 2,134,705        |
| Routes   | 4,363,277        | 4,297,767        |
| Depreciation   |                  |                  |
| - owned assets   | 1,502,013        | 1,301,601        |
| - assets held under finance leases   | 495,869          | 537,692          |
| Amortisation of deferred expenditure   | 40,089           | 578              |
| Operating lease charges  |                  |                  |
| - aircraft and other flight equipment  | 1,536,466        | 1,416,524        |
| - buildings  | 135,528          | 129,982          |
| Staff costs  |                  |                  |
| - salaries, wages and welfare  | 1,496,191        | 1,538,617        |
| - contributions to retirement schemes  | 150,447          | 131,622          |
| Office and administration  | 470,565          | 452,432          |
| Auditors' remuneration   | 8,200            | 8,200            |
| Other  | 572,182          | 523,818          |
|  | -----            | -----            |
|  | 17,014,394       | 15,992,543       |
|  | -----            |                  |
| Interest expense   |                  |                  |
| Interest on bank and other loans wholly repayable within five years                | 288,293          | 335,953          |
| Interest on other loans  | 176,026          | 142,679          |
| Finance charges on obligations under finance leases                                | 442,483          | 544,747          |
| Less: borrowing costs capitalised (Note)   | (83,077)         | (64,186)         |
|  | -----            | -----            |
| Net interest expense   | 823,725          | 959,193          |

and after crediting:

|  |        |       |
|--|--------|-------|
| Amortisation of gains on sale and leaseback transactions | -      | 2,579 |
| Dividend income from unlisted investments                | 17,220 | 7,116 |

Note: The borrowing costs have been capitalised at rates ranging 1.62% to 5.46% per annum (2002: 5.70%).

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NOTES TO THE FINANCIAL STATEMENTS (Cont'd)  
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4 (LOSS)/PROFIT BEFORE TAXATION AND MINORITY INTERESTS (cont'd)

The (loss)/profit attributable to shareholders for the year ended 31 December, 2003 includes a loss of RMB580,959,000 (2002: profit of RMB 381,305,000) which has been dealt with in the financial statements of the Company.

5 (LOSS)/GAIN ON SALE OF FIXED ASSETS

(Loss)/gain on sale of fixed assets represents:

|   | 2003<br>RMB' 000 | 2002<br>RMB' 000 |
|---|------------------|------------------|
| Aircraft (Note)                         | (20,405)         | 199,394          |
| Staff quarters (Note 28)                | -                | (17,624)         |
| Flight equipment and other fixed assets | (1,812)          | (11,030)         |
|   | (22,217)         | 170,740          |

Note:

During 2003, the Group incurred a loss of RMB20,405,000 on early retirement of two old Boeing 737-200 aircraft.

Pursuant to certain sale and leaseback arrangements, the Group sold four Boeing 757-200 aircraft during 2002 to independent third parties and then entered into operating leases with such parties to lease back the aircraft for a period of eight to nine years. For the year ended 31 December, 2002, the Group recognised a profit of RMB199,394,000, being the excess of the sale proceeds which approximated the aircraft's fair value on the date of disposal, over the aircraft's net book value and related disposal costs.

6 EMOLUMENTS OF DIRECTORS, SUPERVISORS AND SENIOR MANAGEMENT

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(a) DIRECTORS' AND SUPERVISORS' EMOLUMENTS

|   | 2003<br>RMB' 000 | 2002<br>RMB' 000 |
|---|------------------|------------------|
| -----                                     |                  |                  |
| Fees                                      | 203              | 103              |
| Salaries, allowances and benefits in kind | 1,244            | 970              |
| Retirement benefits                       | 98               | 67               |
| Bonuses                                   | 943              | 264              |
| -----                                     |                  |                  |
|   | 2,488            | 1,404            |
| =====                                     |                  |                  |

Included in the above were fees of RMB203,000 (2002: RMB103,000) paid to non-executive independent directors during the year.

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NOTES TO THE FINANCIAL STATEMENTS (Cont'd)  
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6 EMOLUMENTS OF DIRECTORS, SUPERVISORS AND SENIOR MANAGEMENT (cont'd)

(a) DIRECTORS' AND SUPERVISORS' EMOLUMENTS (cont'd)

An analysis of directors' and supervisors' emoluments by number of individuals and emolument ranges is as follows:

|  | 2003<br>Number | 2002<br>Number |
|--|----------------|----------------|
| -----  |                |                |
| Nil to HK\$1,000,000 (RMB1,066,000 equivalent) | 18             | 14             |
| -----  |                |                |

(b) SENIOR MANAGEMENT'S EMOLUMENTS

Details of emoluments paid to the five highest paid individuals (including directors and supervisors) of the Group during the year are as follows:

|   | 2003<br>RMB' 000 | 2002<br>RMB' 000 |
|---|------------------|------------------|
| -----                                     |                  |                  |
| Salaries, allowances and benefits in kind | 1,701            | 1,496            |
| Retirement benefits                       | 25               | 24               |
| -----                                     |                  |                  |
|   | 1,726            | 1,520            |
| =====                                     |                  |                  |



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An analysis of emoluments paid to the five highest paid individuals (including directors and supervisors) by number of individuals and emolument ranges is as follows:

|  | 2003<br>Number | 2002<br>Number |
|--|----------------|----------------|
| -----  |                |                |
| Directors and supervisors                      | -              | 1              |
| Employees                                      | 5              | 4              |
| -----  |                |                |
|  | 5              | 5              |
| =====  |                |                |
| Nil to HK\$1,000,000 (RMB1,066,000 equivalent) | 5              | 5              |
| =====  |                |                |

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NOTES TO THE FINANCIAL STATEMENTS (Cont'd)  
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7 TAXATION (CREDIT)/EXPENSE

Taxation (credit)/expense in the consolidated profit and loss account comprises:

|  | 2003<br>RMB'000 | 2002<br>RMB'000 |
|--|-----------------|-----------------|
| -----  |                 |                 |
| PRC income tax                                   | 46,938          | 71,651          |
| Share of taxation of associated companies        | 3,342           | 9,424           |
| Share of taxation of jointly controlled entities | 6,372           | -               |
| -----  |                 |                 |
|  | 56,652          | 81,075          |
| Deferred taxation (Note 16)                      |                 |                 |
| - current year                                   | 11,208          | 317,152         |
| - adjustment for change in income tax rate       | (392,137)       | -               |
| -----  |                 |                 |
| Taxation (credit)/expense                        | (324,277)       | 398,227         |
| =====  |                 |                 |

On 17 October, 2003, the Company's registered address was moved to Guangzhou Economic & Technology Development Zone. In accordance with the Rules and Regulations for Implementation of Income Tax for Foreign Investment Enterprises and Foreign Enterprises of the PRC and a taxation approval document "Guangzhou Municipal State Tax Bureau Suo De Shui Zi Que 020043", the Company is entitled to enjoy the preferential tax policy implemented in the Guangzhou Economic & Technology Development Zone

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effective 1 October, 2003. As a result, the Company's income tax rate has been changed to 15% from 33% beginning from that date.

As a result of the reduction in income tax rate, the Company's net deferred taxation liability balance brought forward from 31 December, 2002 of RMB507,077,000 was reduced by RMB392,137,000 and a net deferred tax credit of RMB392,137,000 was recognised for such reduction in income tax rate in the consolidated profit and loss account for the year ended 31 December, 2003.

In respect of the Group's overseas airline activities, the Group has either obtained exemptions from overseas taxation pursuant to the bilateral aviation agreements between the overseas governments and PRC government, or has sustained tax losses in these overseas jurisdictions. Accordingly, no provision for overseas tax has been made for the year (2002: nil).

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NOTES TO THE FINANCIAL STATEMENTS (Cont'd)  
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7 TAXATION (CREDIT)/EXPENSE (cont'd)

Actual taxation amount in the consolidated profit and loss account differed from the amount computed by applying the PRC income tax rate of 15% to consolidated (loss)/profit before taxation and minority interests as a result of the following:

|   | 2003<br>RMB'000 | 2002<br>RMB'000 |
|---|-----------------|-----------------|
| Consolidated (loss)/profit before taxation and minority interests | (511,610)       | 1,139,099       |
| Expected PRC income tax (credit)/expense at 15% (2002: 33%)       | (76,742)        | 375,903         |
| Adjustments:  |                 |                 |
| Gains on sale and leaseback transactions and their amortisation   | -               | (851)           |
| Effect of change in income tax rate                               | (392,137)       | -               |
| Rate differential on subsidiaries                                 | -               | (60,530)        |
| Non-deductible expenses   | 79,907          | 61,454          |
| Other, net  | 64,695          | 22,251          |
|   | (324,277)       | 398,227         |

In accordance with relevant PRC tax regulations, a PRC lessee is liable to pay PRC withholding tax in respect of any lease payments regularly made to an overseas lessor. Depending on the circumstances, this tax is generally imposed at a fixed rate ranging from 10% to 20% of the lease payments, or in certain cases, the interest components of such payments. Pursuant to an approval document from the State Tax Bureau, lease arrangements executed prior to 1 September, 1999 are exempted from PRC withholding tax.

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For the year ended 31 December, 2003, the PRC withholding tax payable by the Group in respect of the leases executed on or after 1 September, 1999 of RMB7,706,000 (2002: RMB14,305,000) has been included as part of the operating lease charges for the year.

### 8 DIVIDENDS

No interim dividend was paid during the year ended 31 December, 2003 (2002: Nil).

The board of directors of the Company does not recommend the payment of a final dividend in respect of the year ended 31 December, 2003.

A final dividend of RMB0.02 per share totalling RMB67,484,000 in respect of the year ended 31 December, 2001 was approved and paid during 2002.

### 9 BASIC (LOSS)/EARNINGS PER SHARE

The calculation of basic (loss)/earnings per share is based on the consolidated loss attributable to shareholders of RMB358,267,000 (2002: profit of RMB575,761,000) and the weighted average number of shares in issue during the year of 3,831,712,000 (2002: 3,374,178,000).

The amount of diluted (loss)/earnings per share is not presented as there were no dilutive potential ordinary shares in existence for both years.

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NOTES TO THE FINANCIAL STATEMENTS (Cont'd)  
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### 10 FIXED ASSETS

|   |           | AIRCRAFT   |            | OTHER FLIGHT |
|---|-----------|------------|------------|--------------|
|   |           | -----      |            | EQUIPMENT,   |
|   | BUILDINGS | OWNED      | HELD UNDER | INCLUDING    |
|   | RMB'000   | RMB'000    | FINANCE    | ROTABLE      |
|   |           |            | LEASES     | SPARES       |
|   |           |            | RMB'000    | RMB'000      |
|   |           |            |            |              |
| (a) THE GROUP                                       |           |            |            |              |
| Cost or valuation:                                  |           |            |            |              |
| At 1 January, 2003                                  | 3,160,073 | 13,510,717 | 11,459,978 | 6,283,470    |
| Exchange adjustments                                | 16,572    | -          | -          | -            |
| Reclassification on exercise<br>of purchase options | -         | 997,403    | (997,403)  | -            |
| Additions   | 11,382    | 2,818,475  | -          | 558,594      |
| Transferred from construction<br>in progress        | 133,839   | -          | -          | -            |
| Disposals   | (34,273)  | (104,235)  | -          | -            |
|   |           |            |            |              |
| At 31 December, 2003                                | 3,287,593 | 17,222,360 | 10,462,575 | 6,842,064    |
|   |           |            |            |              |

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|   |           |            |            |           |
|---|-----------|------------|------------|-----------|
| Representing:                                       |           |            |            |           |
| Cost  | 2,932,399 | 10,993,419 | 6,123,034  | 4,667,887 |
| Valuation - 1996                                    | 355,194   | 6,228,941  | 4,339,541  | 2,174,177 |
|   | 3,287,593 | 17,222,360 | 10,462,575 | 6,842,064 |
| Accumulated depreciation:                           |           |            |            |           |
| At 1 January, 2003                                  | 476,867   | 2,145,849  | 2,499,495  | 3,177,253 |
| Exchange adjustments                                | 2,892     | -          | -          | -         |
| Reclassification on exercise<br>of purchase options | -         | 389,958    | (389,958)  | -         |
| Charge for the year                                 | 128,776   | 710,509    | 495,869    | 467,202   |
| Written back on disposal                            | (14,740)  | (54,555)   | -          | -         |
| At 31 December, 2003                                | 593,795   | 3,191,761  | 2,605,406  | 3,644,455 |
| Net book value:                                     |           |            |            |           |
| At 31 December, 2003                                | 2,693,798 | 14,030,599 | 7,857,169  | 3,197,609 |
| At 31 December, 2002                                | 2,683,206 | 11,364,868 | 8,960,483  | 3,106,217 |

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10 FIXED ASSETS (cont'd)

|   | BUILDINGS<br>RMB'000 | AIRCRAFT         |  | OTHER FLIGHT<br>EQUIPMENT,<br>INCLUDING<br>ROTABLE<br>SPARES<br>RMB'000 |
|---|----------------------|------------------|--|---|
|   |                      | OWNED<br>RMB'000 | HELD UNDER<br>FINANCE<br>LEASES<br>RMB'000 |   |
| (b) THE COMPANY   |                      |                  |  |   |
| Cost or valuation:  |                      |                  |  |   |
| At 1 January, 2003  | 1,036,612            | 9,053,359        | 11,459,978                                 | 3,941,880   |
| Reclassification on exercise<br>of purchase options                             | -                    | 997,403          | (997,403)                                  | -   |
| Additions   | 2,228                | 2,818,475        | -  | 455,763   |
| Additions through transfer<br>of fixed assets upon<br>dissolution of subsidiary | 514,197              | -                | -  | 998,215   |
| Transferred from construction<br>in progress                                    | 91,018               | -                | -  | -   |
| Disposals   | (347)                | -                | -  | -   |
| At 31 December, 2003  | 1,643,708            | 12,869,237       | 10,462,575                                 | 5,395,858   |

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|   |           |            |            |           |
|---|-----------|------------|------------|-----------|
| Representing:   |           |            |            |           |
| Cost  | 1,449,476 | 8,255,920  | 6,123,034  | 3,570,949 |
| Valuation - 1996  | 194,232   | 4,613,317  | 4,339,541  | 1,824,909 |
|   | 1,643,708 | 12,869,237 | 10,462,575 | 5,395,858 |
| Accumulated depreciation:   |           |            |            |           |
| At 1 January, 2003  | 176,841   | 1,327,363  | 2,499,495  | 2,387,634 |
| Reclassification on exercise<br>of purchase options                             | -         | 389,958    | (389,958)  | -         |
| Charge for the year   | 72,980    | 514,000    | 495,869    | 373,896   |
| Additions through transfer<br>of fixed assets upon<br>dissolution of subsidiary | 73,772    | -          | -          | 311,097   |
| Written back on disposal  | (23)      | -          | -          | -         |
| At 31 December, 2003  | 323,570   | 2,231,321  | 2,605,406  | 3,072,627 |
| Net book value:   |           |            |            |           |
| At 31 December, 2003  | 1,320,138 | 10,637,916 | 7,857,169  | 2,323,231 |
| At 31 December, 2002  | 859,771   | 7,725,996  | 8,960,483  | 1,554,246 |

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10 FIXED ASSETS (cont'd)

Substantially all of the Group's buildings are located in the PRC. The Group was formally granted the rights to use the twenty one parcels of land in Guangzhou, Shenzhen, Zhuhai, Beihai, Changsha, Shantou, Haikou, Zhengzhou, Guiyang and Wuhan by the relevant PRC authorities for a period of 30 to 70 years, which expire between 2020 and 2068. For other land in the PRC on which the Group's buildings are erected, the Group was formally granted the rights to use such land for periods of one to five years commencing in the second quarter of 1997 pursuant to various lease agreements between the Company and CSAHC. The leases with initial one-year term are automatically renewable for another one-year period unless the Group gives appropriate notice of termination. In this connection, rental payments totalling RMB15,224,000 (2002: RMB15,224,000) were paid to CSAHC during 2003 in respect of these leases.

During the year, the Company entered into operating lease arrangements to lease certain flight training facilities and buildings to Zhuhai Xiang Yi Aviation Technology Company Limited ("Zhuhai Xiang Yi"), a jointly controlled entity of the Company. The leases with initial one-year term are automatically renewable for another one year unless either party gives appropriate notice of termination. In this connection, rental income totalling RMB34,175,000 was received by the Company during 2003 in respect of the leases. As at 31 December, 2003, the cost and accumulated

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depreciation of the relevant fixed assets totalled RMB787,432,000 and RMB462,281,000 respectively. As at 31 December, 2003, the Company's rental receivable in respect of the leases due in 2004 amounted to RMB34,175,000.

In compliance with the PRC rules and regulations governing initial public offering of shares by PRC joint stock limited companies, the fixed assets of the Group as at 31 December, 1996 were revalued. This revaluation was conducted by Guangzhou Assets Appraisal Corp. ("GAAC"), a firm of independent valuers registered in the PRC, on a depreciated replacement cost basis, and approved by the China State-owned Assets Administration Bureau.

In accordance with IAS 16 "Property, plant and equipment", subsequent to the 1996 revaluation, which was based on replacement costs, the fixed assets of the Group are carried at revalued amount, being the fair value at the date of the revaluation less any subsequent accumulated depreciation and impairment losses. Revaluation is performed periodically to ensure that the carrying amount does not differ materially from that which would be determined using fair value at the balance sheet date. In accordance with the revaluation performed by the directors in respect of fixed assets held by the Group as at 31 December, 2000, the carrying amounts of fixed assets did not differ materially from their respective fair value.

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10 FIXED ASSETS (cont'd)

The effect of the above revaluation was to increase future annual depreciation charges of the Group by approximately RMB33,000,000 (2002: RMB33,000,000). Had the fixed assets of the Group and the Company been stated at cost, that is, the effect of the revaluation was excluded, the net book values of fixed assets of the Group and the Company as at 31 December, 2003 would have been approximately RMB28,522,787,000 and RMB22,793,781,000 respectively (2002: RMB26,874,709,000 and RMB19,440,211,000 respectively), made up as follows:

|                                | THE GROUP       |                 | THE COMPANY     |                 |
|--------------------------------|-----------------|-----------------|-----------------|-----------------|
|                                | 2003<br>RMB'000 | 2002<br>RMB'000 | 2003<br>RMB'000 | 2002<br>RMB'000 |
| Buildings                      | 3,109,988       | 2,982,468       | 1,610,075       | 1,002,979       |
| Aircraft                       |                 |                 |                 |                 |
| - owned                        | 18,344,930      | 14,694,256      | 13,657,746      | 9,841,868       |
| - held under finance leases    | 10,942,131      | 11,939,534      | 10,942,131      | 11,939,534      |
| Flight equipment and others    | 9,634,146       | 8,927,679       | 6,910,210       | 5,163,355       |
|                                | 42,031,195      | 38,543,937      | 33,120,162      | 27,947,736      |
| Less: Accumulated depreciation | 13,508,408      | 11,669,228      | 10,326,381      | 8,507,525       |

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28,522,787    26,874,709    22,793,781    19,440,211

As at 31 December, 2003, certain aircraft of the Group and the Company with an aggregate carrying value of approximately RMB14,575,906,000 and RMB12,795,867,000 respectively (2002: RMB14,782,559,000 and RMB12,893,592,000, respectively) were mortgaged under certain loan and lease agreements (see Notes 21 and 22).

The Company entered into two separate arrangements (the "Arrangements") with certain independent third parties during each of 2002 and 2003. Under each of the Arrangements, the Company sold an aircraft and then immediately leased back the aircraft for an agreed period. As agreed, the lease payment obligations, with pre-determined net present value, are to be satisfied solely out of the sale proceeds and such amount has been placed irrevocably by the Company in form of deposits and debt securities in favour of the lessors. The Company has an option to purchase the aircraft at a pre-determined date and an agreed purchase price to be satisfied by the balances of the deposits and debt securities outstanding at that date. In the event that the lease agreement is early terminated by the Company, the Company is liable to pay a pre-determined penalty to the lessor. As long as the Company complies with the lease agreements, the Company is entitled to the continued possession and operation of the aircraft. Since the Company retains substantially all risks and rewards incident to ownership of the aircraft and enjoys substantially the same rights to their use as before the Arrangements, no adjustment has been made to the fixed assets. As at 31 December, 2003, the net present value of the lease commitments and the corresponding defeased deposits and debt securities amounted to RMB2,409,252,000 (2002: RMB1,322,843,000). As a result of the Arrangements, the Company received net cash benefits of RMB51,682,000 and RMB69,121,000 in 2002 and 2003 respectively which have been recognised as income for the respective years.

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11      CONSTRUCTION IN PROGRESS

Construction in progress comprises expenditure incurred on the construction of buildings and other operating facilities not yet substantially completed at 31 December, 2003, details as follows:

|                                 | 2003<br>RMB'000 | 2002<br>RMB'000 |
|---------------------------------|-----------------|-----------------|
| THE COMPANY                     |                 |                 |
| Guangzhou new airport base      | 1,378,063       | 432,580         |
| Hubei catering building         | 27,911          | 23,407          |
| Zhengzhou ticket selling office | 22,016          | 21,988          |
| Material and engineering system | 21,066          | 21,063          |
| Henan office building           | 13,986          | 3,717           |
| Guangzhou ticket selling office | -               | 45,988          |
| Other                           | 69,420          | 66,768          |

|                                    |           |         |
|------------------------------------|-----------|---------|
|                                    | 1,532,462 | 615,511 |
| -----                              |           |         |
| SUBSIDIARIES                       |           |         |
| Guangzhou new cargo centre         | 67,697    | -       |
| Fuzhou Chang Le airport facilities | 14,244    | 14,839  |
| Other                              | 15,286    | 31,002  |
|                                    | 97,227    | 45,841  |
|                                    | 1,629,689 | 661,352 |
| =====                              |           |         |

12 INTEREST IN SUBSIDIARIES

|  | THE COMPANY     |                 |
|--|-----------------|-----------------|
|  | 2003<br>RMB'000 | 2002<br>RMB'000 |
| Unlisted shares/capital contributions, at cost | 977,540         | 1,086,793       |
| Amounts due from subsidiaries                  | 468,291         | 319,217         |
|  | 1,445,831       | 1,406,010       |
| =====  |                 |                 |

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NOTES TO THE FINANCIAL STATEMENTS (Cont'd)  
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12 INTEREST IN SUBSIDIARIES (cont'd)

In March 2003, China Southern Airlines (Group) Shenzhen Co., a wholly owned subsidiary of the Company was dissolved in March 2003. Its operation and respective assets and liabilities were transferred to the Company since then. No material gains or losses were incurred by the Group on dissolution of the subsidiary.

Details of the Company's subsidiaries are set out in Note 36.

13 INTEREST IN ASSOCIATED COMPANIES

|       | THE GROUP       |                 | THE COMPANY     |                 |
|-------|-----------------|-----------------|-----------------|-----------------|
|       | 2003<br>RMB'000 | 2002<br>RMB'000 | 2003<br>RMB'000 | 2002<br>RMB'000 |
| ----- |                 |                 |                 |                 |



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|   |         |         |          |          |
|---|---------|---------|----------|----------|
| Share of attributable net assets        |         |         |          |          |
| other than goodwill                     | 422,201 | 692,026 | -        | -        |
| Unlisted capital contributions, at cost | -       | -       | 348,502  | 428,840  |
| Impairment loss for investment          |         |         |          |          |
| in associated company                   | -       | -       | (61,267) | (61,267) |
|   | -----   | -----   | -----    | -----    |
|   | 422,201 | 692,026 | 287,235  | 367,573  |
|   | =====   | =====   | =====    | =====    |

Details of the Group's associated companies are set out in Note 37.

14 INTEREST IN JOINTLY CONTROLLED ENTITIES

|   | THE GROUP |         | THE COMPANY |         |
|---|-----------|---------|-------------|---------|
|   | 2003      | 2002    | 2003        | 2002    |
|   | RMB'000   | RMB'000 | RMB'000     | RMB'000 |
| Share of attributable net assets        |           |         |             |         |
| other than goodwill                     | 731,323   | 461,962 | -           | -       |
| Unlisted capital contributions, at cost | -         | -       | 563,736     | 474,042 |
|   | -----     | -----   | -----       | -----   |
|   | 731,323   | 461,962 | 563,736     | 474,042 |
|   | =====     | =====   | =====       | =====   |

Details of the Company's jointly controlled entities are set out in Note 37.

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14 INTEREST IN JOINTLY CONTROLLED ENTITIES (cont'd)

An analysis of the Group's attributable share of assets, liabilities, revenues and expenses of the jointly controlled entities is set out below:

|                         | 2003      | 2002      |
|-------------------------|-----------|-----------|
|                         | RMB'000   | RMB'000   |
| Non-current assets      | 606,185   | 290,088   |
| Current assets          | 618,799   | 326,712   |
| Non-current liabilities | (235,718) | -         |
| Current liabilities     | (257,943) | (154,838) |
|                         | -----     | -----     |
| Net assets              | 731,323   | 461,962   |
|                         | =====     | =====     |
| Income                  | 486,049   | -         |
| Expenses                | (525,544) | (3,352)   |

-----  
 Net loss (39,495) (3,352)  
 =====

15 DEFERRED EXPENDITURE

Deferred expenditure mainly comprises custom duties and other direct costs incurred in respect of the Group's operating leased aircraft upon the inception of the respective leases, and lump sum housing benefits provided to eligible employees of the Group:

|                                      | THE GROUP |         | THE COMPANY |         |
|--------------------------------------|-----------|---------|-------------|---------|
|                                      | 2003      | 2002    | 2003        | 2002    |
|                                      | RMB'000   | RMB'000 | RMB'000     | RMB'000 |
| Custom duties and other direct costs | 60,135    | 257,509 | 36,551      | 168,265 |
| Lump sum housing benefits (Note 28)  | 260,000   | 260,000 | 260,000     | 260,000 |
|                                      | 320,135   | 517,509 | 296,551     | 428,265 |
| Less: Accumulated amortisation       | 71,282    | 234,206 | 56,037      | 155,629 |
|                                      | 248,853   | 283,303 | 240,514     | 272,636 |

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16 DEFERRED TAXATION

Movements in net deferred tax liabilities are as follows:

|   | THE GROUP |           | THE COMPANY |           |
|---|-----------|-----------|-------------|-----------|
|   | 2003      | 2002      | 2003        | 2002      |
|   | RMB'000   | RMB'000   | RMB'000     | RMB'000   |
| Balance at 1 January,                             | (779,234) | (519,577) | (507,077)   | (293,991) |
| Land use rights adjustment (Note 26 (f))          | -         | 57,495    | -           | 57,495    |
| Transferred from profit and loss account (Note 7) |           |           |             |           |
| - current year                                    | (11,208)  | (317,152) | 25,232      | (270,581) |
| - adjustment for change in income tax rate        | 392,137   | -         | 392,137     | -         |
| Balance at 31 December,                           | (398,305) | (779,234) | (89,708)    | (507,077) |

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The net deferred tax liabilities at 31 December, 2003 were made up of the following taxation effects:

|                                       | THE GROUP |           | THE COMPANY |           |
|---------------------------------------|-----------|-----------|-------------|-----------|
|                                       | 2003      | 2002      | 2003        | 2002      |
|                                       | RMB'000   | RMB'000   | RMB'000     | RMB'000   |
| -----                                 |           |           |             |           |
| Deferred tax assets:                  |           |           |             |           |
| Tax losses                            | 222,936   | 149,338   | 222,936     | 149,338   |
| Repairs and maintenance accruals      | 87,608    | 63,896    | 93,097      | 69,385    |
| Repair charges capitalised            | 261,312   | 319,697   | 199,292     | 259,147   |
| Accrued expenses                      | 18,883    | 311,893   | 18,883      | 311,893   |
| Other                                 | 8,989     | 129,423   | 10,829      | 144,463   |
| -----                                 |           |           |             |           |
| Total deferred tax assets             | 599,728   | 974,247   | 545,037     | 934,226   |
| -----                                 |           |           |             |           |
| Deferred tax liabilities:             |           |           |             |           |
| Undistributed profits of subsidiaries | -         | 254,210   | -           | 254,210   |
| Repairs and maintenance accruals      | 80,545    | 78,083    | -           | -         |
| Depreciation of fixed assets          | 847,781   | 1,403,278 | 590,543     | 1,187,093 |
| Other                                 | 69,707    | 17,910    | 44,202      | -         |
| -----                                 |           |           |             |           |
| Total deferred tax liabilities        | 998,033   | 1,753,481 | 634,745     | 1,441,303 |
| -----                                 |           |           |             |           |
| Net deferred tax liabilities          | (398,305) | (779,234) | (89,708)    | (507,077) |
| =====                                 |           |           |             |           |

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### 17 INVENTORIES

|                           | THE GROUP |         | THE COMPANY |         |
|---------------------------|-----------|---------|-------------|---------|
|                           | 2003      | 2002    | 2003        | 2002    |
|                           | RMB'000   | RMB'000 | RMB'000     | RMB'000 |
| -----                     |           |         |             |         |
| Expendable spare parts    |           |         |             |         |
| and maintenance materials | 486,290   | 489,554 | 182,742     | 106,300 |
| Other supplies            | 57,487    | 56,146  | 30,477      | 11,700  |
| -----                     |           |         |             |         |
|                           | 543,777   | 545,700 | 213,219     | 118,000 |
| =====                     |           |         |             |         |

No significant amount of inventories was carried at net realisable value at 31 December, 2002 and 2003.

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### 18 TRADE RECEIVABLES

Credit terms granted by the Group to sales agents and other customers generally range from one to three months. An ageing analysis of trade receivables, net of impairment losses, is set out below:

|   | THE GROUP       |                 | THE COMPANY     |                 |
|---|-----------------|-----------------|-----------------|-----------------|
|   | 2003<br>RMB'000 | 2002<br>RMB'000 | 2003<br>RMB'000 | 2002<br>RMB'000 |
| -----   |                 |                 |                 |                 |
| Within 1 month                                | 589,080         | 576,789         | 445,980         | 394,744         |
| More than 1 month but less than<br>3 months   | 235,828         | 88,133          | 228,530         | 62,536          |
| More than 3 months but less than<br>12 months | 8,696           | 6,854           | 8,696           | 7,650           |
| -----   |                 |                 |                 |                 |
|   | 833,604         | 671,776         | 683,206         | 464,930         |
| =====   |                 |                 |                 |                 |

As at 31 December, 2003, the Group and the Company had an amount due from a fellow subsidiary of RMB54,161,000 (2002: RMB89,550,000) which was included in trade receivables.

All of the trade receivables are expected to be recovered within one year.

### 19 AMOUNTS DUE TO RELATED COMPANIES

Amounts due to related companies, which represent balances with CSAHC and its affiliates, and the Group's associated companies and jointly controlled entities, are unsecured, interest free and repayable within one year. The balance at 31 December, 2002 also included balances with the CAAC and its affiliates.

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### 20 CASH AND CASH EQUIVALENTS

Cash and cash equivalents comprise cash at bank and in hand and deposits with Southern Airlines Group Finance Company Limited ("SA Finance"), a PRC authorised financial institution controlled by CSAHC and an associated company of the Group. In accordance with the financial agreement dated 22 May, 1997 between the Company and SA Finance, all the Group's deposits accepted by SA Finance at 31 December, 2003 were simultaneously placed with several designated major PRC banks by SA Finance. As at 31 December, 2003, the Group's and the Company's deposits with SA Finance amounted to RMB365,906,000 and RMB346,357,000 respectively (2002: RMB 900,979,000 and RMB877,449,000 respectively).

### 21 BANK AND OTHER LOANS

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|   | THE GROUP       |                 | 2002<br>RMB'000 | 2003<br>RMB'000 |
|---|-----------------|-----------------|-----------------|-----------------|
|   | 2002<br>RMB'000 | 2003<br>RMB'000 |                 |                 |
| Bank loans due:                           |                 |                 |                 |                 |
| Within one year                           | 5,240,726       | 7,096,846       | 5,958,401       |                 |
| In the second year                        | 839,036         | 646,492         | 401,826         |                 |
| In the third to fifth year, inclusive     | 3,730,849       | 1,223,710       | 826,442         |                 |
| After the fifth year                      | 1,262,549       | 2,648,533       | 2,442,629       |                 |
|   | 11,073,160      | 11,615,581      | 9,629,670       |                 |
| Other loans due:                          |                 |                 |                 |                 |
| In the second year                        | 3,000           | 3,000           |                 |                 |
|   | 11,076,160      | 11,618,581      | 9,629,670       |                 |
| Portion classified as current liabilities | (5,240,726)     | (7,096,846)     | (5,958,401)     |                 |
|   | 5,835,434       | 4,521,735       | 3,670,269       |                 |

As at 31 December, 2003, bank loans of the Group and the Company totalling RMB4,902,118,000 and RMB3,822,826,000 respectively (2002: RMB 4,117,778,000 and RMB2,783,418,000 respectively) were secured by mortgages over certain of the Group's and the Company's aircraft.

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21 BANK AND OTHER LOANS (cont'd)

As at 31 December, 2003, certain bank loans were guaranteed by the following parties:

|   | THE GROUP       |                 | THE COMP        |
|---|-----------------|-----------------|-----------------|
|   | 2003<br>RMB'000 | 2002<br>RMB'000 | 2003<br>RMB'000 |
| Export-Import Bank of the United States                     | 2,207,393       | 2,680,801       | 1,236,160       |
| Bank of China   | 357,193         | 604,010         | 262,231         |
| China Construction Bank                                     | -               | 76,134          | -               |
| CSAHC   | 359,300         | 3,340,118       | 228,800         |
| Guangzhou Baiyun International<br>Airport Company Limited   | 63,000          | -               | -               |
| Shenzhen Yingshun Investment<br>Development Company Limited | 21,000          | -               | -               |
| SA Finance  | 10,052          | 561,531         | -               |

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3,017,938

7,262,594

1,727,191

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21 BANK AND OTHER LOANS (cont'd)

Details of bank and other loans with original maturity over one year are as follows:

|   |   | THE GROUP       |                 |
|---|---|-----------------|-----------------|
| Interest rate and final maturity                                  |   | 2003<br>RMB'000 | 2002<br>RMB'000 |
| RMB denominated loans:  |   |                 |                 |
| Loans for construction projects                                   | Floating interest rates ranging from 4.94% to 5.25% per annum as at 31 December, 2003, with maturities through 2009 | 12,357          | 893,800         |
|   | Non-interest bearing loan from a municipal government authority, repayable in 2005                                  | 3,000           | 3,000           |
| Loans for purchase of aircraft                                    | Floating interest rate of 5.49% per annum as at 31 December, 2003, with maturities through 2004                     | 63,500          | 2,310,200       |
| U.S. dollar denominated loans:                                    |   |                 |                 |
| Loans for purchase of aircraft                                    | Fixed interest rates ranging from 5.00% to 8.33% per annum as at 31 December, 2003, with maturities through 2011    | 2,612,687       | 3,426,000       |
|   | Floating interest rates ranging from 1.48% to 1.50% per annum as at 31 December, 2003, with maturities through 2013 | 2,505,134       |                 |
| Loan for purchase of flight equipment                             | Fixed interest rate of 8.35% per annum as at 31 December, 2003, with maturity in 2004                               | 13,097          | 20,000          |
|   |   | 5,209,775       | 6,653,200       |
| Less: Loans due within one year classified as current liabilities |   | (688,040)       | (817,800)       |
|   |   | 4,521,735       | 5,835,400       |

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21 BANK AND OTHER LOANS (cont'd)

As at 31 December, 2003, bank and other loans of the Group and the Company included short-term bank loans totalling RMB6,408,806,000 and RMB5,577,841,000 respectively (2002: RMB4,422,926,000 and RMB 2,914,158,000 respectively). On such date, the Group's and the Company's weighted average interest rate on short-term borrowings were 1.76% and 1.65% respectively (2002: 3.11% and 2.66% respectively).

As at 31 December, 2003, the Group had banking facilities with several PRC commercial banks for providing loan finance up to an approximate amount of RMB9,860 million (2002: RMB12,360 million). As at 31 December, 2003, an approximate amount of RMB4,412 million (2002: RMB7,258 million) was utilised.

22 OBLIGATIONS UNDER FINANCE LEASES

The Group and the Company have commitments under finance lease agreements in respect of aircraft and related equipment expiring during the years 2004 to 2009. As at 31 December, 2003, future payments under these finance leases, which were 74% and 26% respectively (2002: 78% and 22% respectively) denominated in United States dollars and Japanese yen, are as follows:

|                                       | PAYMENTS  | 2003<br>INTEREST | OBLIGATIONS | Pay |
|---------------------------------------|-----------|------------------|-------------|-----|
|                                       | RMB'000   | RMB'000          | RMB'000     | RM  |
| -----                                 |           |                  |             |     |
| THE GROUP AND THE COMPANY             |           |                  |             |     |
| Balance due:                          |           |                  |             |     |
| Within one year                       | 1,648,141 | 350,286          | 1,297,855   | 2,0 |
| In the second year                    | 1,356,614 | 290,163          | 1,066,451   | 1,6 |
| In the third to fifth year, inclusive | 4,348,235 | 439,418          | 3,908,817   | 4,1 |
| After the fifth year                  | 608,124   | 40,308           | 567,816     | 1,9 |
|                                       | 7,961,114 | 1,120,175        | 6,840,939   | 9,7 |
| -----                                 |           |                  |             |     |
| Less: Balance due within              |           |                  |             |     |
| one year classified as                |           |                  |             |     |
| current liabilities                   |           |                  | (1,297,855) |     |
|                                       |           |                  | 5,543,084   |     |
| =====                                 |           |                  |             |     |

Certain lease financing arrangements comprised finance leases between the Company and certain of its subsidiaries, and corresponding borrowings

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between such subsidiaries and banks. The Company has guaranteed the subsidiaries' obligations under the bank borrowings and accordingly, the relevant leased assets and obligations are recorded in the balance sheet to reflect the substance of the transactions. The future payments under these leases have therefore been presented by the Company and the Group in amounts that reflect the payments under the bank borrowings between the subsidiaries and banks.

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### 22 OBLIGATIONS UNDER FINANCE LEASES (cont'd)

Under the terms of the leases, the Group has an option to purchase, at or near the end of the lease term, certain aircraft at fair market value and others at either fair market value or a percentage of the respective lessor's defined cost of the aircraft.

Security, including charges over the assets concerned and relevant insurance policies, is provided to the lessors.

As at 31 December, 2003, certain of the Group's and the Company's aircraft with carrying amount of RMB7,857,169,000 (2002: RMB8,960,483,000) were mortgaged to secure facilities with financial institutions granted to lessors totalling RMB6,840,939,000 (2002: RMB8,198,449,000).

### 23 ACCOUNTS PAYABLE

An ageing analysis of accounts payable is set out below:

|  | THE GROUP |         | THE COMPANY |         |
|--|-----------|---------|-------------|---------|
|  | 2003      | 2002    | 2003        | 2002    |
|  | RMB'000   | RMB'000 | RMB'000     | RMB'000 |
| Due within 1 month or on demand        | 279,165   | 164,442 | 206,620     | 88,640  |
| Due after 1 month but within 3 months  | 278,113   | 157,731 | 231,115     | 89,290  |
| Due after 3 months but within 6 months | 370,815   | 210,307 | 308,153     | 119,050 |
|  | 928,093   | 532,480 | 745,888     | 296,980 |

As at 31 December, 2003, the Group and the Company had an amount due to a fellow subsidiary of RMB693,345,000 (2002: RMB267,468,000) which was included in accounts payable.

All of the accounts payable are expected to be settled within one year.

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### 24 PROVISION FOR MAJOR OVERHAULS

Details of provision for major overhauls in respect of aircraft held under operating leases are as follows:

|   | The Group       |                 | The Company     |                 |
|---|-----------------|-----------------|-----------------|-----------------|
|   | 2003<br>RMB'000 | 2002<br>RMB'000 | 2003<br>RMB'000 | 2002<br>RMB'000 |
| Balance at 1 January,                                 | 193,887         | 187,125         | 63,389          | 48,389          |
| Additional amount provided                            | 68,620          | 49,051          | 67,603          | 33,603          |
| Amount utilised                                       | (62,326)        | (42,289)        | -               | (18,289)        |
| Balance at 31 December,                               | 200,181         | 193,887         | 130,992         | 63,693          |
| Less: Current portion included in<br>accrued expenses | 10,717          | 52,000          | -               | -               |
|   | 189,464         | 141,887         | 130,992         | 63,693          |

### 25 SHARE CAPITAL

|  | 2003<br>RMB'000 | 2002<br>RMB'000 |
|--|-----------------|-----------------|
| Registered capital:                            |                 |                 |
| 2,200,000,000 domestic shares of RMB 1.00 each | 2,200,000       | 2,200,000       |
| 1,174,178,000 H shares of RMB 1.00 each        | 1,174,178       | 1,174,178       |
| 1,000,000,000 A shares of RMB 1.00 each        | 1,000,000       | -               |
|  | 4,374,178       | 3,374,178       |
| Issued and paid up capital:                    |                 |                 |
| 2,200,000,000 domestic shares of RMB 1.00 each | 2,200,000       | 2,200,000       |
| 1,174,178,000 H shares of RMB 1.00 each        | 1,174,178       | 1,174,178       |
| 1,000,000,000 A shares of RMB 1.00 each        | 1,000,000       | -               |
|  | 4,374,178       | 3,374,178       |

In July 2003, the Company issued 1,000,000,000 A shares with a par value of RMB1.00 each at issue price of RMB2.70 by way of a public offering to natural persons and institutional investors in the PRC. The share premium received by the Company, net of the issuance costs of RMB59,233,000, amounted to RMB1,640,767,000 and was credited to share premium account.

All the domestic, H and A shares rank pari passu in all material respects.

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26 RESERVES

Movements on reserves during the year comprise:

|   |       | THE GROUP        |                  |
|---|-------|------------------|------------------|
|   | Notes | 2003<br>RMB' 000 | 2002<br>RMB' 000 |
| -----   |       |                  |                  |
| Share premium   |       |                  |                  |
| Balance at 1 January,   |       | 3,683,956        | 3,813,659        |
| Land use rights adjustment  | (f)   | -                | (129,703)        |
| Share premium from issuance of shares,<br>net of related issuance costs |       | 1,640,767        | -                |
| -----   |       |                  |                  |
| Balance at 31 December,   |       | 5,324,723        | 3,683,956        |
| -----   |       |                  |                  |
| Statutory surplus reserve   | (a)   |                  |                  |
| Balance at 1 January,   |       | 337,195          | 391,867          |
| Adjustments from adoption of new PRC<br>accounting regulations          | (c)   | -                | (106,007)        |
| Transfer from profit and loss account                                   |       | 23,856           | 51,335           |
| -----   |       |                  |                  |
| Balance at 31 December,   |       | 361,051          | 337,195          |
| -----   |       |                  |                  |
| Statutory public welfare fund   | (b)   |                  |                  |
| Balance at 1 January,   |       | 171,574          | 225,440          |
| Adjustments from adoption of new PRC<br>accounting regulations          | (c)   | -                | (79,533)         |
| Transfer from profit and loss account                                   |       | 1,113            | 25,667           |
| -----   |       |                  |                  |
| Balance at 31 December,   |       | 172,687          | 171,574          |
| -----   |       |                  |                  |
| Discretionary surplus reserve   | (d)   |                  |                  |
| Balance at 1 January,   |       | 76,603           | 69,867           |
| Adjustments from adoption of new PRC<br>accounting regulations          | (c)   | -                | -                |
| Transfer from profit and loss account                                   |       | -                | 6,736            |
| -----   |       |                  |                  |
| Balance at 31 December,   |       | 76,603           | 76,603           |
| -----   |       |                  |                  |
| Retained earnings/(Accumulated losses)                                  |       |                  |                  |
| Balance at 1 January,   |       | 1,969,701        | 1,346,652        |
| Adjustments from adoption of new PRC                                    |       |                  |                  |

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|                            |     |           |           |
|----------------------------|-----|-----------|-----------|
| accounting regulations     | (c) | -         | 185,540   |
| Land use rights adjustment | (f) | -         | 12,970    |
| (Loss)/profit for the year |     | (358,267) | 575,761   |
| Appropriations to reserves |     | (24,969)  | (83,738)  |
| Dividends paid             |     | -         | (67,484)  |
|                            |     |           |           |
| Balance at 31 December,    |     | 1,586,465 | 1,969,701 |
|                            |     |           |           |
| Total                      |     | 7,521,529 | 6,239,029 |
|                            |     |           |           |

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### 26 RESERVES (cont'd)

#### Notes:

- (a) According to the PRC Company Law and the Articles of Association of the Company and certain of its subsidiaries, the Company and the relevant subsidiaries are required to transfer 10% of their annual net profits after taxation, as determined under relevant PRC accounting regulations, to a statutory surplus reserve until the reserve balance reaches 50% of the registered capital. The transfer to this reserve must be made before distribution of a dividend to shareholders.

Statutory surplus reserve can be used to offset prior years' losses, if any, and may be converted into share capital by the issue of new shares to shareholders in proportion to their existing shareholding or by increasing the par value of the shares currently held by them, provided that the balance after such issue is not less than 25% of the registered capital.

- (b) According to the PRC Company Law and the Articles of Association of the Company and certain of its subsidiaries, the Company and the relevant subsidiaries are required to transfer between 5% to 10% of their annual net profits after taxation, as determined under PRC accounting regulations, to the statutory public welfare fund. This fund can only be utilised on capital items for the collective benefits of the Company's and the relevant subsidiaries' employees such as the construction of dormitories, canteen and other staff welfare facilities. This fund is non-distributable other than in liquidation. The transfer to this reserve must be made before distribution of a dividend to shareholders.
- (c) During 2002, the Group and the Company adopted certain new PRC accounting regulations which resulted in adjustments to the amounts of the Group's and Company's profits determined under PRC accounting regulations in respect of prior years and corresponding adjustments to amounts appropriated to the statutory surplus reserve, statutory public welfare fund and discretionary surplus reserve for the prior years.

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- (d) The usage of this reserve is similar to that of statutory surplus reserve.
- (e) Under PRC Company Law and the Company's Articles of Association, the net profit after taxation as reported in the PRC statutory financial statements of the Company can only be distributed as dividends after allowances have been made for:
- (i) making up cumulative prior years' losses, if any;
  - (ii) allocations to the statutory surplus reserve of at least 10% of after-tax profit, until the fund aggregates to 50% of the Company's registered capital;
  - (iii) allocations of 5% to 10% of after-tax profit to the Company's statutory public welfare fund; and
  - (iv) allocations to the discretionary surplus reserve, if approved by the shareholders.

Pursuant to the Articles of Association of the Company, the net profit of the Company for the purpose of profit distribution is deemed to be the lesser of (i) the net profit determined in accordance with the PRC accounting principles and financial regulations and (ii) the net profit determined in accordance with IFRS; or if the financial statements of the Company are not prepared in accordance with IFRS, the accounting standards of one of the countries in which its shares are listed. As at 31 December, 2003, the Company did not have any distributable reserves (2002: RMB445,636,000).

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### 26 RESERVES (cont'd)

Notes: (cont'd)

- (f) The Group adopted IAS 40 "Investment Property" in 2002. According to IAS 40, the land use rights which were previously included in fixed assets at revaluation base are now presented as lease prepayments and carried at historical cost base with effect from 1 January, 2002. Accordingly, the unamortised surplus on previous revaluations of the land use rights, net of related deferred tax asset, are reversed to the share premium and retained profits accounts. The IAS 40 was adopted prospectively in 2002 as the effect of this change did not have a material impact on the Group's financial condition and results of operations in the periods prior to the change.

### 27 RELATED PARTY TRANSACTIONS

The Group obtained various operational and financial services provided by CSAHC and its affiliates, and the Group's associated companies and jointly controlled entities during the normal course of its business. In the past, CSAHC was under the direct control of the CAAC. However, such control has been shifted to the State Assets Administration Committee since early 2003. Consequently, transactions with the CAAC and its affiliates are no

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longer presented as related party transactions of the Group.

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27 RELATED PARTY TRANSACTIONS (cont'd)

The following is a summary of significant transactions carried out in the normal course of business between the Group, CSAHC and its affiliates, and the Group's associated companies and jointly controlled entities during the year:

|  | Notes | 2003<br>RMB'000 |
|--|-------|-----------------|
| -----  |       |                 |
| EXPENSES   |       |                 |
| PAID TO CSAHC AND OTHER RELATED PARTIES                      |       |                 |
| Handling charges   | (a)   | 27,051          |
| Wet lease rentals  | (b)   | 35,751          |
| Advertising expenses   | (c)   | -               |
| Sundry aviation supplies                                     | (d)   | 42,849          |
| Commission expense   | (e)   | 4,896           |
| Air catering expense   | (f)   | 28,199          |
| Repairing charges  | (g)   | 693,303         |
| Housing benefits   | (h)   | 85,000          |
| Lease charges for land and buildings                         | (i)   | 15,224          |
| Flight simulation service charges                            | (j)   | 101,355         |
| PAID TO CAAC AND ITS AFFILIATES                              |       |                 |
| Jet fuel supplies  |       | -               |
| Aircraft insurance   |       | -               |
| Guarantee fees   |       | -               |
| Ticket reservation service charges                           |       | -               |
| Passenger departure and cargo handling charges               |       | -               |
| Aircraft and traffic servicing charges                       |       | -               |
| Commission expense   |       | -               |
| INCOME   |       |                 |
| RECEIVED FROM CSAHC AND OTHER RELATED PARTIES                |       |                 |
| Rental income  | (j)   | 34,175          |
| Wet lease rentals  | (k)   | -               |
| Interest income  | (l)   | 3,100           |
| RECEIVED FROM CAAC AND ITS AFFILIATES                        |       |                 |
| Ground services income                                       |       | -               |
| Commission income  |       | -               |
| OTHERS   |       |                 |
| Short term advances from CSAHC                               | (m)   | 165,995         |
| Refund of medical benefit payments                           | (n)   | 58,120          |
| Acquisition of aircraft and related spare parts and vehicles | (o)   | -               |
| Acquisition of subsidiaries                                  | (p)   | -               |
| =====  |       |                 |

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)  
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## 27 RELATED PARTY TRANSACTIONS (cont'd)

## Notes:

- (a) Handling charges represent fees payable to Southern Airlines (Group) Import and Export Trading Company, a wholly owned subsidiary of CSAHC, in connection with the procurement of aircraft and flight equipment on the Group's behalf. Handling charges are calculated based on a fixed percentage of the purchase value and other charges.
- (b) Wet lease rentals represented rentals payable to Xinjiang Airlines Company, a subsidiary of CSAHC, pursuant to a wet lease agreement in respect of a Boeing 757-200 aircraft effective October 2002. The wet lease agreement was terminated in April 2003.
- (c) Advertising expenses represent expense reimbursements to Southern Airlines Advertising Company ("SAAC") for promotional services rendered to the Group. SAAC was a subsidiary of CSAHC up to July 2002. In August 2002, the Company acquired 90% equity interest in SAAC from CSAHC.
- (d) Sundry aviation supplies represent purchases of aviation supplies from Southern Airlines (Group) Economic Development Company, a subsidiary of CSAHC. Prices charged by this supplier to the Group are similar to those charged to other PRC airlines.
- (e) Commission expense represents commissions payable to certain subsidiaries of CSAHC in connection with services provided in exchange for air tickets sold by them. These commissions are calculated based on a fixed rate ranging from 1.5% to 12% on the ticket value.
- (f) Air catering expense represents purchases of inflight meals and related services from Shenzhen Air Catering Company Limited, a cooperative joint venture established in the PRC, in respect of which CSAHC is entitled to 33% of its profits after tax.
- (g) Repairing charges represent fees incurred by the Group in connection with aircraft repair and maintenance services rendered by Guangzhou Aircraft Maintenance Engineering Company Limited ("GAMECO") and MTU Maintenance Zhuhai Co., Ltd. ("MTU Zhuhai"). GAMECO and MTU Zhuhai are jointly controlled entities of the Company.
- (h) Housing benefits represent a fixed annual fee payable to CSAHC in respect of the provision of quarters to the eligible employees of the Group. (Note 28).
- (i) Charges were paid to CSAHC under certain lease agreements in respect of certain land and buildings in the PRC (Note 10).
- (j) Flight simulation service charges represent fees incurred by the Group in connection with flight simulation services provided by Zhuhai Xiang Yi, a jointly controlled entity of the Company.

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In addition, the Company entered into operating lease agreements to lease certain flight training facilities and buildings to Zhuhai Xiang Yi. Rental income earned by the Company amounted to RMB34,175,000 during 2003 (Note 10).

- (k) During the period from August to October 2002, the Company received wet lease rentals totalling RMB27,599,000 from wet leasing of an Airbus 320-200 aircraft to Sichuan Airlines Corporation Limited, an associated company of the Company.
- (l) Interest income represents interest received from deposits placed with SA Finance. The applicable interest rate is determined in accordance with the deposit rate published by the People's Bank of China (see Note 20).

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27 RELATED PARTY TRANSACTIONS (cont'd)

Notes: (cont'd)

- (m) During the year, CSAHC made short term advances to the Group. These advances are unsecured, interest free and repayable on demand. As at 31 December, 2003, the advances amounted to RMB165,995,000.
- (n) Prior to 1 January, 2002, the Group paid a fixed annual fee to CSAHC in return for CSAHC providing medical benefit, transportation subsidies and other welfare facilities to the retirees of the Group. Such arrangement was terminated on 1 January, 2002. During 2003, CSAHC refunded to the Group the difference between the aggregate fixed annual fees received from the Group and the aggregate cost of services incurred by CSAHC under the above arrangement.
- (o) During 2002, the Group acquired five Boeing 737-300/37K aircraft and related spare parts and certain vehicles from Zhongyuan Airlines, a subsidiary of CSAHC, at a consideration of approximately RMB1,096,866,000. The consideration was satisfied by cash of approximately RMB132,130,000 together with an assumption by the Group of Zhongyuan Airlines' debts of approximately RMB964,736,000. In addition, the Group received reimbursements of wet lease rentals totalling RMB150,000,000.
- (p) In August 2002, the Company acquired 90% equity interest in each of Guangzhou Aviation Hotel, Southern Airlines Advertising Company and South China International Aviation & Travel Services Company from CSAHC at an aggregate cash consideration of approximately RMB107,846,000. Such consideration is determined by reference to the valuation reports prepared by Guangzhou Zhongtian Valuation Company Limited, a firm of independent valuers registered in the PRC.

In addition to the above, certain business undertakings of CSAHC also provided hotel and other services to the Group during the year. The total amount involved is not material to the results of the Group for the year.

The directors of the Company are of the opinion that the above

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transactions with related parties were entered into in the normal course of business and on normal commercial terms or in accordance with the agreements governing such transactions.

### 28 RETIREMENT AND HOUSING BENEFITS

Employees of the Group participate in several defined contribution retirement schemes organised separately by PRC municipal governments in regions where the major operations of the Group are located. The Group is required to contribute to these schemes at the rates ranging from 14% to 19% (2002: 14% to 19%) of salary costs including certain allowances. A member of the retirement schemes is entitled to pension benefits equal to a fixed proportion of the salary at the retirement date. The retirement benefit obligations of all existing and future retired staff of the Group are assumed by these schemes.

In addition, the Group was selected as one of the pilot enterprises to establish a supplementary defined contribution retirement scheme for the benefit of employees. In this connection, employees of the Group participate in a supplementary defined contribution retirement scheme whereby the Group is required to make defined contributions at a rate of 4.5% of total salaries. The Group has no obligation for the payment of pension benefits beyond the contributions described above. Contributions to the retirement schemes are charged to the profit and loss account as and when incurred.

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### 28 RETIREMENT AND HOUSING BENEFITS (cont'd)

Furthermore, pursuant to the comprehensive services agreement (the "Services Agreement") dated 22 May, 1997 between the Company and CSAHC, CSAHC agrees to provide adequate quarters to eligible employees of the Group as and when required. In return, the Group agrees to pay a fixed annual fee of RMB85,000,000 to CSAHC for a ten-year period effective 1 January, 1995.

During 2002, the Group provided additional quarters at its own expense to certain employees who are not eligible for quarters pursuant to the Services Agreement. These quarters were provided to the respective employees in accordance with the relevant PRC housing reform policy. The excess of the cost of these additional quarters over the considerations received by the Group from the employees of RMB17,624,000 were charged to expenses in 2002.

Pursuant to an additional staff housing benefit scheme effective September 2002, the Group agreed to pay lump sum housing allowances to certain employees who have not received quarters from CSAHC or the Group according to the relevant PRC housing reform policy, for subsidising their purchases of housing. Such expenditure has been deferred and amortised on a straight line basis over a period of 10 years, which represents the vesting benefit period of the employees. An employee who quits prior to the end of the vesting benefit period is required to pay back a portion of the lump sum housing benefits determined on a pro-rata basis of the vesting benefit period remained. The Group has the right to effect a charge on the employee's house and to enforce repayment through selling the house in the



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event of default in repayment. Any shortfall in repayment would be charged against profit and loss account. As at 31 December, 2003, the Group already made payments totalling RMB130,479,000 (2002: RMB46,325,000) under the scheme and recorded its remaining contractual liabilities totalling RMB129,521,000 (2002: RMB213,675,000) as accrued liabilities on its balance sheet.

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### 29 COMMITMENTS

#### (a) CAPITAL COMMITMENTS

As at 31 December, 2003, the Group and the Company had capital commitments as follows:

|  | THE GROUP       |                 | THE COMPANY     |    |
|--|-----------------|-----------------|-----------------|----|
|  | 2003<br>RMB'000 | 2002<br>RMB'000 | 2003<br>RMB'000 | R  |
| -----  |                 |                 |                 |    |
| Commitments in respect of aircraft and related equipment (Note)    |                 |                 |                 |    |
| - authorised and contracted for                                    | 10,615,079      | 5,875,996       | 7,739,290       | 5, |
| -----  |                 |                 |                 |    |
| Commitments in respect of investments in the Guangzhou new airport |                 |                 |                 |    |
| - authorised and contracted for                                    | 617,277         | 525,700         | 617,277         |    |
| - authorised but not contracted for                                | 1,454,661       | 2,601,720       | 1,454,661       | 2, |
| -----  |                 |                 |                 |    |
|  | 2,071,938       | 3,127,420       | 2,071,938       | 3, |
| -----  |                 |                 |                 |    |
| Other commitments  |                 |                 |                 |    |
| - authorised and contracted for                                    | 232,570         | 43,887          | 29,628          |    |
| - authorised but not contracted for                                | 708,099         | 500,545         | 229,302         |    |
| -----  |                 |                 |                 |    |
|  | 940,669         | 544,432         | 258,930         |    |
| -----  |                 |                 |                 |    |
|  | 13,627,686      | 9,547,848       | 10,070,158      | 9, |
| =====  |                 |                 |                 |    |

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29 COMMITMENTS (cont'd)

(a) CAPITAL COMMITMENTS (CONT'D)

Note: As at 31 December, 2003, the Group had on order 2 Boeing 757-200 aircraft, 13 Boeing 737-700 aircraft, 4 Airbus 330-200 aircraft, 6 Embraer ERJ-145 aircraft and certain flight equipment, scheduled for deliveries in 2004 to 2005. Deposits of RMB2,494,853,000 have been made towards the purchase of these aircraft and related equipment. At 31 December, 2003, the approximate total future payments, including estimated amounts for price escalation through anticipated delivery dates for these aircraft and related equipment are as follows:

|                          | THE GROUP       |                 | THE COMPANY     |                 |
|--------------------------|-----------------|-----------------|-----------------|-----------------|
|                          | 2003<br>RMB'000 | 2002<br>RMB'000 | 2003<br>RMB'000 | 2002<br>RMB'000 |
| Year ending 31 December, |                 |                 |                 |                 |
| 2003                     | -               | 2,801,451       | -               | 2,801,451       |
| 2004                     | 4,584,823       | 2,343,978       | 3,248,674       | 2,343,978       |
| 2005                     | 6,030,256       | 730,567         | 4,490,616       | 730,567         |
|                          | 10,615,079      | 5,875,996       | 7,739,290       | 5,875,996       |

The Group has taken steps towards the purchase of the airline business of China Northern Airlines Company and Xinjiang Airlines Company. No contractual obligations existed as at 31 December, 2003 and up to the date of approval of these financial statements. The purchase price has not yet been determined.

As at 31 December, 2003, the Group's and the Company's attributable share of the capital commitments of jointly controlled entities was as follows:

|                                   | THE GROUP AND THE COMPANY |                 |
|-----------------------------------|---------------------------|-----------------|
|                                   | 2003<br>RMB'000           | 2002<br>RMB'000 |
| Authorised and contracted for     | 24,137                    | 63,723          |
| Authorised but not contracted for | 283,761                   | 518,000         |
|                                   | 307,898                   | 581,723         |

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)  
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## 29 COMMITMENTS (cont'd)

## (b) OPERATING LEASE COMMITMENTS

As at 31 December, 2003, commitments under non-cancellable aircraft and flight equipment operating leases were as follows:

|   | THE GROUP       |                 | THE COMPANY     |                 |
|---|-----------------|-----------------|-----------------|-----------------|
|   | 2003<br>RMB'000 | 2002<br>RMB'000 | 2003<br>RMB'000 | 2002<br>RMB'000 |
| Payments due                              |                 |                 |                 |                 |
| Within one year                           | 1,482,888       | 1,280,060       | 1,193,892       | 1,050,000       |
| In the second to fifth year,<br>inclusive | 4,248,095       | 4,358,474       | 3,578,618       | 3,750,000       |
| After the fifth year                      | 2,388,874       | 2,898,104       | 2,278,463       | 2,850,000       |
|   | 8,119,857       | 8,536,638       | 7,050,973       | 7,650,000       |

## (c) INVESTING COMMITMENTS

As at 31 December, 2003, the Company was committed to make a capital contribution of approximately RMB446 million and RMB Nil respectively (2002: RMB60 million and RMB201 million respectively) to its jointly controlled entities and associated companies.

## 30 CONTINGENT LIABILITIES

- (a) The Company has been advised by its PRC lawyers that, except for liabilities constituting or arising out of or relating to the businesses assumed by the Company in the Reorganisation, no other liabilities were assumed by the Company, and the Company is not jointly and severally liable for other debts and obligations incurred by CSAHC prior to the Reorganisation. There are not, however, any definitive PRC regulations or other pronouncements confirming such conclusion.
- (b) The Group leases from CSAHC certain land in Guangzhou and certain land and buildings in Wuhan, Haikou and Zhengzhou. The Group has a significant investment in buildings and other leasehold improvements located on such land. However, such land in Guangzhou and such land and buildings in Wuhan, Haikou and Zhengzhou lack adequate documentation evidencing CSAHC's rights thereto.

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NOTES TO THE FINANCIAL STATEMENTS (Cont'd)  
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### 30 CONTINGENT LIABILITIES (cont'd)

With respect to the facilities in Guangzhou, CSAHC has received written assurance from the CAAC to the effect that CSAHC is entitled to continued use and occupancy of the land in Guangzhou. The Company understands that the CAAC is basing its conclusion on an agreement among certain government authorities relating to such land. Such assurance does not constitute formal evidence of CSAHC's right to transfer, mortgage or lease such real property interests. The Group cannot predict the magnitude of the effect on its financial condition or results of operations to the extent that its use of one or more of these parcels of land or the related facilities were successfully challenged. CSAHC has agreed to indemnify the Group against any loss or damage caused by any challenge or interference with the Group's use of any of its land and buildings.

- (c) The Company is currently involved in a civil litigation (Hong Kong High Court Action No. 515 of 2001) ("Litigation"). According to the writ of summons for the Litigation, New Link Consultants Limited, the plaintiff, claimed against the Group (as one of the defendants to the Litigation) on the basis of certain evidence proving that United Aero-Supplies System of China, Limited ("UASSC") entered into an agreement with the defendants for exclusive purchase of aviation equipment consigned to UASSC for sale and, that as the defendants failed to perform the agreement, UASSC has the right to compensation. Since UASSC is in the course of its winding up proceedings, all the rights and benefits of UASSC in connection with the claim have been transferred to the plaintiff. The Company, as one of the defendants to the Litigation, has been claimed for unspecified damages for breach of the agreement. Given that the Litigation is still at its preliminary stage, it is pre-matured to predict the result of the court judgment. Based on the opinion given by its instructing solicitors, the Company's directors consider that the Company has a reasonable chance of success in its defence to the claim. At present, the Company has filed an objection in respect of the jurisdiction of the court, and has requested the court to transfer the case of Mainland China for trial. Accordingly, the Company's directors consider that a provision for such claim and/or the associated legal costs is not required.

### 31 FAIR VALUE OF FINANCIAL INSTRUMENTS AND CONCENTRATION OF RISK

Financial assets of the Group include cash and cash equivalents, investments, trade receivables and other receivables. Financial liabilities of the Group include bank and other loans, amounts due to related companies, other liabilities, accounts payable, bills payable, sales in advance of carriage, accrual expenses and obligations under finance leases.

#### LIQUIDITY RISK

As at 31 December, 2003, the Group's net current liabilities amounted to RMB10,792 million (2002: RMB7,016 million). For the year ended 31 December, 2003, the Group recorded a net cash inflow from operating activities of RMB2,129 million (2002: RMB3,698 million), a net cash outflow from investing activities and financing activities of RMB3,820 million (2002: RMB2,745 million) and a decrease in cash and cash

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equivalents of RMB1,691 million (2002: increase of RMB953 million).

With regard to 2004 and thereafter, the liquidity of the Group is primarily dependent on its ability to maintain adequate cash inflow from operations to meet its debt obligations as they fall due, and on its ability to obtain adequate external finance to meet its committed future capital expenditures. With regard to its short-term bank loans outstanding at 31 December, 2003, the Group has obtained firm commitments from its principal bankers to renew the relevant loans as they fall due during 2004. With regard to its future capital commitments and other financing requirements, the Group has already entered into loan financing agreements with several PRC banks to provide loan finance up to an approximate amount of RMB8,450 million during 2004 and thereafter. The directors of the Company believe that such financing will be available to the Group.

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31 FAIR VALUE OF FINANCIAL INSTRUMENTS AND CONCENTRATION OF RISK (cont'd)

LIQUIDITY RISK (cont'd)

The directors of the Company have carried out a detailed review of the cash flow forecast of the Group for the twelve months ending 31 December, 2004. Based on such forecast, the directors have determined that adequate liquidity exists to finance the working capital and capital expenditure requirements of the Group during that period. In preparing the cash flow forecast, the directors have considered historical cash requirements of the Group as well as other key factors, including the availability of the above-mentioned loan finance which may impact the operations of the Group during the next twelve-month period. The directors are of the opinion that the assumptions and sensitivities which are included in the cash flow forecast are reasonable. However, as with all assumptions in regard to future events, these are subject to inherent limitations and uncertainties and some or all of these assumptions may not be realised.

BUSINESS RISK

The Group conducts its principal operations in the PRC and accordingly is subject to special considerations and significant risks not typically associated with investments in equity securities of the United States of America and Western European companies. These include risks associated with, among others, the political, economic and legal environment, influence of the CAAC over many aspects of its operations, and competition, in the passenger, cargo and mail airlines services industry.

INTEREST RATE RISK

The interest rates and maturity information of the Group's bank and other loans, and the maturity information of the Group's finance lease obligations are disclosed in Notes 21 and 22 respectively.

FOREIGN CURRENCY RISK

The Group has significant exposure to foreign currency as substantially all of the Group's lease obligations and bank loans are denominated in foreign currencies, principally US dollars, and to a lesser extent,

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Japanese Yen. Depreciation or appreciation of the Renminbi against foreign currencies affects the Group's results significantly because the Group's foreign currency payments generally exceed its foreign currency receipts. The Group is not able to hedge its foreign currency exposure effectively other than by retaining its foreign currency denominated earnings and receipts to the extent permitted by the State Administration of Foreign Exchange, or subject to certain restrictive conditions, entering into forward foreign exchange contracts with authorised PRC banks.

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31 FAIR VALUE OF FINANCIAL INSTRUMENTS AND CONCENTRATION OF RISK (cont'd)

CREDIT RISKS

Substantially all of the Group's cash and cash equivalents are deposited with PRC financial institutions.

A significant portion of the Group's air tickets are sold by agents participating in the Billing and Settlement Plan ("BSP"), a clearing scheme between airlines and sales agents organised by International Air Transportation Association. As of 31 December, 2003, the balance due from BSP agents amounted to RMB446,399,000 (2002: RMB353,246,000).

SELF INSURANCE RISK

The Group maintains a limited amount of property insurance in respect of certain personal and real property.

FAIR VALUE

The carrying amounts and estimated fair values of significant financial assets and liabilities at 31 December, 2002 and 2003 are set out below:

|   | 2003                          |                          |                               |
|---|-------------------------------|--------------------------|-------------------------------|
|   | CARRYING<br>AMOUNT<br>RMB'000 | FAIR<br>VALUE<br>RMB'000 | Carrying<br>amount<br>RMB'000 |
| -----                                     |                               |                          |                               |
| THE GROUP                                 |                               |                          |                               |
| Cash and cash equivalents                 | 2,080,174                     | 2,080,174                | 3,771,043                     |
| Trade receivables                         | 833,604                       | 833,604                  | 671,776                       |
| Other receivables                         | 296,047                       | 296,047                  | 372,586                       |
| Bank and other loans, current portion     | 7,096,846                     | 7,164,216                | 5,240,726                     |
| Amounts due to related companies          | 929,003                       | 929,003                  | 525,090                       |
| Other liabilities                         | 1,019,811                     | 1,019,811                | 646,989                       |
| Accounts payable                          | 928,093                       | 928,093                  | 532,480                       |
| Bills payable                             | 438,135                       | 438,135                  | 1,299,680                     |
| Sales in advance of carriage              | 466,087                       | 466,087                  | 390,531                       |
| Accrued expenses                          | 2,527,794                     | 2,527,794                | 2,341,454                     |
| Bank and other loans, non-current portion | 4,521,735                     | 4,743,128                | 5,835,434                     |
| -----                                     |                               |                          |                               |

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)  
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## 31 FAIR VALUE OF FINANCIAL INSTRUMENTS AND CONCENTRATION OF RISK (cont'd)

FAIR VALUE (cont'd)

|   | 2003                          |                          |                               |
|---|-------------------------------|--------------------------|-------------------------------|
|   | CARRYING<br>AMOUNT<br>RMB'000 | FAIR<br>VALUE<br>RMB'000 | Carrying<br>amount<br>RMB'000 |
| -----                                     |                               |                          |                               |
| THE COMPANY                               |                               |                          |                               |
| Cash and cash equivalents                 | 1,404,874                     | 1,404,874                | 2,960,337                     |
| Trade receivables                         | 683,206                       | 683,206                  | 464,930                       |
| Other receivables                         | 222,438                       | 222,438                  | 239,601                       |
| Bank and other loans, current portion     | 5,958,968                     | 6,010,222                | 3,479,322                     |
| Amounts due to related companies          | 870,682                       | 870,682                  | 358,077                       |
| Other liabilities                         | 854,057                       | 854,057                  | 411,218                       |
| Accounts payable                          | 745,888                       | 745,888                  | 296,989                       |
| Bills payable                             | 438,135                       | 438,135                  | 1,299,680                     |
| Sales in advance of carriage              | 405,851                       | 405,851                  | 340,457                       |
| Accrued expenses                          | 1,628,072                     | 1,628,072                | 1,049,806                     |
| Bank and other loans, non-current portion | 3,670,499                     | 3,827,220                | 4,628,372                     |
| -----                                     |                               |                          |                               |

The following methods and assumptions were used to estimate the fair value for each class of financial instrument:

- (i) Cash and cash equivalents, trade receivables, other receivables, amounts due to related companies, other liabilities, accounts payable, bills payable, sales in advance of carriage and accrued expenses

The carrying values approximate fair value because of the short maturities of these instruments.

- (ii) Bank and other loans

The fair value has been estimated by applying a discounted cash flow approach using interest rates available to the Group for similar indebtedness.

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)  
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## 31 FAIR VALUE OF FINANCIAL INSTRUMENTS AND CONCENTRATION OF RISK (cont'd)

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The economic characteristics of the Group's leases vary from lease to lease. It is impractical to compare such leases with those prevailing in the market within the constraints of timeliness and cost for the purpose of estimating the fair value of such leases. Other investments represent unquoted available-for-sale equity securities of companies established in the PRC. There is no quoted market price for such equity securities and accordingly a reasonable estimate of the fair value could not be made without incurring excessive costs.

Fair value estimates are made at a specific point in time and are based on relevant market information about the financial instruments. These estimates are subjective in nature and involve uncertainties and matters of significant judgement and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

### 32 SEGMENTAL INFORMATION

Geographic information about the Group's turnover and operating profit/(loss) are as follows:

|   | DOMESTIC<br>RMB'000                         | HONG KONG<br>REGIONAL<br>RMB'000            | *INTERNATIONAL<br>RMB'000                   |
|---|---|---|---|
| <hr style="border-top: 1px dashed black;"/> |   |   |   |
| 2003  |   |   |   |
| Traffic revenue                             | 13,086,939                                  | 807,677                                     | 3,070,184                                   |
| Other revenue                               | 436,122                                     | -   | 69,201                                      |
|   | <hr style="border-top: 1px dashed black;"/> | <hr style="border-top: 1px dashed black;"/> | <hr style="border-top: 1px dashed black;"/> |
|   | 13,523,061                                  | 807,677                                     | 3,139,385                                   |
|   | <hr style="border-top: 3px double black;"/> |   |   |
| Operating profit/(loss)                     | 440,158                                     | (29,210)                                    | 44,781                                      |
| <hr style="border-top: 3px double black;"/> |   |   |   |
| 2002  |   |   |   |
| Traffic revenue                             | 13,197,589                                  | 1,118,695                                   | 3,165,608                                   |
| Other revenue                               | 485,046                                     | -   | 51,682                                      |
|   | <hr style="border-top: 1px dashed black;"/> | <hr style="border-top: 1px dashed black;"/> | <hr style="border-top: 1px dashed black;"/> |
|   | 13,682,635                                  | 1,118,695                                   | 3,217,290                                   |
|   | <hr style="border-top: 3px double black;"/> |   |   |
| Operating profit                            | 1,614,975                                   | 193,440                                     | 217,662                                     |
| <hr style="border-top: 3px double black;"/> |   |   |   |

\* Mainly routes between the PRC and Asian countries, the United States of America, the Netherlands, Belgium and Australia.

The major revenue-earning assets of the Group are its aircraft fleet, most of which are registered in the PRC. Since the Group's aircraft fleet is employed flexibly across its route network, there is no suitable basis of allocating such assets to geographic segments. Substantially all of the Group's non-aircraft identifiable assets are located in the PRC.



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## 33 RECONCILIATION AND SUPPLEMENTARY STATEMENT OF CASH FLOW INFORMATION

(a) THE RECONCILIATION OF (LOSS)/PROFIT BEFORE TAXATION AND MINORITY INTERESTS TO CASH INFLOWS FROM OPERATIONS IS AS FOLLOWS:

|  | 2003<br>RMB'000 | 2002<br>RMB'000 |
|--|-----------------|-----------------|
| (Loss)/profit before taxation and minority interests     | (511,610)       | 1,133,210       |
| Depreciation and amortisation of fixed assets            | 1,997,882       | 1,833,210       |
| Other amortisation                                       | 40,089          |                 |
| Amortisation of deferred credits                         | (1,541)         |                 |
| Share of associated companies' results                   | (47,798)        | (3,210)         |
| Share of jointly controlled entities' results            | 39,495          |                 |
| Loss/(gain) on sale of fixed assets                      | 22,217          | (17,210)        |
| Interest income  | (13,061)        | (5,210)         |
| Interest expense   | 823,725         | 95,210          |
| Unrealised exchange loss, net                            | 177,356         | 17,210          |
| Decrease/(increase) in inventories                       | 1,923           | (7,210)         |
| Increase in trade receivables                            | (161,828)       | (11,210)        |
| Decrease/(increase) in other receivables                 | 76,539          | (16,210)        |
| (Increase)/decrease in prepaid expenses and other assets | (6,045)         | 12,210          |
| Increase/(decrease) in amounts due to related companies  | 403,913         | (19,210)        |
| Increase/(decrease) in accounts payable                  | 395,613         | (6,210)         |
| (Decrease)/increase in bills payable                     | (861,545)       | 1,293,210       |
| Increase in sales in advance of carriage                 | 75,556          | 1,210           |
| Increase in accrued expenses                             | 203,439         | 8,210           |
| Increase/(decrease) in other liabilities                 | 372,822         | (3,210)         |
| Increase in provision for major overhauls                | 47,577          | 1,210           |
| Cash inflows from operations                             | 3,074,718       | 4,763,210       |

(b) DISCLOSURE OF NON-CASH INVESTING AND FINANCING ACTIVITIES

During 2002, the Group assumed from Zhongyuan Airlines debts totalling RMB964,736,000 in partial satisfaction of the consideration payable for acquisition of five Boeing 737-300/37K aircraft and other assets from Zhongyuan Airlines (Note 27(o)).

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## 33 RECONCILIATION AND SUPPLEMENTARY STATEMENT OF CASH FLOW INFORMATION (cont'd)

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## (c) EFFECT OF ACQUISITION OF SUBSIDIARIES

|   | 2003<br>RMB' 000 | 2002<br>RMB' 000 |
|---|------------------|------------------|
| -----   |                  |                  |
| Net assets acquired:                              |                  |                  |
| Fixed assets                                      | -                | 96,636           |
| Cash and cash equivalents                         | -                | 17,355           |
| Trade receivables and other current assets        | -                | 20,681           |
|   | -                | 134,672          |
| -----   |                  |                  |
| Accounts payable                                  | -                | 3,623            |
| Accrued expenses and other liabilities            | -                | 11,220           |
|   | -                | 14,843           |
| -----   |                  |                  |
| Net assets value                                  | -                | 119,829          |
| =====   |                  |                  |
| Consideration paid                                | -                | 107,846          |
| Cash and cash equivalents acquired                | -                | 17,355           |
| -----   |                  |                  |
| Net cash outflow from acquisition of subsidiaries | -                | 90,491           |
| =====   |                  |                  |

### 34 ULTIMATE HOLDING COMPANY

The directors of the Company consider the ultimate holding company to be CSAHC, a state-owned enterprise established in the PRC.

### 35 SUBSEQUENT EVENTS

In April 2004, the Company entered into a purchase agreement with Airbus SNC for the acquisition of fifteen Airbus 320-200 aircraft and six Airbus 319-100 aircraft, scheduled for deliveries in 2005 and 2006.

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### 36 SUBSIDIARIES

The particulars of the Company's principal subsidiaries at 31 December, 2003 are as follows:

| PLACE AND<br>DATE OF | ATTRIBUTABLE<br>EQUITY INTEREST | ISSUED/ |
|----------------------|---------------------------------|---------|
|----------------------|---------------------------------|---------|

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| NAME OF COMPANY   | ESTABLISHMENT/<br>OPERATION   | -----       |               | REGISTERED<br>CAPITAL# | PRINCIPAL<br>ACTIVITY     |
|---|-------------------------------|-------------|---------------|------------------------|---------------------------|
|   |                               | DIRECT<br>% | INDIRECT<br>% |                        |                           |
| China Southern Airlines<br>(Group) Zhuhai Helicopter<br>Company Limited (a) | PRC<br>31 August, 1993        | 100         | -             | 100,000,000            | Helicopter<br>transport   |
| Guangxi Airlines<br>Company Limited (a)                                     | PRC<br>28 April, 1994         | 60          | -             | 170,900,000            | Airline                   |
| Southern Airlines Group<br>Shantou Airlines<br>Company Limited (a)          | PRC<br>20 July, 1993          | 60          | -             | 280,000,000            | Airline                   |
| Zhuhai Airlines<br>Company Limited (a)                                      | PRC<br>8 May, 1995            | 60          | -             | 250,000,000            | Airline                   |
| Xiamen Airlines<br>Company Limited (a)                                      | PRC<br>11 August, 1984        | 60          | -             | 588,434,000            | Airline                   |
| Guizhou Airlines<br>Company Limited (a)                                     | PRC<br>12 November, 1991      | 60          | -             | 80,000,000             | Airline                   |
| Guangzhou Nanland Air<br>Catering Company<br>Limited (b)                    | PRC<br>21 November, 1989      | 51          | -             | 55,980,000             | Air catering              |
| China Southern West<br>Australian Flying<br>College Pty Ltd                 | Australia<br>26 January, 1971 | 65          | -             | A\$ 100,000            | Pilot training<br>service |
| Guangzhou Baiyun International<br>Logistic Company Ltd                      | PRC<br>23 July, 2002          | 61          | -             | 20,000,000             | Logistics<br>operation    |
| Guangzhou Aviation Hotel  | PRC<br>8 January, 1997        | 90          | -             | 63,290,000             | Hotel operation           |

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36 SUBSIDIARIES (cont' d)

| NAME OF COMPANY | PLACE AND<br>DATE OF<br>ESTABLISHMENT/<br>OPERATION | ATTRIBUTABLE<br>EQUITY INTEREST |               | ISSUED/<br>REGISTERED<br>CAPITAL# |
|-----------------|---|---------------------------------|---------------|-----------------------------------|
|                 |   | -----<br>DIRECT<br>%            | INDIRECT<br>% |                                   |

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|  |                                     |     |    |            |    |
|--|-------------------------------------|-----|----|------------|----|
| Southern Airlines Advertising Company Ltd                    | PRC<br>3 March, 1994                | 90  | -  | 2,000,000  | Av |
| South China International Aviation & Travel Services Company | PRC<br>11 May, 1992                 | 90  | -  | 2,100,000  | Tr |
| CZ Flamingo Limited  | Cayman Islands<br>8 December, 1993  | 100 | -  | US\$ 1,000 | Ai |
| CZ Skylark Limited   | Cayman Islands<br>17 November, 1993 | 100 | -  | US\$ 1,000 | Ai |
| CZ Kapok Limited   | Cayman Islands<br>26 October, 1993  | 100 | -  | US\$ 1,000 | Ai |
| CSA-I Limited  | Cayman Islands<br>1 September, 1993 | 100 | -  | US\$ 1,000 | Ai |
| CZ93B Limited  | Cayman Islands<br>11 May, 1993      | 100 | -  | US\$ 1,000 | Ai |
| CZ97A Limited  | Cayman Islands<br>2 January, 1997   | 100 | -  | US\$ 1,000 | Ai |
| Zhong Yuan 99A Limited                                       | Cayman Islands<br>15 February, 1999 | 100 | -  | US\$ 1,000 | Ai |
| CXA92A Limited   | Cayman Islands<br>3 August, 1992    | -   | 60 | US\$ 1,000 | Ai |
| CXA93A Limited   | Cayman Islands<br>1 July, 1993      | -   | 60 | US\$ 1,000 | Ai |
| CXA95B Limited   | Cayman Islands<br>7 July, 1995      | -   | 60 | US\$ 1,000 | Ai |

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36 SUBSIDIARIES (cont' d)

| NAME OF COMPANY | PLACE AND DATE OF ESTABLISHMENT/ OPERATION | ATTRIBUTABLE EQUITY INTEREST |            | ISSUED/ REGISTERED CAPITAL# | PRIN ACTIV |
|-----------------|--|------------------------------|------------|-----------------------------|------------|
|                 |  | DIRECT %                     | INDIRECT % |                             |            |
| CXA95C Limited  | Cayman Islands<br>16 October, 1995         | -                            | 60         | US\$ 1,000                  | Aircraf    |
| CXA98A Limited  | Cayman Islands                             | -                            | 60         | US\$ 1,000                  | Aircraf    |

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20 March, 1998

|  |                                |   |      |                |                      |
|--|--------------------------------|---|------|----------------|----------------------|
| Xiamen Aviation Property Development Company (a) | PRC<br>22 June, 1993           | - | 60   | 5,000,000      | Property development |
| Xiamen Aviation Advertising Company Limited (a)  | PRC<br>17 December, 1992       | - | 60   | 620,218        | Aviation advertising |
| Xiamen Aviation Supplies Limited (a)             | PRC<br>30 July, 1997           | - | 60   | 8,560,000      | Aviation supplies    |
| Xiamen Aviation Development Company Limited (a)  | PRC<br>18 February, 1998       | - | 54   | 5,000,000      | Hotel management     |
| Bai Lu Finance Limited                           | Hong Kong<br>22 February, 1996 | - | 54   | HK\$10,000,000 | Investment holding   |
| Xiamen Air Holidays Limited                      | Hong Kong<br>28 April, 1994    | - | 54   | HK\$ 3,000,000 | Travel services      |
| Xiamen Macau Holidays Limited                    | Macau<br>11 May, 1995          | - | 27.5 | MOP 1,000,000  | Travel services      |
| Shantou Hua Kang Air Catering Company Ltd (a)    | PRC<br>22 June, 1994           | - | 42   | 10,000,000     | Air catering         |

# Expressed in RMB, unless otherwise stated

(a) These subsidiaries are PRC limited companies.

(b) These subsidiaries are Sino-foreign equity joint venture companies

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37 ASSOCIATED COMPANIES AND JOINTLY CONTROLLED ENTITIES

The particulars of the Group's principal associated companies and jointly controlled entities as at 31 December, 2003 are as follows:

| NAME OF COMPANY | PLACE AND DATE OF ESTABLISHMENT/ OPERATION | ATTRIBUTABLE EQUITY INTEREST |            | ISSUED/ REGISTERED CAPITAL# | PR ACT |
|-----------------|--|------------------------------|------------|-----------------------------|--------|
|                 |  | -----                        |            |                             |        |
|                 |  | DIRECT %                     | INDIRECT % |                             |        |

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|  |                              |    |       |                 |                              |
|--|------------------------------|----|-------|-----------------|------------------------------|
| Guangzhou Aircraft Maintenance Engineering Company Limited* (Note) | PRC<br>28 October, 1989      | 50 | -     | US\$ 27,500,000 | Prov<br>ai<br>re<br>ma<br>se |
| Southern Airlines Group Finance Company Limited                    | PRC<br>28 June, 1995         | 32 | 15.42 | 424,330,000     | Prov<br>fi<br>se             |
| Hainan Phoenix Information System Limited                          | PRC<br>12 March, 1994        | 45 | -     | US\$ 16,360,000 | Prov<br>ti<br>re<br>sy<br>se |
| Hong Kong Business Aviation Centre Company Limited                 | Hong Kong<br>7 January, 1998 | 20 | -     | HKD 1,000,000   | Prov<br>pr<br>fl<br>lo<br>se |
| Sichuan Airlines Corporation Limited                               | PRC<br>28 August, 2002       | 39 | -     | 350,000,000     | Airl                         |
| MTU Maintenance Zhuhai Co. Ltd.*                                   | PRC<br>6 April, 2001         | 50 | -     | US\$ 63,100,000 | Prov<br>en<br>re<br>ma<br>se |
| China Postal Airlines Limited*                                     | PRC<br>25 November, 1996     | 49 | -     | 306,000,000     | Airl                         |

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NOTES TO THE FINANCIAL STATEMENTS (Cont' d)  
(Prepared under International Financial Reporting Standards)  
(Expressed in Renminbi)

37 ASSOCIATED COMPANIES AND JOINTLY CONTROLLED ENTITIES (cont' d)

| NAME OF COMPANY                                      | PLACE AND DATE OF ESTABLISHMENT/ OPERATION | ATTRIBUTABLE EQUITY INTEREST |            | ISSUED/ REGISTERED CAPITAL# | PRIN ACTIV                     |
|--|--|------------------------------|------------|-----------------------------|--------------------------------|
|  |  | DIRECT %                     | INDIRECT % |                             |                                |
| Zhuhai Xiang Yi Aviation Technology Company Limited* | PRC<br>10 July, 2002                       | 51                           | -          | US\$29,800,000              | Provis<br>flig<br>simu<br>serv |
| CSN-ETC e-commerce Limited*                          | PRC<br>10 February, 2003                   | 51                           | -          | 5,880,000                   | Provis<br>inte<br>serv         |

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# Expressed in RMB, unless otherwise stated

\* These are jointly controlled entities

Note: Guangzhou Aircraft Maintenance Engineering Company Limited has been reclassified from an associated company to a jointly controlled entity since 2003 due to a change in the composition of its shareholders in 2003.

[LOGO] CHINA SOUTHERN AIRLINES COMPANY LIMITED 2003 ANNUAL REPORT 99

REPORT OF THE AUDITORS

[KPMG HUAZHEN LOGO]

KPMG - AH (2004) AR No. 0022

TO THE SHAREHOLDERS OF CHINA SOUTHERN AIRLINES COMPANY LIMITED:

We have audited the accompanying Company' s consolidated balance sheet and balance sheet at 31 December, 2003, and the consolidated income and profit appropriation statement, income and profit appropriation statement, consolidated cash flow statement and cash flow statement for the year then ended. The preparation of these financial statements is the responsibility of the Company' s management. Our responsibility is to express an audit opinion on these financial statements based on our audit.

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

In our opinion, the above-mentioned financial statements comply with the requirements of the Accounting Standards for Business Enterprises and the Accounting Regulations for Business Enterprises issued by the Ministry of Finance of the People' s Republic of China and present fairly, in all material respects, the Company' s consolidated financial position and financial position at 31 December, 2003, and the consolidated results of operations, results of operations, and consolidated cash flows and cash flows for the year then ended.

KPMG HUAZHEN

Certified Public Accountants  
Registered in the People's Republic  
of China

8/F, Office Tower E2  
Oriental Plaza  
No.1, East Chang An Avenue  
Beijing, The People' s Republic of China  
Post Code: 100738

JIN NAI WEN  
CHEN YU HONG  
23 April, 2004

100 CHINA SOUTHERN AIRLINES COMPANY LIMITED 2003 ANNUAL REPORT [LOGO]

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### CONSOLIDATED BALANCE SHEET

As at 31 December, 2003

(Prepared under PRC Accounting Rules and Regulations)

|                                | Note | 2003<br>RMB' 000 | 2002<br>RMB' 000 |
|--------------------------------|------|------------------|------------------|
| <hr/>                          |      |                  |                  |
| ASSETS                         |      |                  |                  |
| Current assets                 |      |                  |                  |
| Cash and cash equivalents      | 6    | 2,321,483        | 4,145,300        |
| Trade receivables              | 7    | 891,827          | 742,962          |
| Other receivables              | 8    | 316,665          | 404,279          |
| Advance payments               | 9    | 84,832           | 14,237           |
| Inventories                    | 10   | 631,669          | 653,011          |
| Prepaid expenses               | 11   | 203,370          | 165,754          |
| <hr/>                          |      |                  |                  |
| TOTAL CURRENT ASSETS           |      | 4,449,846        | 6,125,543        |
| <hr/>                          |      |                  |                  |
| LONG-TERM EQUITY INVESTMENTS   | 12   | 622,372          | 576,850          |
| <hr/>                          |      |                  |                  |
| Fixed assets:                  |      |                  |                  |
| Cost                           |      | 40,898,104       | 37,080,309       |
| Less: accumulated depreciation |      | 11,502,684       | 9,514,246        |
| <hr/>                          |      |                  |                  |
| Net book value of fixed assets | 13   | 29,395,420       | 27,566,063       |
| Construction materials         | 14   | 1,730            | 1,485            |
| Construction in progress       | 15   | 1,937,390        | 1,006,964        |
| <hr/>                          |      |                  |                  |
| TOTAL FIXED ASSETS             |      | 31,334,540       | 28,574,512       |
| <hr/>                          |      |                  |                  |
| OTHER ASSETS:                  |      |                  |                  |
| Lease and equipment deposits   | 16   | 2,932,591        | 2,147,038        |
| Deferred expenditure           | 17   | 26,473           | 34,136           |
| Long-term receivables          | 18   | 6,382            | 12,034           |
| <hr/>                          |      |                  |                  |
| TOTAL OTHER ASSETS             |      | 2,965,446        | 2,193,208        |
| <hr/>                          |      |                  |                  |
| TOTAL ASSETS                   |      | 39,372,204       | 37,470,113       |
| <hr/>                          |      |                  |                  |

The notes on pages 116 to 182 form part of these financial statements.

[LOGO] CHINA SOUTHERN AIRLINES COMPANY LIMITED 2003 ANNUAL REPORT 101

CONSOLIDATED BALANCE SHEET (Cont' d)  
As at 31 December, 2003  
(Prepared under PRC Accounting Rules and Regulations)



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|  | Note | 2003<br>RMB' 000 | 2002<br>RMB' 000 |
|--|------|------------------|------------------|
| -----  |      |                  |                  |
| LIABILITIES AND SHAREHOLDERS' EQUITY         |      |                  |                  |
| CURRENT LIABILITIES:                         |      |                  |                  |
| Short-term loans                             | 19   | 6,429,306        | 4,443,426        |
| Bills payable                                | 20   | 447,778          | 1,299,680        |
| Trade accounts payable                       | 21   | 1,667,383        | 900,926          |
| Sales in advance of carriage                 | 22   | 466,087          | 390,531          |
| Wages payable                                |      | 74,956           | 73,702           |
| Staff welfare payable                        |      | 131,284          | 179,984          |
| Taxes payable                                | 4    | 102,134          | 122,657          |
| CAAC infrastructure development fund payable | 23   | 353,592          | 280,706          |
| Other creditors                              | 24   | 5,756            | 2,897            |
| Other payables                               | 25   | 892,299          | 692,246          |
| Accrued expenses                             | 26   | 2,386,987        | 2,286,136        |
| Long-term liabilities due within one year    | 27   | 1,985,895        | 2,384,498        |
| -----  |      |                  |                  |
| TOTAL CURRENT LIABILITIES                    |      | 14,943,457       | 13,057,389       |
| -----  |      |                  |                  |
| LONG-TERM LIABILITIES:                       |      |                  |                  |
| Long-term borrowings                         | 28   | 4,779,678        | 5,911,590        |
| Obligations under finance leases             | 29   | 5,543,084        | 6,631,751        |
| Provision for major overhauls                | 30   | 189,464          | 141,887          |
| Deferred credits                             | 31   | 217,162          | 249,411          |
| -----  |      |                  |                  |
| TOTAL LONG-TERM LIABILITIES                  |      | 10,729,388       | 12,934,639       |
| -----  |      |                  |                  |
| DEFERRED TAXATION:                           |      |                  |                  |
| Deferred tax liabilities                     | 32   | 391,638          | 1,043,303        |
| -----  |      |                  |                  |
| TOTAL LIABILITIES                            |      | 26,064,483       | 27,035,331       |
| -----  |      |                  |                  |
| MINORITY INTERESTS                           |      | 1,757,872        | 1,540,188        |
| -----  |      |                  |                  |

The notes on pages 116 to 182 form part of these financial statements.

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CONSOLIDATED BALANCE SHEET (Cont'd)  
As at 31 December, 2003  
(Prepared under PRC Accounting Rules and Regulations)

|                      | Note | 2003<br>RMB' 000 | 2002<br>RMB' 000 |
|----------------------|------|------------------|------------------|
| -----                |      |                  |                  |
| SHAREHOLDERS' EQUITY |      |                  |                  |

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|  |    |            |            |
|--|----|------------|------------|
| Share capital                              | 33 | 4,374,178  | 3,374,178  |
| Capital reserves                           | 34 | 5,801,345  | 4,160,578  |
| Surplus reserves                           | 35 | 610,341    | 585,372    |
|  |    | 172,687    | 171,574    |
| Including: Statutory public welfare fund   |    |            |            |
|  |    | 763,985    | 774,466    |
|  |    | 11,549,849 | 8,894,594  |
| TOTAL SHAREHOLDERS' EQUITY                 |    |            |            |
|  |    | 39,372,204 | 37,470,113 |
| TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY |    |            |            |
|  |    |            |            |

These financial statements have been approved by the Board of Directors on 23 April, 2004

|   |  |  |   |
|---|--|--|---|
| YAN ZHI QING<br>Chairman of<br>Board of Directors | WANG CHANG SHUN<br>Vice Chairman of<br>Board of Directors and<br>President | XU JIE BO<br>Director and<br>Chief Financial Officer | XIAO LI XIN<br>General Manager of<br>Finance Department |
|---|--|--|---|

The notes on pages 116 to 182 form part of these financial statements.

[LOGO] CHINA SOUTHERN AIRLINES COMPANY LIMITED 2003 ANNUAL REPORT 103

BALANCE SHEET  
As at 31 December, 2003  
(Prepared under PRC Accounting Rules and Regulations)

|                                | Note | 2003<br>RMB' 000 | 2002<br>RMB' 000 |
|--------------------------------|------|------------------|------------------|
| -----                          |      |                  |                  |
| ASSETS                         |      |                  |                  |
| Current assets                 |      |                  |                  |
| Cash and cash equivalents      | 6    | 1,404,874        | 2,960,337        |
| Trade receivables              | 7    | 683,206          | 476,532          |
| Other receivables              | 8    | 754,381          | 244,635          |
| Advance payments               | 9    | 67,537           | 9,439            |
| Inventories                    | 10   | 211,489          | 116,649          |
| Prepaid expenses               | 11   | 114,317          | 109,893          |
|                                |      | 3,235,804        | 3,917,485        |
| TOTAL CURRENT ASSETS           |      |                  |                  |
|                                |      | 3,657,618        | 4,290,122        |
| LONG-TERM EQUITY INVESTMENTS   |      |                  |                  |
| -----                          |      |                  |                  |
| Fixed assets:                  |      |                  |                  |
| Cost                           |      | 31,795,443       | 26,416,967       |
| Less: accumulated depreciation |      | 8,972,242        | 6,856,976        |

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|                                |    |                   |                   |
|--------------------------------|----|-------------------|-------------------|
| Net book value of fixed assets | 13 | 22,823,201        | 19,559,991        |
| Construction materials         | 14 | 1,730             | 1,485             |
| Construction in progress       | 15 | 1,543,420         | 637,770           |
| <b>TOTAL FIXED ASSETS</b>      |    | <b>24,368,351</b> | <b>20,199,246</b> |
| <b>OTHER ASSETS:</b>           |    |                   |                   |
| Lease and equipment deposits   | 16 | 2,228,754         | 2,065,192         |
| Deferred expenditure           | 17 | 17,349            | 23,469            |
| <b>TOTAL AND OTHER ASSETS</b>  |    | <b>2,246,103</b>  | <b>2,088,661</b>  |
| <b>TOTAL ASSETS</b>            |    | <b>33,507,876</b> | <b>30,495,514</b> |

The notes on pages 116 to 182 form part of these financial statements.

104 CHINA SOUTHERN AIRLINES COMPANY LIMITED 2003 ANNUAL REPORT [LOGO]

BALANCE SHEET (Cont'd)

As at 31 December, 2003

(Prepared under PRC Accounting Rules and Regulations)

|  | Note | 2003<br>RMB'000   | 2002<br>RMB'000   |
|--|------|-------------------|-------------------|
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>  |      |                   |                   |
| <b>CURRENT LIABILITIES:</b>                  |      |                   |                   |
| Short-term loans                             | 19   | 5,577,841         | 2,914,158         |
| Bills payable                                | 20   | 438,135           | 1,299,680         |
| Trade accounts payable                       | 21   | 1,447,804         | 451,497           |
| Sales in advance of carriage                 | 22   | 405,851           | 340,457           |
| Wages payable                                |      | 30,391            | 36,001            |
| Staff welfare payable                        |      | -                 | 24,387            |
| Taxes payable                                | 4    | 11,101            | 39,751            |
| CAAC infrastructure development fund payable | 23   | 293,223           | 201,476           |
| Other creditors                              | 24   | 689               | 979               |
| Other payables                               | 25   | 766,741           | 693,726           |
| Accrued expenses                             | 26   | 1,682,680         | 1,159,416         |
| Long-term liabilities due within one year    | 27   | 1,678,982         | 2,131,862         |
| <b>TOTAL CURRENT LIABILITIES</b>             |      | <b>12,333,438</b> | <b>9,293,390</b>  |
| <b>LONG-TERM LIABILITIES:</b>                |      |                   |                   |
| Long-term borrowings                         | 28   | 3,670,499         | 4,628,372         |
| Obligations under finance leases             | 29   | 5,543,084         | 6,631,751         |
| Provision for major overhauls                | 30   | 130,992           | 63,389            |
| Deferred credits                             | 31   | 217,162           | 249,411           |
| <b>TOTAL LONG-TERM LIABILITIES</b>           |      | <b>9,561,737</b>  | <b>11,572,923</b> |

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|                          |    |            |            |
|--------------------------|----|------------|------------|
| DEFERRED TAXATION:       |    |            |            |
| Deferred tax liabilities | 32 | 62,852     | 734,607    |
| -----                    |    |            |            |
| TOTAL LIABILITIES        |    | 21,958,027 | 21,600,920 |
| -----                    |    |            |            |

The notes on pages 116 to 182 form part of these financial statements.

[LOGO] CHINA SOUTHERN AIRLINES COMPANY LIMITED 2003 ANNUAL REPORT 105

BALANCE SHEET (Cont'd)  
As at 31 December, 2003  
(Prepared under PRC Accounting Rules and Regulations)

|  | Note | 2003<br>RMB'000 | 2002<br>RMB'000 |
|--|------|-----------------|-----------------|
| -----                                      |      |                 |                 |
| SHAREHOLDERS' EQUITY                       |      |                 |                 |
| Share capital                              | 33   | 4,374,178       | 3,374,178       |
| Capital reserves                           | 34   | 5,801,345       | 4,160,578       |
| Surplus reserves                           | 35   | 587,545         | 585,372         |
|  |      | -----           | -----           |
| Including: Statutory public welfare fund   |      | 172,298         | 171,574         |
|  |      | -----           | -----           |
| Retained profits                           |      | 786,781         | 774,466         |
| TOTAL SHAREHOLDERS' EQUITY                 |      | 11,549,849      | 8,894,594       |
| -----                                      |      |                 |                 |
| TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY |      | 33,507,876      | 30,495,514      |
| =====                                      |      |                 |                 |

These financial statements have been approved by the Board of Directors on 23 April, 2004

|                    |                        |                         |                    |
|--------------------|------------------------|-------------------------|--------------------|
| YAN ZHI QING       | WANG CHANG SHUN        | XU JIE BO               | XIAO LI XIN        |
| Chairman of        | Vice Chairman of       | Director and            | General Manager of |
| Board of Directors | Board of Directors and | Chief Financial Officer | Finance Department |
|                    | President              |                         |                    |

The notes on pages 116 to 182 form part of these financial statements.

106 CHINA SOUTHERN AIRLINES COMPANY LIMITED 2003 ANNUAL REPORT [LOGO]

CONSOLIDATED INCOME AND PROFIT APPROPRIATION STATEMENT  
For the year ended 31 December, 2003  
(Prepared under PRC Accounting Rules and Regulations)

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|  | Note | RMB'000  |
|--|------|----------|
| REVENUE FROM PRINCIPAL OPERATIONS                      | 37   | 17,351,0 |
| Less: Transfer to CAAC infrastructure development fund |      | 250,8    |
| NET REVENUE FROM PRINCIPAL OPERATIONS                  |      | 17,100,2 |
| Less: Costs of principal operations                    |      | 14,221,9 |
| Business taxes and surcharges                          | 38   | 190,6    |
| PROFIT FROM PRINCIPAL OPERATIONS                       |      | 2,687,5  |
| Add: Profit from other operations                      | 39   | 325,9    |
| Less: Selling expenses                                 |      | 1,519,4  |
| Administrative expenses                                |      | 893,3    |
| Financial expenses                                     | 40   | 995,5    |
| OPERATING (LOSS)/ PROFIT                               |      | (394,8   |
| Add: Investment income                                 | 41   | 61,6     |
| Non-operating income                                   | 42   | 43,0     |
| Less: Non-operating expenses                           | 43   | 71,4     |
| (LOSS)/PROFIT BEFORE INCOME TAX                        |      | (361,5   |
| Less: Income tax                                       | 44   | (604,7   |
| Minority interests                                     |      | 228,7    |
| NET PROFIT FOR THE YEAR                                |      | 14,4     |

The notes on pages 116 to 182 form part of these financial statements.

[LOGO] CHINA SOUTHERN AIRLINES COMPANY LIMITED 2003 ANNUAL REPORT 107

CONSOLIDATED INCOME AND PROFIT APPROPRIATION STATEMENT (Cont'd)  
For the year ended 31 December, 2003  
(Prepared under PRC Accounting Rules and Regulations)

|  | Note | 2003<br>RMB'000 | 2002<br>RMB'000 |
|--|------|-----------------|-----------------|
| NET PROFIT FOR THE YEAR                            |      | 14,488          | 513,345         |
| Add: Retained profits at the beginning of the year |      | 774,466         | 412,343         |
| PROFITS AVAILABLE FOR DISTRIBUTION                 |      | 788,954         | 925,688         |

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|  |    |         |         |
|--|----|---------|---------|
| Less: Transfer to statutory surplus reserve        | 36 | 23,856  | 51,335  |
| Transfer to statutory public welfare fund          | 36 | 1,113   | 25,667  |
| -----  |    |         |         |
| PROFITS AVAILABLE FOR DISTRIBUTION TO SHAREHOLDERS |    | 763,985 | 848,686 |
| Less: Transfer to discretionary surplus reserve    | 36 | -       | 6,736   |
| Dividends distributed to shareholders              | 36 | -       | 67,484  |
| -----  |    |         |         |
| RETAINED PROFITS AT THE END OF THE YEAR            |    | 763,985 | 774,466 |
| =====  |    |         |         |

The notes on pages 116 to 182 form part of these financial statements.

108 CHINA SOUTHERN AIRLINES COMPANY LIMITED 2003 ANNUAL REPORT [LOGO]

INCOME AND PROFIT APPROPRIATION STATEMENT  
For the year ended 31 December, 2003  
(Prepared under PRC Accounting Rules and Regulations)

|  | Note | 2003<br>RMB'000 | 2002<br>RMB'000 |
|--|------|-----------------|-----------------|
| REVENUE FROM PRINCIPAL OPERATIONS                      | 37   | 11,917,893      | 9,496,8         |
| Less: Transfer to CAAC Infrastructure development fund |      | 167,942         | 375,7           |
| -----  |      |                 |                 |
| NET REVENUE FROM PRINCIPAL OPERATIONS                  |      | 11,749,951      | 9,121,0         |
| Less: Costs of principal operations                    |      | 10,242,766      | 6,324,6         |
| Business taxes and surcharges                          | 38   | 132,488         | 255,9           |
| -----  |      |                 |                 |
| PROFIT FROM PRINCIPAL OPERATIONS                       |      | 1,374,697       | 2,540,5         |
| Add: Profit from other operations                      | 39   | 253,060         | 264,3           |
| Less: Selling expenses                                 |      | 1,110,849       | 917,1           |
| Administrative expenses                                |      | 547,390         | 412,5           |
| Financial expenses                                     | 40   | 887,644         | 988,8           |
| -----  |      |                 |                 |
| OPERATING (LOSS)/ PROFIT                               |      | (918,126)       | 486,2           |
| Add: Investment income                                 | 41   | 266,925         | 268,5           |
| Non-operating income                                   | 42   | 17,896          | 2,8             |
| Less: Non-operating expenses                           | 43   | 23,962          | 9,3             |
| -----  |      |                 |                 |
| (LOSS)/PROFIT BEFORE INCOME TAX                        |      | (657,267)       | 748,3           |
| Less: Income tax                                       | 44   | (671,755)       | 235,0           |
| -----  |      |                 |                 |
| NET PROFIT FOR THE YEAR                                |      | 14,488          | 513,3           |

The notes on pages 116 to 182 form part of these financial statements.

[LOGO] CHINA SOUTHERN AIRLINES COMPANY LIMITED 2003 ANNUAL REPORT 109

INCOME AND PROFIT APPROPRIATION STATEMENT (Cont'd)  
For the year ended 31 December, 2003  
(Prepared under PRC Accounting Rules and Regulations)

|  | Note | 2003<br>RMB'000 | 2002<br>RMB'000 |
|--|------|-----------------|-----------------|
| NET PROFIT FOR THE YEAR                            |      | 14,488          | 513,345         |
| Add: Retained profits at the beginning of the year |      | 774,466         | 412,343         |
| PROFITS AVAILABLE FOR DISTRIBUTION                 |      | 788,954         | 925,688         |
| Less: Transfer to statutory surplus reserve        | 36   | 1,449           | 51,335          |
| Transfer to statutory public welfare fund          | 36   | 724             | 25,667          |
| PROFITS AVAILABLE FOR DISTRIBUTION TO SHAREHOLDERS |      | 786,781         | 848,686         |
| Less: Transfer to discretionary surplus reserve    | 36   | -               | 6,736           |
| Dividends distributed to shareholders              | 36   | -               | 67,484          |
| RETAINED PROFITS AT THE END OF THE YEAR            |      | 786,781         | 774,466         |

The notes on pages 116 to 182 form part of these financial statements.

110 CHINA SOUTHERN AIRLINES COMPANY LIMITED 2003 ANNUAL REPORT [LOGO]

CONSOLIDATED CASH FLOW STATEMENT  
For year ended 31 December, 2003  
(Prepared under PRC Accounting Rules and Regulations)

|  | Note | 2003<br>RMB'000 | 2002<br>RMB'000 |
|--|------|-----------------|-----------------|
| CASH FLOWS FROM OPERATING ACTIVITIES:                      |      |                 |                 |
| Cash received from sale of goods and rendering of services |      | 17,542,503      | 19,074,2        |
| Other cash received relating to operating activities       |      | 181,567         | 133,2           |
| SUB-TOTAL OF CASH INFLOWS                                  |      | 17,724,070      | 19,207,5        |

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|   |  |               |          |
|---|--|---------------|----------|
| Cash paid for goods and services  |  | 12,271,446    | 10,151,5 |
| Cash paid to and on behalf of employees                                       |  | 1,633,970     | 1,613,4  |
| Cash paid for all types of taxes  |  | 463,614       | 1,839,5  |
| Other cash paid relating to operating activities                              |  | 512,887       | 828,2    |
| SUB-TOTAL OF CASH OUTFLOWS  |  | 14,881,917    | 14,432,7 |
| NET CASH INFLOW FROM OPERATING ACTIVITIES                                     |  | (i) 2,842,153 | 4,774,7  |
| CASH FLOWS FROM INVESTING ACTIVITIES:   |  |               |          |
| Cash received from return on investments                                      |  | 17,140        | 3,0      |
| Net cash received from disposal of fixed assets<br>and other long-term assets |  | 64,757        | 825,6    |
| Refund of deposits for fixed asset purchases                                  |  | 1,066,086     | 2,247,3  |
| Other cash received relating to investing activities                          |  | 13,061        | 52,6     |
| SUB-TOTAL OF CASH INFLOWS   |  | 1,161,044     | 3,128,7  |
| Cash paid for acquisition of fixed assets and<br>other long-term assets       |  | 6,697,501     | 8,845,6  |
| Cash paid for acquisition of investments                                      |  | 4,209         | 138,3    |
| SUB-TOTAL OF CASH OUTFLOWS  |  | 6,701,710     | 8,984,0  |
| NET CASH OUTFLOW FROM INVESTING ACTIVITIES                                    |  | (5,540,666)   | (5,855,2 |

The notes on pages 116 to 182 form part of these financial statements.

[LOGO] CHINA SOUTHERN AIRLINES COMPANY LIMITED 2003 ANNUAL REPORT 111

CONSOLIDATED CASH FLOW STATEMENT (Cont'd)  
For year ended 31 December, 2003  
(Prepared under PRC Accounting Rules and Regulations)

|                                       | Note | 2003<br>RMB'000 | 2002<br>RMB'000 |
|---------------------------------------|------|-----------------|-----------------|
| CASH FLOWS FROM FINANCING ACTIVITIES: |      |                 |                 |
| Cash received from investors          |      | 3,931           | 83,037          |
| Cash received from borrowings         |      | 9,116,113       | 7,093,436       |
| Proceeds from A share issue           |      | 2,640,767       | -               |
| SUB-TOTAL OF CASH INFLOWS             |      | 11,760,811      | 7,176,473       |



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|   |       |             |           |
|---|-------|-------------|-----------|
| Cash paid for repayment of borrowings                 |       | 9,947,252   | 3,741,471 |
| Cash paid for dividends or interest                   |       | 938,863     | 1,167,377 |
| -----   |       |             |           |
| Sub-total of cash outflows                            |       | 10,886,115  | 4,908,848 |
| -----   |       |             |           |
| NET CASH INFLOW FROM FINANCING ACTIVITIES             |       | 874,696     | 2,267,625 |
| -----   |       |             |           |
| NET (DECREASE)/ INCREASE IN CASH AND CASH EQUIVALENTS | (iii) | (1,823,817) | 1,187,139 |
| =====   |       |             |           |

The notes on pages 116 to 182 form part of these financial statements.

112 CHINA SOUTHERN AIRLINES COMPANY LIMITED 2003 ANNUAL REPORT [LOGO]

CONSOLIDATED CASH FLOW STATEMENT (Cont'd)  
 For year ended 31 December, 2003  
 (Prepared under PRC Accounting Rules and Regulations)

NOTES TO THE CONSOLIDATED CASH FLOW STATEMENTS

|       |   |   |
|-------|---|---|
| (i)   | RECONCILIATION OF NET PROFIT TO CASH FLOWS FROM OPERATING ACTIVITIES                      |   |
|       | Net profit  |   |
|       | Add: Depreciation of fixed assets   | 2 |
|       | Amortisation of deferred expenditure  |   |
|       | Amortisation of deferred credits  |   |
|       | Loss on sale of fixed assets  |   |
|       | Financial expenses  |   |
|       | Minority interests  |   |
|       | Investment income   |   |
|       | Increase in operating receivables   |   |
|       | Decrease/ (increase) in inventories   |   |
|       | Increase in prepaid expenses  |   |
|       | Increase in operating payables  |   |
|       | Increase in sales in advance of carriage  |   |
|       | Increase in accrued expenses  |   |
|       | Decrease in taxes payable   |   |
|       | Increase/ (decrease) in other creditors   |   |
|       | (Decrease)/ increase in deferred taxation   |   |
|       | Increase in provision for major overhauls   |   |
| ----- |   |   |
|       | NET CASH INFLOW FROM OPERATING ACTIVITIES   | 2 |
| ===== |   |   |
| (ii)  | INVESTING AND FINANCING ACTIVITIES NOT REQUIRING THE USE OF CASH<br>AND CASH EQUIVALENTS: |   |
|       | Purchase of fixed assets by assumption of debts   |   |
| ===== |   |   |
| (iii) | NET (DECREASE)/ INCREASE IN CASH AND CASH EQUIVALENTS                                     |   |
|       | Cash and cash equivalents at the end of the year  | 2 |
|       | Less: Cash and cash equivalents at the beginning of the year                              | 4 |

NET (DECREASE)/ INCREASE IN CASH AND CASH EQUIVALENTS

(1)

The notes on pages 116 to 182 form part of these financial statements.

[LOGO] CHINA SOUTHERN AIRLINES COMPANY LIMITED 2003 ANNUAL REPORT 113

CASH FLOW STATEMENT  
For year ended 31 December, 2003  
(Prepared under PRC Accounting Rules and Regulations)

|   | Note | 2003<br>RMB'000 |
|---|------|-----------------|
| <b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>                                  |      |                 |
| Cash received from sale of goods and rendering of services                    |      | 11,991,375      |
| Other cash received relating to operating activities                          |      | 87,718          |
| <hr/>   |      |                 |
| SUB-TOTAL OF CASH INFLOWS   |      | 12,079,093      |
| <hr/>   |      |                 |
| Cash paid for goods and services  |      | 9,317,477       |
| Cash paid to and on behalf of employees                                       |      | 1,255,342       |
| Cash paid for all types of taxes  |      | 192,743         |
| Other cash paid relating to operating activities                              |      | 230,534         |
| <hr/>   |      |                 |
| SUB-TOTAL OF CASH OUTFLOWS  |      | 10,996,096      |
| <hr/>   |      |                 |
| NET CASH INFLOW FROM OPERATING ACTIVITIES                                     | (i)  | 1,082,997       |
| <hr/>   |      |                 |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>                                  |      |                 |
| Cash received from return on investments                                      |      | 2,693           |
| Net cash received from disposal of fixed assets<br>and other long-term assets |      | 7,081           |
| Refund of deposits for fixed asset purchases                                  |      | 1,066,086       |
| Other cash received relating to investing activities                          |      | 7,666           |
| <hr/>   |      |                 |
| SUB-TOTAL OF CASH INFLOWS   |      | 1,083,526       |
| <hr/>   |      |                 |
| Cash paid for acquisition of fixed assets and<br>other long-term assets       |      | 5,512,354       |
| Cash paid for acquisition of investments                                      |      | 12,026          |
| <hr/>   |      |                 |
| SUB-TOTAL OF CASH OUTFLOWS  |      | 5,524,380       |
| <hr/>   |      |                 |
| NET CASH OUTFLOW FROM INVESTING ACTIVITIES                                    |      | (4,440,854)     |

The notes on pages 116 to 182 form part of these financial statements.

114 CHINA SOUTHERN AIRLINES COMPANY LIMITED 2003 ANNUAL REPORT [LOGO]

CASH FLOW STATEMENT (Cont'd)  
 For year ended 31 December, 2003  
 (Prepared under PRC Accounting Rules and Regulations)

|  | Note | 2003<br>RMB'000          | 2002<br>RMB'000  |
|--|------|--------------------------|------------------|
| <b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>                 |      |                          |                  |
| Cash received from borrowings                                |      | 8,083,007                | 6,374,224        |
| Proceeds from A share issue                                  |      | 2,640,767                | -                |
| <b>SUB-TOTAL OF CASH INFLOWS</b>                             |      | <b>10,723,774</b>        | <b>6,374,224</b> |
| <b>Cash paid for repayment of borrowings</b>                 |      |                          |                  |
| Cash paid for dividends or interest                          |      | 8,116,528                | 2,972,465        |
|  |      | 804,852                  | 993,763          |
| <b>SUB-TOTAL OF CASH OUTFLOWS</b>                            |      | <b>8,921,380</b>         | <b>3,966,228</b> |
| <b>NET CASH INFLOW FROM FINANCING ACTIVITIES</b>             |      | <b>1,802,394</b>         | <b>2,407,996</b> |
| <b>NET (DECREASE)/ INCREASE IN CASH AND CASH EQUIVALENTS</b> |      | <b>(iii) (1,555,463)</b> | <b>822,755</b>   |

The notes on pages 116 to 182 form part of these financial statements.

[LOGO] CHINA SOUTHERN AIRLINES COMPANY LIMITED 2003 ANNUAL REPORT 115

CASH FLOW STATEMENT (Cont'd)  
 For year ended 31 December, 2003  
 (Prepared under PRC Accounting Rules and Regulations)

NOTES TO THE CASH FLOW STATEMENTS 2003  
RMB'000

|  |                                      |           |
|--|--------------------------------------|-----------|
| <b>(i) RECONCILIATION OF NET PROFIT TO CASH FLOWS FROM OPERATING ACTIVITIES:</b> |                                      |           |
| Net profit   |                                      | 14,488    |
| Add:   | Depreciation of fixed assets         | 1,574,366 |
|  | Amortisation of deferred expenditure | 7,421     |
|  | Amortisation of deferred credits     | (32,249)  |

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|       |  |             |
|-------|--|-------------|
|       | (Gain)/loss on sale of fixed assets  | (2,521)     |
|       | Financial expenses   | 871,066     |
|       | Investment income  | (266,925)   |
|       | (Increase)/decrease in operating receivables   | (664,172)   |
|       | (Increase)/decrease in inventories   | (23,230)    |
|       | Decrease/(increase) in prepaid expenses  | 277         |
|       | Increase in operating payables   | 93,667      |
|       | Increase in sales in advance of carriage   | 65,394      |
|       | Increase/(decrease) in accrued expenses  | 78,662      |
|       | Decrease in taxes payable  | (28,650)    |
|       | Decrease in other creditors  | (445)       |
|       | (Decrease)/increase in deferred taxation   | (671,755)   |
|       | Increase in provision for major overhauls  | 67,603      |
| ----- |  |             |
|       | NET CASH INFLOW FROM OPERATING ACTIVITIES  | 1,082,997   |
| ===== |  |             |
| (ii)  | INVESTING AND FINANCING ACTIVITIES NOT REQUIRING THE USE OF CASH AND CASH EQUIVALENTS: |             |
|       | Purchase of fixed assets by assumption of debts  | -           |
| ===== |  |             |
| (iii) | NET (DECREASE)/ INCREASE IN CASH AND CASH EQUIVALENTS:                                 |             |
|       | Cash and cash equivalents at the end of the year                                       | 1,404,874   |
|       | Less: Cash and cash equivalents at the beginning of the year                           | 2,960,337   |
| ----- |  |             |
|       | NET (DECREASE)/ INCREASE IN CASH AND CASH EQUIVALENTS                                  | (1,555,463) |
| ===== |  |             |

The notes on pages 116 to 182 form part of these financial statements.

116 CHINA SOUTHERN AIRLINES COMPANY LIMITED 2003 ANNUAL REPORT [LOGO]

NOTES TO THE FINANCIAL STATEMENTS

(Prepared under PRC Accounting Rules and Regulations)

1 BACKGROUND OF THE COMPANY

China Southern Airlines Company Limited (the "Company") and its subsidiary companies (collectively the "Group") are principally engaged in the provision of domestic, Hong Kong regional and international passenger, cargo and mail airline services, with flights operating primarily from the Guangzhou Baiyun International Airport, which is both the main hub of the Group's route network and the location of its corporate headquarters.

The Company is a joint stock limited company established by China Southern Air Holding Company ("CSAHC") pursuant to approval document Ti Gai Sheng [1994] No. 139 from the State Commission for Economic Restructuring of the Peoples' Republic of China ("PRC"). CSAHC injected airline-related assets and liabilities as at 1 January, 1994 into the Company in exchange for 2,200,000,000 domestic shares with a par value of RMB1.00 each. The Company was established on 25 March, 1995, and took over the control of the airline business from CSAHC since that date.

Pursuant to an approval document Zheng Wei Fa [1997] No. 33 from the China Securities Regulatory Commission, the Company listed its 1,174,178,000 H Shares on both the Stock Exchange of Hong Kong Limited

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and the New York Stock Exchange in July 1997.

Pursuant to an extraordinary general meeting of shareholders held on 21 May, 2002, a resolution was passed authorising the Company to issue not more than 1,000,000,000 A shares of par value of RMB1.00 each. Pursuant to an approval document (2003) No. 70 from the China Securities Regulatory Commission, the Company issued and listed its 1,000,000,000 A shares with a par value of RMB1.00 each on the Stock Exchange of Shanghai in July 2003.

On 13 March, 2003, the Company obtained an approval certificate Wai Jing Mao Zi Yi [2003] No. 273 from the Ministry of Commerce to change to a permanent limited company with foreign investments and obtained the business licence (Qi Gu Guo Fu Zi No. 000995) on 17 October, 2003 issued by the State Administration of Industry and Commerce of the People's Republic of China.

### 2 CHANGE IN ACCOUNTING POLICY

The Company changed its accounting policy in order to conform with the revised "Accounting standard for business enterprises - Events occurring after the balance sheet date" ("Revised Standard"). According to the original standard, the appropriation of profit for the current year approved by the board of directors after the balance sheet date was an adjusting event. Pursuant to the revised "Accounting standard for business enterprises - Events occurring after the balance sheet date" (Cai Kuai [2003] No. 12) issued by the Ministry of Finance ("MOF") on 14 April, 2003, cash dividends for the current period declared and approved by the board of directors after the balance sheet date, but before the financial statements are authorised for issue, should be presented separately under shareholders' funds on the balance sheet. The Company has adopted the Revised Standard by adjusting retrospectively for the dividend for 2001 which was paid in 2002.

This change in accounting policy has no impact on the retained profits as at 1 January, 2003. The effect of the change in accounting policy for prior years is set out below:

|                                     | BEFORE<br>ADJUSTMENT<br>RMB' 000 | ADJUSTMENT<br>RMB' 000 |
|-------------------------------------|----------------------------------|------------------------|
| Retained profits at 1 January, 2002 | 344,859                          | 67,484                 |
|                                     |                                  |                        |

[LOGO] CHINA SOUTHERN AIRLINES COMPANY LIMITED 2003 ANNUAL REPORT 117

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)  
(Prepared under PRC Accounting Rules and Regulations)

### 3 SIGNIFICANT ACCOUNTING POLICIES

The significant accounting policies adopted by the Group in the preparation of the financial statements conform to the Accounting Standards for Business Enterprises and the "Accounting Regulations for Business Enterprises" and other relevant regulations issued by the MOF.

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Pursuant to a notice Cai Kuai (2003) No.18 from the MOF, the Group adopts the "Accounting Method for Civil Aviation Industry" since 1 January, 2003. The significant accounting policies adopted in the preparation of these financial statements are set out below:

(a) ACCOUNTING YEAR

The accounting year of the Group is from 1 January to 31 December.

(b) BASIS OF CONSOLIDATION

The consolidated financial statements have been prepared in accordance with "Accounting Regulations for Business Enterprises" and Cai Kuai Zi [1995] No.11 "Provisional regulations on consolidated financial statements" issued by the MOF.

The consolidated financial statements include the financial statements of the Company and all of its principal subsidiaries. Subsidiaries are those entities in which the Company has more than 50% equity interest or those entities controlled by the Company. The consolidated income statement of the Company only includes the results of the subsidiaries during the period when the Company has more than 50% equity interest, or when the Company does not have more than 50% equity interest, but has control over those entities. The effect of minority interests on equity and profit/loss attributable to minority interests are separately shown in the consolidated financial statements. For those subsidiaries whose assets and results of operations are not significant and have no significant effect on the Group's consolidated financial statements, the Company does not consolidate these subsidiaries.

Where the accounting policies adopted by subsidiaries are different from the policies adopted by the Company, the financial statements of the subsidiaries have been adjusted in accordance with the accounting policies adopted by the Company on consolidation. All significant intercompany balances and transactions, and any unrealised gains arising from inter-company transactions, have been eliminated on consolidation.

For those jointly controlled entities which the Company has joint control with other investors under contractual arrangements, the Company consolidates their assets, liabilities, revenues, costs and expenses based on the proportionate consolidation method according to the percentage of holding of equity interest in those entities in the consolidated financial statements.

(c) BASIS OF PREPARATION

The financial statements of the Group have been prepared on an accrual basis under the historical costs convention, unless otherwise stated.

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NOTES TO THE FINANCIAL STATEMENTS (Cont'd)  
(Prepared under PRC Accounting Rules and Regulations)

### 3 SIGNIFICANT ACCOUNTING POLICIES (cont'd)

(d) REPORTING CURRENCY

The financial statements are prepared in Renminbi.

(e) TRANSLATION OF FOREIGN CURRENCIES

Foreign currency transactions during the year are translated into Renminbi at the exchange rates quoted by the People's Bank of China at the transaction dates. Monetary assets and liabilities denominated in foreign currencies are translated into Renminbi at the exchange rates quoted by the People's Bank of China at the balance sheet date. Exchange gains and losses on foreign currency translation, except for the gains and losses relating to the transactions referred to below, are dealt with in the income statement.

Exchange differences directly relating to the purchase or construction of fixed assets (including exchange differences on funds borrowed specifically for the purchase or construction of fixed assets) before they are ready for use are capitalised as part of the cost of fixed assets.

(f) CASH EQUIVALENTS

Cash equivalents are short-term, highly liquid investments which are readily convertible into known amounts of cash, and which are subject to an insignificant risk of change in value.

(g) ALLOWANCE FOR DOUBTFUL ACCOUNTS

Trade accounts receivable showing signs of uncollectibility are identified individually and allowance is then made based on the probability of being uncollectible. In respect of trade accounts receivable showing no sign of uncollectibility, allowance is made with reference to the ageing analysis and management's estimation based on past experience.

Allowances for other receivables are made based on the nature of the receivables and estimation of the corresponding collectibility risk.

(h) INVENTORIES

Inventories, which consist primarily of expendable spare parts and supplies, are carried at the lower of cost and net realisable value. Inventories are measured at their actual cost upon acquisition. The cost of inventories is calculated using the weighted average method. Any excess of the cost over the net realisable value of each class of inventories is recognised as a provision for diminution in value of inventories. Net realisable value is determined based on amount recoverable in the normal course of business after the balance sheet date or estimates made by management based on market conditions. Inventories are recorded using the perpetual stocking method.

Inventories are amortised in full when issue for use.

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)  
(Prepared under PRC Accounting Rules and Regulations)

## 3 SIGNIFICANT ACCOUNTING POLICIES (cont'd)

## (i) LONG-TERM EQUITY INVESTMENTS

Long-term investments are stated at the lower of cost and the recoverable amount. A provision for impairment is determined on an individual basis on difference between the cost and the recoverable amount, if the latter is lower.

A long-term equity investment in an investee enterprise that the Company has the power to control, jointly control or exercise significant influence over is accounted for under the equity method of accounting whereby the investment is initially recorded at cost and adjusted thereafter for any post acquisition change in the Company's share of the net assets of the enterprise. Equity investment difference, which is the difference between the initial investment cost and the Company's share of the equity of the investee enterprise, is accounted for as follows:

- Any excess of the initial investment cost over the Company's share of the equity is amortised on a straight-line basis. The amortisation period is determined according to the investment period as stipulated in the relevant agreement, or 10 years if the investment period is not specified in the agreement.
- Any shortfall of the initial investment cost over the Group's share of investors' equity is amortised on a straight-line basis over 10 years if the investment was acquired before the issuance of the "Questions and answers on implementing Accounting Regulations for Business Enterprises and related accounting standards (II)" (Cai Kuai [2003] No. 10) on 7 April, 2003. Otherwise, the shortfalls are recognised in "Capital surplus - reserve for equity investment".

A long-term equity investment in an investee enterprise that the Group does not control, jointly control or exercise significant influence over is accounted for under the cost method. Investment income is recognised when an investee enterprise declares a cash dividend or distributes profits.

Upon disposal or transfer of long-term equity investments, the difference between the proceeds received and the carrying value of the investments is recognised in the income statement.



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(Prepared under PRC Accounting Rules and Regulations)

## 3 SIGNIFICANT ACCOUNTING POLICIES (cont'd)

### (j) FIXED ASSETS AND CONSTRUCTION IN PROGRESS

Fixed assets represent the assets held by the Group for rendering services and administrative purposes with useful lives over 1 year and comparatively high unit values.

Fixed assets are stated in the balance sheet at cost or revalued amount less accumulated depreciation and impairment losses. Construction in progress are stated in the balance sheet at cost less impairment losses. Valuation is carried out in accordance with the relevant rules and regulations in the PRC and fixed assets and construction in progress are adjusted to the revalued amounts accordingly.

All direct and indirect costs related to the acquisition or construction of fixed assets, incurred before the assets are ready for their intended uses, are capitalised as construction in progress. Those costs include borrowing costs, which include foreign exchange differences, on specific borrowings for the construction of the fixed assets during the construction period.

Construction in progress is transferred to fixed assets when the asset is ready for its intended use.

Pursuant to an approval document Cai Kuai Han [2004] No. 39 from the MOF, the Group accounts for rotables as fixed assets.

Depreciation is provided to write off the cost of fixed assets over their estimated useful lives on a straight-line basis, after taking into account their estimated residual values. The respective estimated useful lives, residual values and annual depreciation rates for fixed assets are as follows:

|   | DEPRECIABLE LIFE |
|---|------------------|
| Owned and leased aircraft               | 8 to 15 years    |
| Other flight equipment:                 |                  |
| - Jet engines                           | 8 to 15 years    |
| - Others, including high value rotables | 8 to 15 years    |
| Buildings                               | 15 to 40 years   |
| Machinery and equipment                 | 5 to 10 years    |
| Motor vehicles                          | 6 years          |

Land use rights are stated in the balance sheet at cost or revalued amount less accumulated depreciation and impairment losses, and are amortised on a straight line basis over the period for land use rights.

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NOTES TO THE FINANCIAL STATEMENTS (Cont'd)  
(Prepared under PRC Accounting Rules and Regulations)

3 SIGNIFICANT ACCOUNTING POLICIES (cont'd)

(k) LEASED ASSETS

(i) FINANCE LEASE

A finance lease is a lease that transfers substantially all the risks and benefits of ownership of an asset to the lessee, whether or not the legal title to the asset is eventually transferred. Flight equipment acquired by way of finance leases are stated at an amount equal to the lower of their original carrying value in the books of the legal owner (the lessor) and the present value of the minimum lease payments at inception of the lease. Depreciation of leased assets is calculated using the straight-line method. If there is no reasonable certainty that the lessee will obtain ownership of the leased assets at the end of the lease term, the leased assets are depreciated over the shorter of the lease term or their estimated useful lives. If there is reasonable certainty that the lessee will obtain ownership of the leased assets at the end of the lease term, the leased assets are depreciated over their estimated useful lives. At the inception of the lease, the minimum lease payments are recorded as obligations under finance leases. The difference between the value of the leased assets and the minimum lease payments is recognised as unrecognised finance charges under finance leases.

Unrecognised finance charges are amortised on an effective interest method over the lease term.

(ii) OPERATING LEASE

An operating lease is a lease other than a finance lease. Operating lease payments are charged to the income statement on a straight line basis over the terms of the related leases. Contingent rental is recognised as expenses of the current period when actually occurs.

(l) DEFERRED EXPENDITURE

Custom duties and other direct costs in relation to modifying, introducing and certifying certain operating leased aircraft are deferred and amortised on a straight line basis over the terms of the related leases.

3 SIGNIFICANT ACCOUNTING POLICIES (cont'd)

(m) IMPAIRMENT OF LONG-TERM INVESTMENTS, FIXED ASSETS,  
CONSTRUCTION IN PROGRESS AND OTHER ASSETS

The carrying amounts of individual assets are reviewed regularly to determine whether the recoverable amounts have declined below the carrying value. These assets are tested for impairment whenever events or changes in circumstances indicate that their recorded carrying amounts may not be recoverable. When such a decline has occurred, the carrying amount is reduced to the recoverable amount. The recoverable amount is the greater of the estimated net selling price and the estimated value in use. In determining the value in use, estimated future cash flows to be generated by the asset are discounted to their present value. The provision for impairment loss is determined on an item-by-item basis and recognised as an expense in the income statement.

If there is an indication that an impairment loss recognised for an asset in prior years may no longer exist, or if there has been a change in the estimates used to determine the recoverable amount, which reduces the impairment loss, the provision for impairment loss is reversed. The reversed amount is credited to the income statement in the period in which the reversal is recognised.

(n) INCOME TAX

Income tax is recognised using the tax effect accounting method. Income tax for the year comprises current and deferred tax.

Current tax is calculated at the applicable tax rate on taxable profit.

Deferred tax is provided under the liability method, for timing differences between the accounting profit before tax and the taxable profit arising from the differences in the accounting and tax treatment of income and expenses or losses. When the tax rates change or new types of tax are levied, adjustments are made to the amounts originally recognised for the timing differences. The current tax rates are used in arriving at the reversal amounts when the timing differences are reversed.

Deferred tax assets arising from the tax value of losses, which are expected to be utilised against future taxable income, are set off against the deferred tax liabilities of the same tax payer and within the same jurisdiction. Deferred tax assets are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

(o) MAINTENANCE AND OVERHAUL COSTS

Routine maintenance and repairs and overhauls in respect of owned aircraft and aircraft held under finance leases are expensed as and when incurred. In respect of aircraft held under operating leases, a provision is made over the lease term for the estimated cost of scheduled overhauls that are required to be performed on the related aircraft prior to their return to the lessors.

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)  
(Prepared under PRC Accounting Rules and Regulations)

3 SIGNIFICANT ACCOUNTING POLICIES (cont'd)

(p) REVENUE RECOGNITION

Provided it is probable that the economic benefits will flow to the Group and the revenue and costs can be measured reliably, revenue is recognised in the income statement as follows:.

- (i) Passenger, cargo and mail revenues are recognised when the transportation is provided. Ticket sales for transportation not yet provided are included in current liabilities as sales in advance of carriage;
- (ii) Revenues from airline-related businesses are recognised when the relevant services are rendered;
- (iii) Interest income is recognised on a time-apportioned basis on the principal outstanding and at the applicable rate; and
- (iv) Dividend income is recognised when the Group's right to receive the dividend is established.

(q) TRAFFIC COMMISSIONS

Traffic commissions are expensed when the transportation is provided and the related revenue is recognised. Traffic commissions for transportation not yet provided are recorded on the balance sheet as a prepaid expense.

(r) BORROWING COSTS

Borrowing costs incurred on specific borrowings for the construction of fixed assets are capitalised into the cost of the fixed assets during the construction period in which the assets are brought to their intended uses.

Except for the above borrowing costs, other borrowing costs are recognised as financial expenses in the income statement when incurred.

(s) DIVIDENDS

Cash dividends to shareholders are recognised in the income and profit appropriation statement when approved. Dividends proposed or approved after the balance sheet date but before the date on which the financial statements are authorised for issue are separately disclosed under shareholders' equity in the balance sheet.

(t) RETIREMENT BENEFITS

Contributions to retirement schemes and additional retirement benefits paid to retired employees are charged to the income statement as and when incurred.

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)  
(Prepared under PRC Accounting Rules and Regulations)

3 SIGNIFICANT ACCOUNTING POLICIES (cont'd)

(u) FREQUENT FLYER AWARD PROGRAMMES

The Group maintains two frequent flyer award programmes, namely, the China Southern Airlines Sky Pearl Club and Egret Mileage Plus, which provide travel awards to members based on accumulated mileage. The estimated incremental cost of providing free travel is recognised as an expense and accrued as a current liability as members accumulate mileage. As members redeem awards or their entitlements expire, the incremental cost liability is reduced accordingly, to reflect the acquittal of the outstanding obligations.

Revenue from mileage sales to third parties under the frequent flyer award programmes is recognised when the related transportation services are provided.

(v) RELATED PARTY

Parties are considered to be related to the Group if the Group has the ability, directly or indirectly, to control the party or exercise significant influence over the party in making financial and operating decisions, or vice versa, or where the Group and the party are subject to common control or common significant influence. Related parties may be individuals or entities.

4 TAXATION

(a) TAXES APPLICABLE TO RENDERING OF SERVICES BY THE GROUP ARE AS FOLLOWS:

| CATEGORIES OF TAXES   | TAX RATES | BASIS OF TAX  |
|-----------------------|-----------|---|
| Business tax          | 3% or 5%  | Traffic revenue, ground services income and commission income. All inbound international and Hong Kong regional flights are exempted from business tax. |
| City construction tax | 7%        | Business tax  |
| Education surcharge   | 3%        | Business tax  |

Pursuant to approval documents Cai Shui [2003] No. 113 and Cai Shui [2003] No. 227 jointly issued by the MOF and State Tax Bureau, passenger revenue from airline operations are exempted from business tax, city construction tax and education surcharge during the period from 1 May, 2003 to 31 December, 2003.

As mentioned in Note 1 to the financial statements, the Company's status has changed to foreign investment enterprise. Accordingly, pursuant to the relevant regulations, the Company is exempted from city construction tax and education surcharge

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since 1 October, 2003.

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NOTES TO THE FINANCIAL STATEMENTS (Cont'd)  
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## 4 TAXATION (cont'd)

### (b) INCOME TAX

The tax rate applicable to the Company for the period from 1 January, 2003 to 30 September, 2003 and for the period from 1 October, 2003 to 31 December, 2003 is 33% and 15% respectively.

On 17 October, 2003, the Company's registered address was moved to Guangzhou Economic & Technology Development Zone. In accordance with the Rules and Regulations for Implementation of Income Tax for Foreign Investment Enterprises and Foreign Enterprises of the PRC and a taxation approval document "Guangzhou Municipal State Tax Bureau Suo De Shui Zi Que 020043", the Company is entitled to enjoy the preferential tax policy implemented in the Guangzhou Economic & Technology Development Zone effective 1 October, 2003. As a result, the Company's income tax rate has been changed to 15% beginning from that date.

In respect of the Group's overseas airline activities, the Group has either obtained exemptions from overseas taxation pursuant to the bilateral aviation agreements between the overseas governments and PRC government, or has sustained tax losses in these overseas jurisdictions. Accordingly, no provision for overseas tax has been made for the period.

Certain subsidiaries and jointly controlled entities of the Company have been granted with tax concessions which are set out below:

| NAME OF SUBSIDIARIES  | APPLICABLE TAX RATE | REASONS FOR GRANTING  |
|---|---------------------|---|
| Zhuhai Airlines Company Limited                             | 15%                 | Operated in a special economic zone and accordingly enjoyed a reduced tax rate pursuant to documents Cai Shui Zi (87) No. 115 and Cai Shui Zi (87) No. 115                                    |
| Southern Airlines Group<br>Shantou Airlines Company Limited | 15%                 | Ditto   |
| Xiamen Airlines Company Limited                             | 15%                 | Ditto   |
| Guangzhou Nanland Air Catering<br>Company Limited           | 27%                 | Pursuant to Rules and Regulations for Implementation of Income Tax for Foreign Investment Enterprises and Foreign Enterprises of the PRC, the applicable tax rate is 24% and local income tax |
| Zhuhai Xiang Yi Aviation Technology                         | -                   | Pursuant to Zhu Guo Shui Han  |

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Company Limited

issued by Zhuhai Municipal S  
exempted from income tax.

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NOTES TO THE FINANCIAL STATEMENTS (Cont'd)  
(Prepared under PRC Accounting Rules and Regulations)

4 TAXATION (cont'd)

(b) INCOME TAX (cont' d)

| NAME OF JOINTLY<br>CONTROLLED ENTITY                          | APPLICABLE<br>TAX RATE | REASONS FOR GRANTING CONCO  |
|---|------------------------|---|
| Guangzhou Aircraft Maintenance<br>Engineering Company Limited | 15%                    | Pursuant to Sui Guo Shui Zhi Fa [ issued by Guangzhou Municipal Sta applicable income tax rate is 15% |

(c) TAX PAYABLE

|                       | THE GROUP       |                 | THE COMPANY     |                 |
|-----------------------|-----------------|-----------------|-----------------|-----------------|
|                       | 2003<br>RMB'000 | 2002<br>RMB'000 | 2003<br>RMB'000 | 2002<br>RMB'000 |
| Enterprise income tax | 46,052          | 33,734          | -               | -               |
| Business tax          | 25,224          | 75,256          | 2,732           | 35,998          |
| City construction tax | 1,663           | 5,463           | 956             | 3,032           |
| Value added tax       | 12,829          | 6,694           | 177             | 250             |
| Other                 | 16,366          | 1,510           | 7,236           | 471             |
| <b>Total</b>          | <b>102,134</b>  | <b>122,657</b>  | <b>11,101</b>   | <b>39,751</b>   |

5 CAAC INFRASTRUCTURE DEVELOPMENT FUND

The CAAC infrastructure development fund is levied at a certain percentage on traffic revenue and payable to the CAAC. Pursuant to the regulation, Cai Zhong Zi [1999] No. 11 jointly issued by the MOF and the State Development Commission, the CAAC infrastructure development Fund is levied at 5% and 2% on domestic traffic revenue and international/Hong Kong regional traffic revenue respectively.

Pursuant to the approval documents Cai Zong Ming Dian No. 1 and Ming Hang Ji No. 2026, the Group was exempted from paying the CAAC infrastructure development fund during the period from 1 May, 2003 to 31 December, 2003.

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NOTES TO THE FINANCIAL STATEMENTS (Cont' d)  
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6. CASH AND CASH EQUIVALENTS

|                                      | THE GROUP                    |             |                              |             |                              |             |
|--------------------------------------|------------------------------|-------------|------------------------------|-------------|------------------------------|-------------|
|                                      | 2003                         |             | 2002                         |             | 2003                         |             |
|                                      | Original<br>currency<br>'000 | RMB<br>'000 | Original<br>currency<br>'000 | RMB<br>'000 | Original<br>currency<br>'000 | RMB<br>'000 |
| -----                                |                              |             |                              |             |                              |             |
| Cash in hand                         |                              |             |                              |             |                              |             |
| Renminbi                             | -                            | 1,544       | -                            | 1,817       | -                            | 7           |
| US Dollars                           | 334                          | 2,766       | 581                          | 4,806       | 321                          | 2,6         |
| Other currencies                     | -                            | 1,081       | -                            | 1,311       | -                            | 6           |
|                                      |                              | 5,391       |                              | 7,934       |                              | 4,0         |
| -----                                |                              |             |                              |             |                              |             |
| Cash at bank                         |                              |             |                              |             |                              |             |
| Renminbi                             | -                            | 1,382,773   | -                            | 2,613,406   | -                            | 623,6       |
| US Dollars                           | 31,562                       | 261,227     | 26,642                       | 220,522     | 17,890                       | 148,0       |
| HK Dollars                           | 10,136                       | 10,802      | 43,443                       | 46,096      | 3,570                        | 3,8         |
| Japanese Yen                         | 536,855                      | 41,479      | 1,243,503                    | 85,846      | 536,855                      | 41,4        |
| Singapore Dollars                    | 2,399                        | 11,657      | 6,128                        | 29,237      | 2,399                        | 11,6        |
| Thai Bahts                           | 55,520                       | 11,587      | 72,633                       | 13,901      | 52,496                       | 10,9        |
| Malayshian Kroners                   | 20,489                       | 44,503      | 51,127                       | 111,303     | 18,522                       | 40,2        |
| Euro                                 | 1,921                        | 19,860      | 6,305                        | 54,451      | 1,764                        | 18,2        |
| Korean Won                           | 13,440,253                   | 95,359      | 2,087,009                    | 14,380      | 13,472,347                   | 93,2        |
| Vietnam Dong                         | 41,530,902                   | 21,974      | 12,182,156                   | 6,554       | 41,530,902                   | 21,9        |
| Australian Dollars                   | 5,653                        | 35,056      | 8,251                        | 38,603      | 5,201                        | 32,2        |
| Other currencies                     | -                            | 8,837       | -                            | 2,088       | -                            | 8,8         |
|                                      |                              | 1,945,114   |                              | 3,236,387   |                              | 1,054,4     |
| -----                                |                              |             |                              |             |                              |             |
| Deposits in financial<br>institution |                              |             |                              |             |                              |             |
| Renminbi                             | -                            | 370,978     | -                            | 540,503     | -                            | 346,3       |
| US Dollars                           | -                            | -           | 43,550                       | 360,476     | -                            | -           |
|                                      |                              | 370,978     |                              | 900,979     |                              | 346,3       |
| -----                                |                              |             |                              |             |                              |             |
| Total                                |                              | 2,321,483   |                              | 4,145,300   |                              | 1,404,8     |
| =====                                |                              |             |                              |             |                              |             |

Deposits in financial institution represent deposits with Southern Airlines Group Finance Company Limited ("SA Finance"), a PRC authorised financial institution controlled by CSAHC and an associated company of the Group (Note 45).



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The Group does not have any collateralised or frozen bank deposits as at 31 December, 2003. As at 31 December, 2003, the Group's overseas bank deposits amounted to RMB342,555,000 (2002: RMB441,078,000). These overseas bank deposits are not subject to any significant risk of uncollectibility.

The above cash, bank deposits and deposits with financial institution denominated in foreign currencies are translated into Renminbi at the following exchange rates:

|                   | 2003      | 2002      |
|-------------------|-----------|-----------|
| -----             |           |           |
| US Dollar         | 8.2767    | 8.2773    |
| HK Dollar         | 1.0657    | 1.0611    |
| Japanese Yen      | 0.077263  | 0.069035  |
| Singapore Dollar  | 4.85865   | 4.77050   |
| Thai Baht         | 0.2087    | 0.1914    |
| Malaysian Ringgit | 2.172     | 2.1770    |
| Euro              | 10.3383   | 8.6360    |
| Korean Won        | 0.006925  | 0.006890  |
| Vietnam Dong      | 0.0005291 | 0.0005380 |
| Australian Dollar | 6.2013    | 4.6787    |
| =====             |           |           |

Note: Balances dominated in foreign currencies in these financial statements are translated into Renminbi at the above rates, unless otherwise stated.

### 7 TRADE RECEIVABLES

|   | THE GROUP |         | THE COMPANY |         |
|---|-----------|---------|-------------|---------|
|   | 2003      | 2002    | 2003        | 2002    |
|   | RMB'000   | RMB'000 | RMB'000     | RMB'000 |
| -----   |           |         |             |         |
| Gross trade receivables                       | 961,824   | 803,080 | 739,958     | 505,172 |
| Less: Provision for<br>bad and doubtful debts | 69,997    | 60,118  | 56,752      | 28,640  |
| -----   |           |         |             |         |
|   | 891,827   | 742,962 | 683,206     | 476,532 |
| =====   |           |         |             |         |

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NOTES TO THE FINANCIAL STATEMENTS (Cont'd)  
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### 7 TRADE RECEIVABLES (cont'd)

The ageing analysis of trade receivables is as follows:

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|                                     | 2003              |   |                                  |                                    |                   | % total receiv % |
|-------------------------------------|-------------------|---|----------------------------------|------------------------------------|-------------------|------------------|
|                                     | AMOUNT<br>RMB'000 | % OF<br>TOTAL TRADE<br>RECEIVABLES<br>% | BAD DEBT<br>PROVISION<br>RMB'000 | % OF<br>BAD DEBT<br>PROVISION<br>% | Amount<br>RMB'000 |                  |
| Within 1 year                       | 896,722           | 93.2%                                   | 4,895                            | 0.5%                               | 771,411           |                  |
| After 1 year but<br>within 2 years  | 42,408            | 4.4%                                    | 42,408                           | 100.0%                             | 18,176            |                  |
| After 2 years but<br>within 3 years | 14,383            | 1.5%                                    | 14,383                           | 100.0%                             | 5,150             |                  |
| After 3 years                       | 8,311             | 0.9%                                    | 8,311                            | 100.0%                             | 8,343             |                  |
| <b>Total</b>                        | <b>961,824</b>    | <b>100.0%</b>                           | <b>69,997</b>                    | <b>7.3%</b>                        | <b>803,080</b>    |                  |

THE COMPANY

|                                     | 2003              |   |                                  |                                    |                   | % total receiv % |
|-------------------------------------|-------------------|---|----------------------------------|------------------------------------|-------------------|------------------|
|                                     | AMOUNT<br>RMB'000 | % OF<br>TOTAL TRADE<br>RECEIVABLES<br>% | BAD DEBT<br>PROVISION<br>RMB'000 | % OF<br>BAD DEBT<br>PROVISION<br>% | Amount<br>RMB'000 |                  |
| Within 1 year                       | 684,656           | 92.5%                                   | 1,450                            | 0.2%                               | 491,032           |                  |
| After 1 year but<br>within 2 years  | 42,106            | 5.7%                                    | 42,106                           | 100.0%                             | 7,499             |                  |
| After 2 years but<br>within 3 years | 8,267             | 1.1%                                    | 8,267                            | 100.0%                             | 2,228             |                  |
| After 3 years                       | 4,929             | 0.7%                                    | 4,929                            | 100.0%                             | 4,413             |                  |
| <b>Total</b>                        | <b>739,958</b>    | <b>100.0%</b>                           | <b>56,752</b>                    | <b>7.7%</b>                        | <b>505,172</b>    |                  |

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NOTES TO THE FINANCIAL STATEMENTS (Cont'd)  
(Prepared under PRC Accounting Rules and Regulations)

7 TRADE RECEIVABLES (cont'd)

Provision for bad and doubtful debts

|                          | THE GROUP       |                 | THE COMPANY     |                 |
|--------------------------|-----------------|-----------------|-----------------|-----------------|
|                          | 2003<br>RMB'000 | 2002<br>RMB'000 | 2003<br>RMB'000 | 2002<br>RMB'000 |
| Balance as at 1 January, | 60,118          | 59,019          | 28,640          | 28,108          |
| Add: Charge for the year | 12,031          | 1,162           | 9,072           | 595             |

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|                                 |        |        |        |        |
|---------------------------------|--------|--------|--------|--------|
| Transfer in arising             |        |        |        |        |
| from dissolution of subsidiary  | -      | -      | 19,040 | -      |
| Less: Write-off during the year | 2,152  | 63     | -      | 63     |
| -----                           |        |        |        |        |
| Balance as at 31 December,      | 69,997 | 60,118 | 56,752 | 28,640 |
| =====                           |        |        |        |        |

There were no receivables from shareholders who hold 5% or more of the voting rights of the Company in the balance of trade receivables.

During the year, the Group and the Company had no individually significant recovery of doubtful debts that had been fully or substantially provided for in prior years.

At 31 December, 2003, the Group and the Company did not have any individually significant trade receivables aged over three years.

At 31 December, 2003, the total amounts of the Group's and the Company's largest 5 trade receivables were as follows:

|                              | THE GROUP |         | THE COMPANY |         |
|------------------------------|-----------|---------|-------------|---------|
|                              | 2003      | 2002    | 2003        | 2002    |
| -----                        |           |         |             |         |
| Amounts (RMB'000)            | 543,365   | 497,388 | 459,410     | 402,238 |
| % of total trade receivables | 56%       | 62%     | 62%         | 80%     |
| =====                        |           |         |             |         |

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NOTES TO THE FINANCIAL STATEMENTS (Cont'd)  
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8 OTHER RECEIVABLES

|   | THE GROUP       |                 | THE COMPANY     |                 |
|---|-----------------|-----------------|-----------------|-----------------|
|   | 2003<br>RMB'000 | 2002<br>RMB'000 | 2003<br>RMB'000 | 2002<br>RMB'000 |
| -----   |                 |                 |                 |                 |
| Subsidiaries                                  | -               | -               | 527,143         | -               |
| Related companies                             | 17,280          | 12,376          | 17,280          | 12,376          |
| Others  | 329,289         | 421,807         | 239,862         | 262,163         |
|   | 346,569         | 434,183         | 784,285         | 274,539         |
| Less: Provision for<br>bad and doubtful debts | 29,904          | 29,904          | 29,904          | 29,904          |
| -----   |                 |                 |                 |                 |
|   | 316,665         | 404,279         | 754,381         | 244,635         |
| =====   |                 |                 |                 |                 |

Provision for bad and doubtful debts

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|  | THE GROUP       |                 | THE COMPANY     |                 |
|--|-----------------|-----------------|-----------------|-----------------|
|  | 2003<br>RMB'000 | 2002<br>RMB'000 | 2003<br>RMB'000 | 2002<br>RMB'000 |
| Balance at 1 January and<br>31 December, | 29,904          | 29,904          | 29,904          | 29,904          |

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NOTES TO THE FINANCIAL STATEMENTS (Cont'd)  
(Prepared under PRC Accounting Rules and Regulations)

8 OTHER RECEIVABLES (cont'd)

The ageing analysis of other receivables is as follows:

THE GROUP

|                                     | 2003              |   |                                  |                                    | Amount<br>RMB'000 | total<br>rece |
|-------------------------------------|-------------------|---|----------------------------------|------------------------------------|-------------------|---------------|
|                                     | AMOUNT<br>RMB'000 | % OF<br>TOTAL OTHER<br>RECEIVABLES<br>% | BAD DEBT<br>PROVISION<br>RMB'000 | % OF<br>BAD DEBT<br>PROVISION<br>% |                   |               |
| Within 1 year                       | 285,290           | 82.3%                                   | -                                | 0.0%                               | 382,663           |               |
| After 1 year but<br>within 2 years  | 20,568            | 5.9%                                    | -                                | 0.0%                               | 15,679            |               |
| After 2 years but<br>within 3 years | 7,330             | 2.1%                                    | -                                | 0.0%                               | 7,336             |               |
| After 3 years                       | 33,381            | 9.7%                                    | 29,904                           | 89.6%                              | 28,505            |               |
| Total                               | 346,569           | 100.0%                                  | 29,904                           | 8.6%                               | 434,183           |               |

THE COMPANY

|                                     | 2003              |   |                                  |                                    | Amount<br>RMB'000 | total<br>rece |
|-------------------------------------|-------------------|---|----------------------------------|------------------------------------|-------------------|---------------|
|                                     | AMOUNT<br>RMB'000 | % OF<br>TOTAL OTHER<br>RECEIVABLES<br>% | BAD DEBT<br>PROVISION<br>RMB'000 | % OF<br>BAD DEBT<br>PROVISION<br>% |                   |               |
| Within 1 year                       | 740,164           | 94.3%                                   | -                                | 0.0%                               | 233,540           |               |
| After 1 year but<br>within 2 years  | 7,709             | 1.0%                                    | -                                | 0.0%                               | 9,878             |               |
| After 2 years but<br>within 3 years | 5,358             | 0.7%                                    | -                                | 0.0%                               | 4,702             |               |
| After 3 years                       | 31,054            | 4.0%                                    | 29,904                           | 96.3%                              | 26,419            |               |

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|       |         |        |        |      |         |
|-------|---------|--------|--------|------|---------|
| Total | 784,285 | 100.0% | 29,904 | 3.8% | 274,539 |
|-------|---------|--------|--------|------|---------|

There were no receivables from shareholders who hold 5% or more of the voting rights of the Company in the balance of other receivables.

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NOTES TO THE FINANCIAL STATEMENTS (Cont'd)  
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8 OTHER RECEIVABLES (cont'd)

During the year, the Group and the Company had no individually significant recovery of doubtful debts that had been fully or substantially provided for in prior years.

At 31 December, 2003, the Group and the Company did not have any individually significant other receivables aged over three years.

At 31 December, 2003, the total amounts of the Group's and the Company's largest 5 other receivables were as follows:

|                              | THE GROUP |         | THE COMPANY |         |
|------------------------------|-----------|---------|-------------|---------|
|                              | 2003      | 2002    | 2003        | 2002    |
| Amounts (RMB'000)            | 110,757   | 191,323 | 458,800     | 188,854 |
| % of total trade receivables | 32%       | 44%     | 58%         | 69%     |

9 ADVANCE PAYMENTS

All advance payments are due within one year. There was no amount due from shareholders who hold 5% or more of the voting rights of the Company in the balance of advance payments.

10 INVENTORIES

|                        | THE GROUP |         | THE COMPANY |         |
|------------------------|-----------|---------|-------------|---------|
|                        | 2003      | 2002    | 2003        | 2002    |
|                        | RMB'000   | RMB'000 | RMB'000     | RMB'000 |
| At cost:               |           |         |             |         |
| Expendable spare parts | 572,649   | 598,223 | 182,742     | 96,614  |
| Consumables            | 35,388    | 23,567  | 16,485      | 8,375   |
| Aviation supplies      | 20,372    | 18,740  | 10,562      | 9,762   |
| Others                 | 3,260     | 12,481  | 1,700       | 1,898   |
| Total                  | 631,669   | 653,011 | 211,489     | 116,649 |

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At 31 December, 2003, no provision for impairment in value was necessary for the inventories of the Group and the Company.

All of the above inventories were obtained by way of purchase.

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NOTES TO THE FINANCIAL STATEMENTS (Cont'd)  
(Prepared under PRC Accounting Rules and Regulations)

10 INVENTORIES (cont'd)

The Group's and the Company's cost of inventories charged to costs and expenses in the income statement were as follows:

|             | 2003<br>RMB'000 | 2002<br>RMB'000 |
|-------------|-----------------|-----------------|
| The Group   | 501,125         | 521,038         |
| The Company | 293,454         | 201,064         |
|             |                 |                 |

11 PREPAID EXPENSES

|                          |       | THE GROUP       |                 | THE COMPANY     |                 |
|--------------------------|-------|-----------------|-----------------|-----------------|-----------------|
|                          |       | 2003<br>RMB'000 | 2002<br>RMB'000 | 2003<br>RMB'000 | 2002<br>RMB'000 |
|                          | Notes |                 |                 |                 |                 |
|                          |       |                 |                 |                 |                 |
| Operating lease rentals  | (a)   | 127,099         | 118,233         | 75,091          | 72,897          |
| Ticket sales commission  | (b)   | 20,900          | 20,900          | 18,500          | 18,500          |
| Catering and consumables | (c)   | 33,313          | 15,687          | -               | 13,317          |
| Insurance premium        |       | 11,098          | 2,454           | 11,004          | 2,454           |
| Others                   |       | 10,960          | 8,480           | 9,722           | 2,725           |
|                          |       |                 |                 |                 |                 |
| Total                    |       | 203,370         | 165,754         | 114,317         | 109,893         |
|                          |       |                 |                 |                 |                 |

Notes:

- (a) Pursuant to aircraft operating lease agreements, the Group is required to prepay one to six months' rentals to lessors. The prepaid rentals are then amortised over the relevant lease period. The balance at the period end represents the unamortised balance of the prepaid rentals.
- (b) The Group pays sales commission to sales agents for tickets sales. The sales commission is initially recorded as a prepaid expense and charged to the income statement upon the provision of the related transportation service.
- (c) A jointly controlled entity of the Group is principally

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engaged in the provision of engine repair and maintenance services. Consumables consumed prior to the completion of the related engine repairs and maintenance are recorded as prepaid expenses and charged to income statement upon the completion of the related engine repairs and maintenance.

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NOTES TO THE FINANCIAL STATEMENTS (Cont'd)  
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12 LONG-TERM EQUITY INVESTMENTS

THE GROUP

|  | INVESTMENTS<br>IN ASSOCIATED<br>COMPANIES<br>RMB'000 | SHARE<br>INVESTMENTS<br>RMB'000 | OTHER<br>EQUITY<br>INVESTMENTS<br>RMB'000 | TOTAL<br>RMB'000 |
|--|--|---------------------------------|---|------------------|
| Balance as at 1 January, 2003                | 379,796  | 57,438                          | 139,616                                   | 576,850          |
| Add: Additions                               | -  | -                               | 4,209                                     | 4,209            |
| Adjustment under equity<br>accounting method | 44,536   | -                               | -   | 44,536           |
| Less: Disposals                              | 2,131  | -                               | 1,092                                     | 3,223            |
| Balance as at 31 December, 2003              | 422,201  | 57,438                          | 142,733                                   | 622,372          |

THE COMPANY

|  | INVESTMENTS<br>IN<br>SUBSIDIARIES<br>RMB'000 | INVESTMENTS<br>IN ASSOCIATED<br>COMPANIES<br>RMB'000 | INVESTMENTS<br>IN JOINTLY<br>CONTROLLED<br>ENTITIES<br>RMB'000 | SHARE<br>INVESTMENTS<br>RMB'000 | OT<br>EQ<br>INVE<br>RM |
|--|--|--|--|---------------------------------|------------------------|
| Balance as at 1 January, 2003                    | 3,201,545                                    | 271,275  | 716,094  | 1,208                           |                        |
| Add: Additions                                   | 2,999  | 8,487  | -  | -                               |                        |
| Adjustment under equity<br>accounting method     | 303,901                                      | 33,362   | (72,413)   | -                               |                        |
| Amortisation of equity<br>investment differences | 2,050  | -  | -  | -                               |                        |
| Less: Disposals                                  | 906,631                                      | 2,131  | -  | -                               |                        |
| Dividends received                               | 2,668  | -  | -  | -                               |                        |
| Balance as at 31 December, 2003                  | 2,601,196                                    | 310,993  | 643,681  | 1,208                           |                        |

At 31 December, 2003, no provision for impairment of the long-term

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equity investments of the Group and the Company was necessary.

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12 LONG-TERM EQUITY INVESTMENTS (cont'd)

In connection with the Group's overseas listing, the assets of the Group as at 31 December, 1996 were revalued. As a result of this revaluation, the Company's subsidiaries had a net revaluation deficit amounting to RMB30,284,000. The Company made corresponding adjustments amounting to RMB20,498,000 to investments in these subsidiaries. These adjustments were recorded as equity investment differences and amortised on a straight-line basis over 10 years, which represented the estimated remaining useful lives of the revalued assets of the subsidiaries. The equity investment differences are analysed as follows:

|                           | EQUITY<br>INVESTMENT<br>DIFFERENCES<br>RMB'000 |
|---------------------------|--|
| -----                     |  |
| ORIGINAL AMOUNT           | 20,498   |
| =====                     |  |
| ACCUMULATED AMORTISATION: |  |
| At 1 January, 2003        | 12,300   |
| Amortisation for the year | 2,050  |
| -----                     |  |
| At 31 December, 2003      | 14,350   |
| =====                     |  |
| UNAMORTISED BALANCE:      |  |
| At 31 December, 2003      | 6,148  |
| =====                     |  |
| At 31 December, 2002      | 8,198  |
| =====                     |  |

Details of the Group's associated companies and jointly controlled entities and the Company's subsidiaries are set out in Notes 49.

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NOTES TO THE FINANCIAL STATEMENTS (Cont'd)  
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12 LONG-TERM EQUITY INVESTMENTS (cont'd)

Details of the Group's and the Company's equity investments accounted for under the equity method are analysed as follows:

THE GROUP



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## Investments in associated companies

|  | SA<br>FINANCE<br>RMB'000 | HONG KONG<br>BUSINESS<br>AVIATION<br>CENTRE<br>COMPANY<br>LIMITED<br>RMB'000 | SICHUAN<br>AIRLINES<br>CORPORATION<br>LIMITED<br>RMB'000 | HAINAN<br>PHOENIX<br>INFORMATION<br>SYSTEM<br>LIMITED<br>RMB'000 | CIVIL<br>AVIATION<br>CARE<br>OF XIA<br>LIMITED<br>RMB'000 |
|--|--------------------------|--|--|--|---|
| -----  |                          |  |  |  |   |
| Attributable equity interest                             |                          |  |  |  |   |
| Direct   | 32%                      | 20%  | 39%  | 45%  | -   |
| Indirect   | 15.42%                   | -  |  | -  | 17.1  |
| Period of operations                                     | -                        | -  | -  | 40 years   | -   |
| Initial investment costs<br>(as at 1 January, 2003)      | 246,476                  | 17,081   | 136,500  | 61,266   | 570   |
| =====  |                          |  |  |  |   |
| Balance as at 1 January, 2003                            | 224,912                  | 15,154   | 139,160  | -  | 570   |
| Add: Adjustment under the<br>equity accounting<br>method | 19,533                   | (496)  | 24,645   | -  | 854   |
| Less: Disposals  | -                        | 2,131  | -  | -  | -   |
| -----  |                          |  |  |  |   |
| Balance as at 31 December, 2003                          | 244,445                  | 12,527   | 163,805  | -  | 1,424   |
| =====  |                          |  |  |  |   |

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NOTES TO THE FINANCIAL STATEMENTS (Cont'd)  
(Prepared under PRC Accounting Rules and Regulations)

12 LONG-TERM EQUITY INVESTMENTS (cont'd)

THE COMPANY

Investments in subsidiaries

|   | CHINA<br>SOUTHERN<br>AIRLINES<br>(GROUP)<br>SHENZHEN<br>CO. (NOTE)<br>RMB'000 | XIAMEN<br>AIRLINES<br>COMPANY<br>LIMITED<br>RMB'000 | SOUTHERN<br>AIRLINES<br>GROUP<br>SHANTOU<br>AIRLINES<br>COMPANY<br>LIMITED<br>RMB'000 | GUANGXI<br>AIRLINES<br>COMPANY<br>LIMITED<br>RMB'000 | ZHUHAI<br>AIRLINES<br>COMPANY<br>LIMITED<br>RMB'000 | GUIZHOU<br>AIRLINES<br>COMPANY<br>LIMITED<br>RMB'000 |
|---|---|---|---|--|---|--|
| -----   |   |   |   |  |   |  |
| Attributable equity interest:                       |   |   |   |  |   |  |
| Direct  | 100%  | 60%   | 60%   | 60%  | 60%   | 60%  |
| Period of operations                                | 10 years  | -   | 16 years  | -  | 20 years  | -  |
| Initial investment costs<br>(as at 1 January, 2003) | 808,980   | 353,061   | 168,000   | 102,540  | 150,000   | 48,000   |

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|   |         |           |         |         |          |        |
|---|---------|-----------|---------|---------|----------|--------|
| Balance as at 1 January, 2003                 | 896,821 | 1,595,231 | 138,816 | 103,975 | 92,890   | 35,196 |
| Add: Additions                                | -       | -         | -       | -       | -        | -      |
| Adjustment under the equity accounting method | -       | 222,175   | 27,836  | 37,942  | (10,711) | 8,986  |
| Amortisation of equity investment differences | -       | 4,053     | (162)   | (1,528) | 3,154    | -      |
| Less: Disposals                               | 896,821 | -         | -       | -       | -        | -      |
| Dividends received                            | -       | -         | -       | -       | -        | -      |
| Balance as at 31 December, 2003               | -       | 1,821,459 | 166,490 | 140,389 | 85,333   | 44,182 |

Note: China Southern Airlines (Group) Shenzhen Co., which was established in the PRC on 14 October 1993, was a wholly owned subsidiary of the Company. It was principally engaged in the provision of airline services. It had a registered capital of RMB808,980,000. Its operations and respective assets and liabilities were transferred to the Company upon its dissolution in March 2003.

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NOTES TO THE FINANCIAL STATEMENTS (Cont'd)  
(Prepared under PRC Accounting Rules and Regulations)

12 LONG-TERM EQUITY INVESTMENTS (cont'd)

THE COMPANY (cont'd)

Investments in associated companies

|   | SA<br>FINANCE<br>RMB'000 | HONG KONG<br>BUSINESS<br>AVIATION<br>CENTRE<br>COMPANY<br>LIMITED<br>RMB'000 | SICHUAN<br>AIRLINES<br>CORPORATION<br>LIMITED<br>RMB'000 | HAINAN<br>PHOENIX<br>INFORMATION<br>SYSTEM<br>LIMITED<br>RMB'000 | R |
|---|--------------------------|--|--|--|---|
| Attributable equity interest:                       |                          |  |  |  |   |
| Direct  | 32%                      | 20%  | 39%  | 45%  |   |
| Initial investment costs<br>(as at 1 January, 2003) | 127,299                  | 17,081   | 136,500  | 61,266   | 3 |
| Balance as at 1 January, 2003                       | 116,961                  | 15,154   | 139,160  | -  | 2 |
| Add: Additions                                      | 8,487                    | -  | -  | -  | - |
| Adjustment under the equity accounting method       | 9,213                    | (496)  | 24,645   | -  | - |
| Less: Disposals                                     | -                        | 2,131  | -  | -  | - |
| Balance as at 31 December, 2003                     | 134,661                  | 12,527   | 163,805  | -  | 3 |

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NOTES TO THE FINANCIAL STATEMENTS (Cont'd)  
(Prepared under PRC Accounting Rules and Regulations)

12 LONG-TERM EQUITY INVESTMENTS (cont'd)

THE COMPANY (cont'd)

Investments in jointly controlled entities

|   | CHINA<br>POSTAL<br>AIRLINES<br>LIMITED<br>RMB'000 | GUANGZHOU<br>AIRCRAFT<br>MAINTENANCE<br>ENGINEERING<br>COMPANY<br>LIMITED<br>RMB'000 | MTU<br>MAINTENANCE<br>ZHUHAI<br>CO., LTD.<br>RMB'000 | TOTAL<br>RMB'000 |
|---|---|--|--|------------------|
| Attributable equity interest                          |   |  |  |                  |
| Direct  | 49%   |  | 50%  |                  |
| Period of operations                                  | 15 years  | 40 years   | 30 years   |                  |
| Initial investment costs<br>(as at 1 January, 2003)   | 150,000   | 86,694   | 261,146  | 497,840          |
| Balance as at 1 January, 2003                         | 146,648   | 312,334  | 257,112  | 716,094          |
| Add: Adjustment under the equity<br>accounting method | (17,387)  | 20,510   | (75,536)   | (72,413)         |
| Balance as at 31 December, 2003                       | 129,261   | 332,844  | 181,576  | 643,681          |

The Group's and the Company's investments in the above companies are not subject to any restrictions on realisation of the investments and remittance of the investment returns.

The Group's and the Company's share investments are analysed as follows:

| NAME OF<br>INVESTED COMPANY   | TYPE OF<br>INVESTMENT | NUMBER OF<br>SHARES HELD | PERCENTAGE<br>OF EQUITY<br>INTEREST<br>HELD | INITIAL<br>INVESTMENT<br>COST<br>RMB'000 | 2003<br>RMB'000 |
|---|-----------------------|--------------------------|---|--|-----------------|
| THE COMPANY<br>Hainan Meilan International<br>Airport Company Limited | Ordinary              | 925,000                  | 0.37%                                       | 1,208                                    | 1,208           |

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SUBSIDIARIES:

|                                  |              |            |        |        |        |
|----------------------------------|--------------|------------|--------|--------|--------|
| Travelsky Technology Limited     | Legal person | 21,924,500 | 2.5%   | 33,730 | 33,730 |
| China Pacific Insurance Co. Ltd. | Ordinary     | 10,000,000 | 0.5%   | 12,480 | 12,480 |
| Bank of Communications           | Ordinary     | 6,600,000  | 0.008% | 10,020 | 10,020 |
|                                  |              |            |        |        | 57,438 |

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NOTES TO THE FINANCIAL STATEMENTS (Cont'd)  
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12 LONG-TERM EQUITY INVESTMENTS (cont'd)

The Group's and the Company's other equity investments are analysed as follows:

| NAME OF INVESTED COMPANY   | INVESTMENT PERIOD (Years) | INITIAL INVESTMENT COST RMB'000 | PERCENTAGE OF EQUITY INTEREST HELD | 2003 RMB'000 | 2002 RMB'000 |
|--|---------------------------|---------------------------------|------------------------------------|--------------|--------------|
| THE COMPANY:   |                           |                                 |                                    |              |              |
| Haikou Meilan International Airport Company Limited                        | -                         | 100,000                         | 7.4%                               | 100,000      | 100,000      |
| Hunan Southern Airlines Travel Service Co. Ltd.                            | 10                        | 540                             | 54%                                | 540          |              |
| COMPANY'S TOTAL  |                           |                                 |                                    | 100,540      | 100,000      |
| THE SUBSIDIARIES:  |                           |                                 |                                    |              |              |
| Xiamen Aviation Industry Co. Ltd.  | -                         | 20,000                          | 10%                                | 20,000       | 20,000       |
| CAAC Express Ltd   | -                         | 7,603                           | 5%                                 | 7,603        | 7,603        |
| Xiamen Football Club   | -                         | 3,000                           | 5.2%                               | 3,000        | 3,000        |
| China Aircraft Services Ltd.   | -                         | 1,547                           | 1%                                 | 1,547        | 1,547        |
| CAAC Data Communication Co. Ltd.   | -                         | 500                             | 4%                                 | 500          | 500          |
| Zhuhai Airlines Holiday Travel Services Co. Ltd. (Note)                    | 10                        | 1,092                           | 91%                                | -            | 1,092        |
| Zhuhai Advertising Co. Ltd. (Note)   | 10                        | 300                             | 60%                                | 300          | 300          |
| Hunan Southern Airlines Travel Service Co. Ltd. (Note)                     | 10                        | 540                             | 51%                                | -            | 540          |
| Zhuhai Air-Express Co. Ltd. (Note)   | -                         | 900                             | 30%                                | 900          | 900          |
| Guilin Guangsheng Development Co. Ltd. (Note)                              | 10                        | 630                             | 30%                                | 630          | 630          |
| Guangzhou Baiyun International Express Customs Supervision Co. Ltd. (Note) | -                         | 2,750                           | 55%                                | 2,750        |              |
| Other  |                           |                                 |                                    | 4,963        | 3,500        |
|  |                           |                                 |                                    | 42,193       | 39,613       |
| TOTAL  |                           |                                 |                                    | 142,733      | 139,613      |

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Note: The impact of these companies on the Group's results is not material. Accordingly, they are accounted for under cost method (Note 49). For those companies of which the Group has more than 50% equity interest, the Company did not consolidate these companies because their aggregate assets, liabilities and results of operation had no significant effect to the Group.

At 31 December, 2003, the proportion of the total amount of the Group's and the Company's investments to the net assets was 5% and 32% respectively (2002: 6% and 48% respectively).

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NOTES TO THE FINANCIAL STATEMENTS (Cont'd)  
(Prepared under PRC Accounting Rules and Regulations)

13 FIXED ASSETS

THE GROUP

|   | LAND USE<br>RIGHTS AND<br>BUILDINGS<br>RMB'000 | AIRCRAFT         |  | OTHER FLIGHT<br>EQUIPMENT,<br>INCLUDING<br>ROTABLE<br>SPARES<br>RMB'000 | MA<br>E<br>AN<br>V<br>R |
|---|--|------------------|--|---|-------------------------|
|   |  | OWNED<br>RMB'000 | HELD UNDER<br>FINANCE<br>LEASES<br>RMB'000 |   |                         |
| -----   |  |                  |  |   |                         |
| Cost or valuation:                                  |  |                  |  |   |                         |
| At 1 January, 2003                                  | 3,673,349                                      | 13,510,717       | 11,459,978                                 | 6,458,704   | 1,                      |
| Reclassification on exercise<br>of purchase options | -  | 997,403          | (997,403)                                  | -   |                         |
| Additions   | 34,680   | 2,818,475        | -  | 558,594   |                         |
| Transferred from construction<br>in progress        | 253,833  | -                | -  | -   |                         |
| Disposals   | (42,138)                                       | (104,235)        | -  | -   |                         |
| -----   |  |                  |  |   |                         |
| At 31 December, 2003                                | 3,919,724                                      | 17,222,360       | 10,462,575                                 | 7,017,298   | 2,                      |
| -----   |  |                  |  |   |                         |
| Accumulated depreciation:                           |  |                  |  |   |                         |
| At 1 January, 2003                                  | 551,912  | 2,145,849        | 2,499,495                                  | 3,214,401   | 1,                      |
| Reclassification on exercise<br>of purchase options | -  | 389,958          | (389,958)                                  | -   |                         |
| Charge for the year                                 | 166,823  | 710,509          | 495,869                                    | 477,002   |                         |
| Written back on disposal                            | (22,155)                                       | (54,555)         | -  | -   |                         |
| -----   |  |                  |  |   |                         |
| At 31 December, 2003                                | 696,580  | 3,191,761        | 2,605,406                                  | 3,691,403   | 1,                      |
| -----   |  |                  |  |   |                         |
| Net book value:                                     |  |                  |  |   |                         |
| At 31 December, 2003                                | 3,223,144                                      | 14,030,599       | 7,857,169                                  | 3,325,895   |                         |
| =====   |  |                  |  |   |                         |
| At 31 December, 2002                                | 3,121,437                                      | 11,364,868       | 8,960,483                                  | 3,244,303   |                         |
| =====   |  |                  |  |   |                         |

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)  
(Prepared under PRC Accounting Rules and Regulations)

## 13 FIXED ASSETS (cont'd)

## THE COMPANY

|   | LAND USE<br>RIGHTS AND<br>BUILDINGS<br>RMB'000 | AIRCRAFT         |  | OTHER FLIGHT<br>EQUIPMENT,<br>INCLUDING<br>ROTABLE<br>SPARES<br>RMB'000 | MA<br>E<br>AN<br>V<br>R |
|---|--|------------------|--|---|-------------------------|
|   |  | OWNED<br>RMB'000 | HELD UNDER<br>FINANCE<br>LEASES<br>RMB'000 |   |                         |
| -----   |  |                  |  |   |                         |
| Cost or valuation:                                  |  |                  |  |   |                         |
| At 1 January, 2003                                  | 1,066,188                                      | 9,053,359        | 11,459,978                                 | 3,941,880   |                         |
| Reclassification on exercise<br>of purchase options | -  | 997,403          | (997,403)                                  | -   |                         |
| Additions through acquisition<br>of subsidiary      | 720,247  | -                | -  | 998,215   |                         |
| Additions   | 2,228  | 2,818,475        | -  | 455,763   |                         |
| Transferred from construction<br>in progress        | 91,018   | -                | -  | -   |                         |
| Disposals   | (347)  | -                | -  | -   |                         |
| -----   |  |                  |  |   |                         |
| At 31 December, 2003                                | 1,879,334                                      | 12,869,237       | 10,462,575                                 | 5,395,858   | 1,                      |
| -----   |  |                  |  |   |                         |
| Accumulated depreciation:                           |  |                  |  |   |                         |
| At 1 January, 2003                                  | 177,334  | 1,327,363        | 2,499,495                                  | 2,387,634   |                         |
| Reclassification on exercise<br>of purchase options | -  | 389,958          | (389,958)                                  | -   |                         |
| Additions through acquisition<br>of subsidiary      | 94,541   | -                | -  | 311,097   |                         |
| Charge for the year                                 | 74,394   | 514,000          | 495,869                                    | 373,896   |                         |
| Written back on disposal                            | (23)   | -                | -  | -   |                         |
| -----   |  |                  |  |   |                         |
| At 31 December, 2003                                | 346,246  | 2,231,321        | 2,605,406                                  | 3,072,627   |                         |
| -----   |  |                  |  |   |                         |
| Net book value:                                     |  |                  |  |   |                         |
| At 31 December, 2003                                | 1,533,088                                      | 10,637,916       | 7,857,169                                  | 2,323,231   |                         |
| =====   |  |                  |  |   |                         |
| At 31 December, 2002                                | 888,854  | 7,725,996        | 8,960,483                                  | 1,554,246   |                         |
| =====   |  |                  |  |   |                         |

At 31 December, 2003, no provision for impairment of the fixed assets of the Group and the Company was necessary.

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### 13 FIXED ASSETS (cont'd)

At 31 December, 2003, certain aircraft and other flight equipment of the Group and the Company were mortgaged under certain bank loans and finance lease agreements (see Notes 28 and 29). The net book value of these fixed assets is analysed as follows:

|                                | THE GROUP  |            | THE COMPANY |            |
|--------------------------------|------------|------------|-------------|------------|
|                                | 2003       | 2002       | 2003        | 2002       |
|                                | RMB'000    | RMB'000    | RMB'000     | RMB'000    |
| -----                          |            |            |             |            |
| Aircraft                       |            |            |             |            |
| Mortgaged under bank loans     | 6,718,737  | 5,822,076  | 4,938,698   | 3,933,109  |
| Mortgaged under finance leases | 7,857,169  | 8,960,483  | 7,857,169   | 8,960,483  |
| -----                          |            |            |             |            |
| Sub-total                      | 14,575,906 | 14,782,559 | 12,795,867  | 12,893,592 |
| Other flight equipment         |            |            |             |            |
| Mortgaged under bank loans     | 26,621     | 22,184     | -           | -          |
| -----                          |            |            |             |            |
| Total                          | 14,602,527 | 14,804,743 | 12,795,867  | 12,893,592 |
| =====                          |            |            |             |            |

At 31 December, 2003, the net book value of the Group's and the Company's fixed assets leased out under operating leases are analysed as follows:

|                        | THE GROUP AND THE COMPANY |         |
|------------------------|---------------------------|---------|
|                        | 2003                      | 2002    |
|                        | RMB'000                   | RMB'000 |
| -----                  |                           |         |
| Land and buildings     | 147,098                   | -       |
| Other flight equipment | 178,053                   | -       |
| -----                  |                           |         |
|                        | 325,151                   | -       |
| =====                  |                           |         |

The useful lives for land use rights range from 30 to 70 years. At 31 December, 2003, the remaining unamortised periods range from 17 to 65 years.

At 31 December 2003, the net book values of the fully depreciated fixed assets of the Group and the Company in use were RMB60,345,000 and RMB42,800,000 respectively (2002: RMB18,704,000 and RMB9,465,000 respectively).

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### 13 FIXED ASSETS (cont'd)

The Company entered into two separate arrangements (the "Arrangements") with certain independent third parties during each of 2002 and 2003. Under each of the Arrangements, the Company sold an aircraft and then immediately leased back the aircraft for an agreed period. As agreed, the lease payment obligations, with pre-determined net present values, were to be satisfied solely out of the sale proceeds and such amounts have been placed irrevocably by the Company in form of deposits and debt securities in favour of the lessors. The Company has an option to purchase the aircraft at a pre-determined date and the agreed purchase price is to be satisfied by the balance of the deposits and debt securities outstanding at that date. In the event that the lease agreement is early terminated by the Company, the Company is liable to pay a pre-determined penalty to the lessor. As long as the Company complies with the lease agreement, the Company is entitled to the continued possession and operation of the aircraft. Since the Company retains substantially all the risks and rewards incident to ownership of the aircraft and enjoys substantially the same rights to its use as before the Arrangements no adjustment has been made to the fixed assets. As at 31 December 2003, the net present value of the lease commitments and the corresponding defeased deposits and debt securities amounted to RMB2,409,252,000 (2002: RMB1,322,843,000). As a result of the Arrangements, the Company received a net cash benefit of RMB51,682,000 and RMB69,121,000 in 2002 and 2003 respectively, which has been recognised as income for the respective years.

### 14 CONSTRUCTION MATERIALS

The Group's and the Company's construction materials represented materials to be used for construction projects.

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NOTES TO THE FINANCIAL STATEMENTS (Cont'd)  
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### 15 CONSTRUCTION IN PROGRESS

| PROJECT NAME                                   | BUDGETED<br>AMOUNT<br>RMB'000 | BALANCE                             | ADDITIONS<br>DURING<br>THE YEAR<br>RMB'000 | TRANSFERRED<br>TO FIXED<br>ASSETS<br>RMB'000 | BALANCE                               |  |
|--|-------------------------------|-------------------------------------|--|--|---------------------------------------|--|
|  |                               | AT 1<br>JANUARY,<br>2003<br>RMB'000 |  |  | AT 31<br>DECEMBER,<br>2003<br>RMB'000 |  |
| -----  |                               |                                     |  |  |                                       |  |
| THE COMPANY                                    |                               |                                     |  |  |                                       |  |
| Guangzhou new airport base                     | 3,560,000                     | 432,580                             | 945,483                                    | -  | 1,378,063                             |  |
| Hubei catering building                        | 30,000                        | 23,407                              | 4,504                                      | -  | 27,911                                |  |
| Zhengzhou ticket<br>selling office             | 48,500                        | 21,988                              | 28   | -  | 22,016                                |  |
| Material and<br>engineering system             | 50,000                        | 21,063                              | 3  | -  | 21,066                                |  |
| Henan office building                          | 18,880                        | 3,717                               | 10,269                                     | -  | 13,986                                |  |
| Guangzhou ticket<br>selling office             | 80,000                        | 45,988                              | 34,012                                     | (80,000)                                     | -                                     |  |
| Computerised maintenance<br>information system | 24,000                        | 5,923                               | -  | (5,923)                                      | -                                     |  |
| Others   | 118,919                       | 83,104                              | 10,597                                     | (13,323)                                     | 80,378                                |  |



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|                                       |           |           |           |           |           |
|---------------------------------------|-----------|-----------|-----------|-----------|-----------|
| COMPANY TOTAL                         | 3,930,299 | 637,770   | 1,004,896 | (99,246)  | 1,543,420 |
| SUBSIDIARIES                          |           |           |           |           |           |
| Guangzhou new cargo centre            | 598,200   | -         | 181,750   | -         | 181,750   |
| Fuzhou Chang Le<br>airport facilities | 74,600    | 14,839    | 109       | (704)     | 14,244    |
| Others                                | 198,122   | 86,046    | -         | (46,143)  | 39,903    |
| SUBSIDIARIES TOTAL                    |           |           |           |           |           |
|                                       | 870,922   | 100,885   | 181,859   | (46,847)  | 235,897   |
| JOINTLY CONTROLLED ENTITIES           |           |           |           |           |           |
| Guangzhou new airport base            | 434,563   | 53,821    | 98,467    | (1,747)   | 150,541   |
| Zhuhai engine repair workshop         | 783,380   | 201,657   | 20,631    | (222,288) | -         |
| Others                                | 7,220     | 12,831    | -         | (5,299)   | 7,532     |
| JOINTLY CONTROLLED ENTITIES<br>TOTAL  |           |           |           |           |           |
|                                       | 1,225,163 | 268,309   | 119,098   | (229,334) | 158,073   |
| GROUP TOTAL                           |           |           |           |           |           |
|                                       | 6,026,384 | 1,006,964 | 1,305,853 | (375,427) | 1,937,390 |

At 31 December 2003, no provision for impairment of the construction in progress of the Group and the Company was necessary.

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NOTES TO THE FINANCIAL STATEMENTS (Cont'd)  
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15 CONSTRUCTION IN PROGRESS (cont'd)

The Group's borrowing costs capitalised in the construction in progress for the year are as follows:

|                            | 2003<br>RMB'000 | 2002<br>RMB'000 |
|----------------------------|-----------------|-----------------|
| Borrowing cost capitalised | 83,077          | 64,186          |

The interest rates at which the Group's and the Company's borrowing costs were capitalised during the year ranged from 1.62% to 5.46% (2002: 5.70%).

16 LEASE AND EQUIPMENT DEPOSITS

| THE GROUP            |  |                      |                      |
|----------------------|--|----------------------|----------------------|
| 2003                 |  | 2002                 | 2003                 |
| ORIGINAL<br>CURRENCY |  | Original<br>currency | ORIGINAL<br>CURRENCY |

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|  | '000    | RMB'000   | '000    | RMB'000   | '000    | RMB'000   |
|--|---------|-----------|---------|-----------|---------|-----------|
| Advanced payments for purchase of aircraft (US\$)          | 303,940 | 2,515,617 | 210,650 | 1,743,610 | 229,487 | 1,899,000 |
| Rental deposits for aircraft under operating leases (US\$) | 50,379  | 416,974   | 48,739  | 403,428   | 39,794  | 329,000   |
|  |         | 2,932,591 |         | 2,147,038 |         | 2,228,000 |

Pursuant to aircraft purchase agreements, the Group is generally required to pay a deposit equal to approximately 30% of the purchase price of the aircraft to aircraft manufacturers six months prior to delivery.

Pursuant to aircraft operating lease agreements, the Group is generally required to pay lessors rental deposits equal to approximately three months' rentals.

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NOTES TO THE FINANCIAL STATEMENTS (Cont'd)  
(Prepared under PRC Accounting Rules and Regulations)

17 DEFERRED EXPENDITURE

|                           | THE GROUP<br>RMB'000 | THE COMPANY<br>RMB'000 |
|---------------------------|----------------------|------------------------|
| Original cost:            |                      |                        |
| At 1 January, 2003        | 261,582              | 168,265                |
| Additions for the year    | 6,426                | 1,301                  |
| Write off for the year    | (203,013)            | (133,013)              |
| At 31 December, 2003      | 64,995               | 36,553                 |
| Accumulated amortisation: |                      |                        |
| At 1 January, 2003        | 227,446              | 144,796                |
| Amortisation for the year | 14,089               | 7,421                  |
| Written back on write off | (203,013)            | (133,013)              |
| At 31 December, 2003      | 38,522               | 19,204                 |
| Net book value:           |                      |                        |
| At 31 December, 2003      | 26,473               | 17,349                 |
| At 31 December, 2002      | 34,136               | 23,469                 |

Deferred expenditure mainly comprises custom duties and other direct costs incurred in respect of the Group's and the Company's operating leased

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aircraft upon the inception of their respective leases. The deferred expenditure is amortised on a straight-line basis over the lease period of the aircraft.

At 31 December, 2003, the remaining unamortised period ranged from 2 to 3 years.

### 18 LONG-TERM RECEIVABLES

Long-term receivables represent insurance premium deposited with a PRC insurance company. Pursuant to the relevant insurance agreement, the insurance premium will be fully returned to the Group upon the expiry of the agreement in 2007.

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### NOTES TO THE FINANCIAL STATEMENTS (Cont'd) (Prepared under PRC Accounting Rules and Regulations)

### 19 SHORT-TERM LOANS

The Group's and the Company's short term loans are analysed as follows:

|                   | THE GROUP                    |           |                              |           |                              |           |
|-------------------|------------------------------|-----------|------------------------------|-----------|------------------------------|-----------|
|                   | 2003                         |           | 2002                         |           | 2003                         |           |
|                   | ORIGINAL<br>CURRENCY<br>'000 | RMB'000   | Original<br>currency<br>'000 | RMB'000   | ORIGINAL<br>CURRENCY<br>'000 | RMB'000   |
| -----             |                              |           |                              |           |                              |           |
| Unsecured loans   |                              |           |                              |           |                              |           |
| US Dollars        | 708,879                      | 5,867,182 | 318,780                      | 2,638,639 | 659,422                      | 5,457,182 |
| Hong Kong Dollars | 194,355                      | 207,124   | -                            | -         | -                            | -         |
| Renminbi          | -                            | 120,000   | -                            | 334,287   | -                            | 120,000   |
| -----             |                              |           |                              |           |                              |           |
| Sub-total         |                              | 6,194,306 |                              | 2,972,926 |                              | 5,577,182 |
| -----             |                              |           |                              |           |                              |           |
| Guaranteed loans  |                              |           |                              |           |                              |           |
| Renminbi          |                              | 235,000   | -                            | 1,470,500 |                              |           |
| -----             |                              |           |                              |           |                              |           |
| Sub-total         |                              | 235,000   |                              | 1,470,500 | -                            |           |
| -----             |                              |           |                              |           |                              |           |
| Total             |                              | 6,429,306 |                              | 4,443,426 |                              | 5,577,182 |
| =====             |                              |           |                              |           |                              |           |

The guaranteed loans were guaranteed by the following parties:

|                                | THE GROUP |           | THE COMPANY |         |
|--------------------------------|-----------|-----------|-------------|---------|
|                                | 2003      | 2002      | 2003        | 2002    |
|                                | RMB'000   | RMB'000   | RMB'000     | RMB'000 |
| -----                          |           |           |             |         |
| CSAHC                          | 151,000   | 1,470,500 | -           | 420,000 |
| Guangzhou Baiyun International |           |           |             |         |

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|   |         |           |   |         |
|---|---------|-----------|---|---------|
| Airport Company Limited                                     | 63,000  | -         | - | -       |
| Shenzhen Yingshun Investment<br>Development Company Limited | 21,000  | -         | - | -       |
|   |         |           |   |         |
|   | 235,000 | 1,470,500 | - | 420,000 |
|   |         |           |   |         |

At 31 December, 2003, the Group's and the Company's weighted average interest rates on short-term borrowings were 1.76% and 1.65% respectively (2002: 3.11% and 2.66% respectively).

At 31 December 2003, the Group and the Company had no overdue loans (2002: Nil).

There were no short-term loans payable to shareholders who hold 5% or more of the voting rights of the Company.

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NOTES TO THE FINANCIAL STATEMENTS (Cont'd)  
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### 20 BILLS PAYABLE

#### THE GROUP

|                     | 2003    |        | 2002      |        |
|---------------------|---------|--------|-----------|--------|
|                     | RMB'000 | %      | RMB'000   | %      |
| Bank accepted bills | 1,949   | 0.4%   | 24,601    | 1.9%   |
| Commercial bills    | 445,829 | 99.6%  | 1,275,079 | 98.1%  |
|                     |         |        |           |        |
| Total               | 447,778 | 100.0% | 1,299,680 | 100.0% |
|                     |         |        |           |        |

#### THE COMPANY

|                     | 2003    |        | 2002      |        |
|---------------------|---------|--------|-----------|--------|
|                     | RMB'000 | %      | RMB'000   | %      |
| Bank accepted bills | 1,949   | 0.4%   | 24,601    | 1.9%   |
| Commercial bills    | 436,135 | 99.6%  | 1,275,079 | 98.1%  |
|                     |         |        |           |        |
| Total               | 438,135 | 100.0% | 1,299,680 | 100.0% |
|                     |         |        |           |        |

All bills payable were due within one year.

There were no bills payable to shareholders who hold 5% or more of the voting rights of the Company.

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21 TRADE ACCOUNTS PAYABLE

The ageing analysis of trade accounts payable is as follows:

|                            | THE GROUP       |                 | THE COMPANY     |                 |
|----------------------------|-----------------|-----------------|-----------------|-----------------|
|                            | 2003<br>RMB'000 | 2002<br>RMB'000 | 2003<br>RMB'000 | 2002<br>RMB'000 |
| Within 3 months            | 1,018,454       | 330,904         | 908,536         | 140,148         |
| Over 3 but within 6 months | 278,114         | 244,295         | 231,115         | 140,793         |
| Over 6 months              | 370,815         | 325,727         | 308,153         | 170,556         |
|                            | 1,667,383       | 900,926         | 1,447,804       | 451,497         |

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NOTES TO THE FINANCIAL STATEMENTS (Cont'd)  
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21 TRADE ACCOUNTS PAYABLE (cont'd)

At 31 December, 2003, the Group and the Company had no individually significant trade accounts payable aged over three years.

There was no amount payable to shareholders who hold 5% or more voting rights of the Company included in trade accounts payable.

22 SALES IN ADVANCE OF CARRIAGE

Sales in advance of carriage represent the proceeds from sales of the Group's and the Company's air tickets in advance of carriage. The sales in advance of carriage were aged within one year.

There was no amount payable to shareholders who hold 5% or more voting rights of the Company included in the balance of sales in advance of carriage.

23 CAAC INFRASTRUCTURE DEVELOPMENT FUND PAYABLE

|                               | THE GROUP       |                 | THE COMPANY     |                 |
|-------------------------------|-----------------|-----------------|-----------------|-----------------|
|                               | 2003<br>RMB'000 | 2002<br>RMB'000 | 2003<br>RMB'000 | 2002<br>RMB'000 |
| At 1 January, 2003            | 280,706         | 525,607         | 201,476         | 418,730         |
| Add: Amount for the year      | 250,802         | 798,386         | 167,942         | 375,734         |
| Less: Payment during the year | 177,916         | 1,043,287       | 76,195          | 592,988         |
| At 31 December, 2003          | 353,592         | 280,706         | 293,223         | 201,476         |

24 OTHER CREDITORS

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Other creditors represent payables for education surcharge.

25 OTHER PAYABLES

Included in other payables was a RMB165,995,000 payable to CSAHC, a shareholder who hold 5% or more voting rights of the Company.

At 31 December, 2003, the Group and the Company had no individually significant other payables aged over three years.

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NOTES TO THE FINANCIAL STATEMENTS (Cont'd)  
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26 ACCRUED EXPENSES

|                               | Notes | THE GROUP        |                  | THE COMPANY      |                  | REASON FOR ACC |
|-------------------------------|-------|------------------|------------------|------------------|------------------|----------------|
|                               |       | 2003<br>RMB'000  | 2002<br>RMB'000  | 2003<br>RMB'000  | 2002<br>RMB'000  |                |
| Custom duties                 |       |                  |                  |                  |                  |                |
| and value-added tax           | (a)   | 336,839          | 360,827          | 103,223          | 56,887           | Accrued but no |
| Landing and takeoff fees      | (b)   | 825,811          | 497,372          | 584,605          | 169,109          | Accrued but no |
| Aircraft and engine           |       |                  |                  |                  |                  |                |
| repair charges                | (b)   | 242,397          | 203,624          | 252,557          | 132,432          | Accrued but no |
| Staff housing benefit         |       |                  |                  |                  |                  |                |
| and lump sum                  |       |                  |                  |                  |                  |                |
| housing allowances            | (c)   | 214,521          | 383,675          | 214,521          | 383,675          | Accrued but no |
| Interest expense              | (d)   | 157,527          | 174,626          | 137,761          | 150,609          | Accrued but no |
| Jet fuel expenses             | (b)   | 254,801          | 297,626          | 117,756          | 109,640          | Accrued but no |
| Sales commissions             |       |                  |                  |                  |                  |                |
| and bonuses                   |       | 62,212           | 39,808           | 62,212           | 9,562            | Accrued but no |
| Air catering expenses         | (b)   | 114,296          | 110,134          | 133,777          | 76,907           | Accrued but no |
| Provision for major overhauls |       |                  |                  |                  |                  |                |
| - current portion (Note 30)   |       | 10,717           | 52,000           | -                | -                | Accrued but no |
| Seat reservation charges      |       | 54,852           | 21,601           | 42,133           | 6,179            | Accrued but no |
| Aircraft insurance premium    |       | -                | 31,137           | -                | 18,240           | Accrued but no |
| Operating lease rentals       |       | 18,144           | 41,396           | 14,813           | -                | Accrued but no |
| Other expenses                |       | 94,870           | 72,310           | 19,322           | 46,176           | Accrued but no |
| <b>Total</b>                  |       | <b>2,386,987</b> | <b>2,286,136</b> | <b>1,682,680</b> | <b>1,159,416</b> |                |

Notes:

(a) CUSTOMS DUTIES AND VALUE-ADDED TAX

Customs duties and value-added tax mainly represent custom duties and value-added tax payable by the Group in connection with purchase of aircraft. These custom duties and value-added tax payable were capitalised as part of the aircraft's costs. The Group is required to pay the customs duties and value-added tax by instalments.

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(b) LANDING AND TAKEOFF FEES, AIRCRAFT AND ENGINE REPAIR CHARGES, JET FUEL EXPENSES AND AIR CATERING EXPENSES

The transaction volumes and amounts involved for the landing and takeoff fees, aircraft and engine repair costs, jet fuel expenses and air catering expenses were significant. Their settlement generally took two to three months. Therefore, such expenses were accrued in the year to which they related in order to match with the revenue.

(c) STAFF HOUSING WELFARE AND LUMP SUM HOUSING ALLOWANCES

Pursuant to Cai Kuai Zi (2001) No. 5 issued by the MOF, lump sum housing allowances payable to employees who joined the Company before 1998 but having not yet allocated with staff housing were recorded as accrued expense.

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NOTES TO THE FINANCIAL STATEMENTS (Cont'd)  
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26 ACCRUED EXPENSES (cont'd)

NOTE: (cont'd)

(d) INTEREST EXPENSE

Interest expense accrual was mainly from finance lease obligations and loans in connection with purchase of aircraft. The Group was generally required to repay the principal and interest once every three or six months. Therefore, the interest expense was accrued in the year to which they related.

27 LONG-TERM LIABILITIES DUE WITHIN ONE YEAR

|  | THE GROUP                    |           |                              |           | THE CO                       |           |
|--|------------------------------|-----------|------------------------------|-----------|------------------------------|-----------|
|  | 2003                         |           | 2002                         |           | 2003                         |           |
|  | ORIGINAL<br>CURRENCY<br>'000 | RMB'000   | Original<br>currency<br>'000 | RMB'000   | ORIGINAL<br>CURRENCY<br>'000 | RMB'000   |
| -----  |                              |           |                              |           |                              |           |
| Long term borrowings due<br>within one year (Note 28)                |                              |           |                              |           |                              |           |
| Guaranteed (RMB)   | -                            | 1,580     | -                            | -         | -                            | -         |
| Unsecured (RMB)  | -                            | 63,810    | -                            | -         | -                            | -         |
| Mortgaged and guaranteed<br>(US\$)                                   | 73,647                       | 609,553   | 96,225                       | 796,485   | 46,048                       | 381,127   |
| Mortgaged (US\$)   | 1,582                        | 13,097    | 2,576                        | 21,315    |                              |           |
| -----  |                              |           |                              |           |                              |           |
| Sub-total  |                              | 688,040   |                              | 817,800   |                              | 381,127   |
| -----  |                              |           |                              |           |                              |           |
| Obligations under finance<br>leases due within one year<br>(Note 29) |                              |           |                              |           |                              |           |
| Mortgaged and guaranteed<br>- US Dollars                             | 135,357                      | 1,120,312 | 154,214                      | 1,276,473 | 135,357                      | 1,120,312 |

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|                |           |           |           |           |           |           |
|----------------|-----------|-----------|-----------|-----------|-----------|-----------|
| - Japanese Yen | 2,297,904 | 177,543   | 4,204,027 | 290,225   | 2,297,904 | 177,543   |
| Sub-total      |           | 1,297,855 |           | 1,566,698 |           | 1,297,855 |
| Total          |           | 1,985,895 |           | 2,384,498 |           | 1,678,982 |

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NOTES TO THE FINANCIAL STATEMENTS (Cont'd)  
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28 LONG-TERM BORROWINGS

THE GROUP

|   | INTEREST RATE        | 2003 ORIGINAL CURRENCY '000 | RMB'000   | Interest Rate        | 2002 Original Currency '000 | RMB'000   |
|---|----------------------|-----------------------------|-----------|----------------------|-----------------------------|-----------|
| Renminbi loans:   |                      |                             |           |                      |                             |           |
| Loans for construction projects                         | 4.94% to 5.25%       | -                           | 89,144    | 4.94% to 6.21%       | -                           | 969,994   |
|   | Non-interest bearing | -                           | 3,000     | Non-interest bearing | -                           | 3,000     |
| Loans for purchase of aircraft                          | 5.49%                | -                           | 63,500    | 5.02% to 5.43%       | -                           | 2,310,268 |
| US dollar loans:  |                      |                             |           |                      |                             |           |
| Loans for purchase of aircraft                          | 1.48% to 8.33%       | 618,341                     | 5,117,821 | 5.00% to 8.33%       | 413,908                     | 3,426,038 |
| Loans for purchase of flight equipment                  | 8.35%                | 1,582                       | 13,097    | 8.35%                | 2,427                       | 20,090    |
| Loans for construction projects                         | 1.91% to 1.94%       | 21,887                      | 181,156   |                      | -                           | -         |
|   |                      |                             | 5,467,718 |                      |                             | 6,729,390 |
| Less: Current portion of long-term borrowings (Note 27) |                      |                             | 688,040   |                      |                             | 817,800   |
|   |                      |                             | 4,779,678 |                      |                             | 5,911,590 |

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28 LONG-TERM BORROWINGS (cont'd)

THE COMPANY

|   | INTEREST<br>RATE | 2003<br>ORIGINAL<br>CURRENCY<br>'000 | RMB'000   | Interest<br>rate | 2002<br>Original<br>currency<br>'000 | RMB'000   |
|---|------------------|--------------------------------------|-----------|------------------|--------------------------------------|-----------|
| -----   |                  |                                      |           |                  |                                      |           |
| Renminbi loans:   |                  |                                      |           |                  |                                      |           |
| Loans for construction projects                         | -                | -                                    | -         | 5.22% to 6.21%   | -                                    | 850,000   |
| Loans for purchase of aircraft                          | -                | -                                    | -         | 5.02% to 5.43%   | -                                    | 2,231,768 |
| US dollar loans:  |                  |                                      |           |                  |                                      |           |
| Loans for purchase of aircraft                          | 1.48% to 8.33%   | 489,522                              | 4,051,626 | 5.00% to 8.33%   | 255,128                              | 2,111,768 |
| -----   |                  |                                      |           |                  |                                      |           |
|   |                  |                                      | 4,051,626 |                  |                                      | 5,193,536 |
| Less: Current portion of long-term borrowings (Note 27) |                  |                                      | 381,127   |                  |                                      | 565,164   |
| -----   |                  |                                      |           |                  |                                      |           |
|   |                  |                                      | 3,670,499 |                  |                                      | 4,628,372 |
| =====   |                  |                                      |           |                  |                                      |           |

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NOTES TO THE FINANCIAL STATEMENTS (Cont'd)  
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28 LONG-TERM BORROWINGS (cont'd)

The long-term borrowings by borrowing terms are analysed as follows:

|                                | THE GROUP       |                 | THE COMPANY     |                 |
|--------------------------------|-----------------|-----------------|-----------------|-----------------|
|                                | 2003<br>RMB'000 | 2002<br>RMB'000 | 2003<br>RMB'000 | 2002<br>RMB'000 |
| -----                          |                 |                 |                 |                 |
| Unsecured loans                | 85,149          | 110,307         | -               | -               |
| Guaranteed loans               | 430,451         | 2,501,305       | 228,800         | 2,410,118       |
| Mortgaged loans                | 2,387,532       | 756,833         | 2,324,435       | 736,743         |
| Mortgaged and guaranteed loans | 2,564,586       | 3,360,945       | 1,498,391       | 2,046,675       |
| -----                          |                 |                 |                 |                 |
|                                | 5,467,718       | 6,729,390       | 4,051,626       | 5,193,536       |
| =====                          |                 |                 |                 |                 |

The guaranteed loans were guaranteed by the following parties:

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|            | THE GROUP       |                 | THE COMPANY     |                 |
|------------|-----------------|-----------------|-----------------|-----------------|
|            | 2003<br>RMB'000 | 2002<br>RMB'000 | 2003<br>RMB'000 | 2002<br>RMB'000 |
| CSAHC      | 420,399         | 1,939,774       | 228,800         | 1,860,118       |
| SA Finance | 10,052          | 561,531         | -               | 550,000         |
|            | 430,451         | 2,501,305       | 228,800         | 2,410,118       |

The mortgaged and guaranteed loans were secured by mortgages over certain of the Group's and the Company's aircraft (Note 13), and were guaranteed by the following parties:

|  | THE GROUP       |                 | THE COMPANY     |                 |
|--|-----------------|-----------------|-----------------|-----------------|
|  | 2003<br>RMB'000 | 2002<br>RMB'000 | 2003<br>RMB'000 | 2002<br>RMB'000 |
| Export-Import Bank<br>of the United States | 2,207,393       | 2,680,801       | 1,236,160       | 1,536,835       |
| Bank of China                              | 357,193         | 604,010         | 262,231         | 433,706         |
| China Construction Bank                    | -               | 76,134          | -               | 76,134          |
|  | 2,564,586       | 3,360,945       | 1,498,391       | 2,046,675       |

The mortgaged loans were secured by mortgages over certain of the Group's and the Company's aircraft and other flight equipment (Note 13).

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28 LONG-TERM BORROWINGS (CONT'D)

The maturity analysis of the long-term borrowings is as follows:

|                      | THE GROUP       |                 | THE COMPANY     |                 |
|----------------------|-----------------|-----------------|-----------------|-----------------|
|                      | 2003<br>RMB'000 | 2002<br>RMB'000 | 2003<br>RMB'000 | 2002<br>RMB'000 |
| Balance due:         |                 |                 |                 |                 |
| Within one year      | 688,040         | 817,800         | 381,127         | 565,164         |
| In the second year   | 682,492         | 842,036         | 401,466         | 522,482         |
| In the third year    | 488,225         | 1,078,074       | 257,299         | 760,740         |
| After the third year | 3,608,961       | 3,991,480       | 3,011,734       | 3,345,150       |

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5,467,718 6,729,390 4,051,626 5,193,536

There was no amount due to shareholders who hold 5% or more of the voting rights of the Company included in the balance of long-term borrowings.

29 OBLIGATIONS UNDER FINANCE LEASES

THE GROUP AND THE COMPANY

|  | 2003<br>RMB'000 | 2002<br>RMB'000 |
|--|-----------------|-----------------|
| At 1 January,  | 8,198,449       | 9,143,563       |
| Add: Additions for the year                          | -               | 426,192         |
| Effect due to fluctuations of foreign exchange rates | 197,880         | 174,911         |
| Less: Payments during the year                       | 1,555,390       | 1,546,217       |
| At 31 December,                                      | 6,840,939       | 8,198,449       |
| Less: Balance due within one year (Note 27)          | 1,297,855       | 1,566,698       |
|  | 5,543,084       | 6,631,751       |

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NOTES TO THE FINANCIAL STATEMENTS (Cont'd)  
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29 OBLIGATIONS UNDER FINANCE LEASES (cont'd)

Obligations under finance leases represent the Group's commitments under finance lease agreements in respect of aircraft and related equipment expiring during 2004 to 2009. At 31 December, 2003, the weighted average interest rate for obligations under finance leases was 5.88%. Future payments of the Group's and the Company's obligations under finance leases are as follows:

|                      | 2003<br>RMB'000 | 2002<br>RMB'000 |
|----------------------|-----------------|-----------------|
| Balance due:         |                 |                 |
| Within one year      | 1,297,855       | 1,566,698       |
| In the second year   | 1,066,451       | 1,273,144       |
| In the third year    | 1,196,858       | 1,066,263       |
| After the third year | 3,279,775       | 4,292,344       |
|                      | 6,840,939       | 8,198,449       |

Under the terms of the leases, the Group has an option to purchase, at or

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near the end of the lease term, certain aircraft at fair market value and others at either fair market value or a percentage of the respective lessor's defined cost of the aircraft.

Certain of the Group's and the Company's aircraft were pledged to secure facilities with financial institutions granted to lessors. The carrying amounts of these aircraft at 31 December, 2003 are disclosed in Note 13.

The Group's and the Company's obligations under finance leases were guaranteed by the following parties:

|   | 2003<br>RMB'000  | 2002<br>RMB'000  |
|---|------------------|------------------|
| Bank of China                               | 2,577,034        | 3,608,705        |
| The Industrial and Commercial Bank of China | 4,263,905        | 4,589,744        |
| <b>Total</b>                                | <b>6,840,939</b> | <b>8,198,449</b> |

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### NOTES TO THE FINANCIAL STATEMENTS (Cont'd) (Prepared under PRC Accounting Rules and Regulations)

#### 29 OBLIGATIONS UNDER FINANCE LEASES (cont'd)

At 31 December, 2003, the Group's and the Company's obligations under finance leases analysed by original currencies were as follows:

|              | 2003                         |                  | 2002                         |                  |
|--------------|------------------------------|------------------|------------------------------|------------------|
|              | ORIGINAL<br>CURRENCY<br>'000 | RMB'000          | Original<br>Currency<br>'000 | 2002<br>RMB'000  |
| US Dollars   | 478,058                      | 3,956,739        | 613,415                      | 5,077,419        |
| Japanese Yen | 20,531,761                   | 1,586,345        | 22,515,137                   | 1,554,332        |
|              |                              | <b>5,543,084</b> |                              | <b>6,631,751</b> |

Balance due within one year is disclosed in Note 27 to the financial statements.

There was no amount due to shareholders who hold 5% or more of the voting rights of the Company included in the balance of obligations under finance leases.

#### 30 PROVISION FOR MAJOR OVERHAULS

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|   | THE GROUP<br>RMB'000 | THE COMPANY<br>RMB'000 |
|---|----------------------|------------------------|
| Balance at 1 January, 2003                                      | 193,887              | 63,389                 |
| Including current portion                                       | 52,000               | -                      |
| Add: Provision for the year                                     | 68,620               | 67,603                 |
| Less: Utilisation during the year                               | 62,326               | -                      |
| Balance at 31 December, 2003                                    | 200,181              | 130,992                |
| Less: Current portion included in<br>accrued expenses (Note 26) | 10,717               | -                      |
|   | 189,464              | 130,992                |

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NOTES TO THE FINANCIAL STATEMENTS (Cont'd)  
(Prepared under PRC Accounting Rules and Regulations)

31 DEFERRED CREDITS

THE GROUP AND THE COMPANY

|  | GAIN ON<br>SALE AND LEASE<br>BACK TRANSACTION<br>RMB' 000 | REBATES<br>AIRCRAFT<br>OPERATING<br>RMB' 0 |
|--|---|--|
| COST:                                    |   |  |
| At 1 January, 2003 and 31 December, 2003 | 258,899   | 24,3                                       |
| ACCUMULATED AMORTISATION:                |   |  |
| At 1 January, 2003                       | 18,465  | 15,4                                       |
| Amortisation for the year                | 29,588  | 2,6  |
| At 31 December, 2003                     | 48,053  | 18,0                                       |
| NET BOOK VALUE:                          |   |  |
| At 31 December, 2003                     | 210,846   | 6,3  |
| At 31 December, 2002                     | 240,434   | 8,9  |

Pursuant to certain sale and leaseback arrangements, the Company sold certain aircraft to independent third parties and then entered into operating leases with such parties to lease back the aircraft for a period of eight to nine years. The gains on sale and leaseback arrangements, being the excess of the sale proceeds, which approximated the aircraft's fair value on the date of disposal, over the aircraft's net book value and related disposal costs, were deferred and amortised over the period the aircraft were expected to be used.

Pursuant to certain operating lease arrangements for aircraft entered

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into in 1998, the Group received cash rebates totalling RMB24,385,000 from a lessor. Such rebates have been deferred and amortised over the terms of the respective leases.

### 32 DEFERRED TAXATION

The movements of net deferred tax liabilities are as follows:

|   | THE GROUP<br>RMB' 000 | THE COMPANY<br>RMB' 000 |
|---|-----------------------|-------------------------|
| Balance at 1 January, 2003                            | 1,043,303             | 734,607                 |
| Less: Addition for the year (Note 44)                 | 135,420               | 155,510                 |
| Effect of change in income<br>tax rate (Note 4b & 44) | 516,245               | 516,245                 |
| Sub-total   | 651,665               | 671,755                 |
| Balance at 31 December, 2003                          | 391,638               | 62,852                  |

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NOTES TO THE FINANCIAL STATEMENTS (Cont'd)  
(Prepared under PRC Accounting Rules and Regulations)

### 32 DEFERRED TAXATION (cont'd)

The net deferred tax liabilities were made up of the taxation effects of:

|   |       | THE GROUP        |                  |                  |
|---|-------|------------------|------------------|------------------|
|   | Notes | 2003<br>RMB' 000 | 2002<br>RMB' 000 | 2001<br>RMB' 000 |
| <b>Deferred tax assets:</b>                 |       |                  |                  |                  |
| Tax losses                                  | (a)   | 222,936          | 149,338          | 222,936          |
| Repairs and maintenance<br>accruals         | (b)   | 87,608           | 63,896           | 9,989            |
| Rotable repair charges<br>capitalised       | (c)   | 261,312          | 319,697          | 19,989           |
| Accrued expenses                            | (d)   | 18,883           | 115,543          | 1,000            |
| Gains on sale and leaseback<br>transactions | (e)   | 31,627           | 80,703           | 3,000            |
| Other                                       |       | 8,989            | 32,580           | 1,000            |
| Total deferred tax assets                   |       | 631,355          | 761,757          | 57,903           |
| <b>Deferred tax liabilities:</b>            |       |                  |                  |                  |
| Undistributed profits of<br>subsidiaries    | (f)   | -                | 254,210          |                  |
| Repairs and maintenance<br>accruals         | (b)   | 80,545           | 78,083           |                  |

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|                                |     |           |             |     |
|--------------------------------|-----|-----------|-------------|-----|
| Depreciation of fixed assets   | (g) | 872,741   | 1,403,278   | 61  |
| Other                          |     | 69,707    | 69,489      | 2   |
| -----                          |     |           |             |     |
| Total deferred tax liabilities |     | 1,022,993 | 1,805,060   | 63  |
| -----                          |     |           |             |     |
| Net deferred tax liabilities   |     | (391,638) | (1,043,303) | (6) |
| =====                          |     |           |             |     |

Notes:

(a) TAX LOSSES

Pursuant to relevant tax regulations, taxable losses can be carried forward over a maximum period of five years to be offset against future taxable profits. The deferred tax is recognised based on the unutilised taxable losses and estimated future taxable profits.

(b) REPAIRS AND MAINTENANCE ACCRUALS

Certain of the Group's and the Company's overhaul expenses were deductible on a cash payment basis for taxation purposes. According to the accounting policies adopted in these financial statements, overhaul expenses are expensed as and when incurred. The Group and the Company recognised deferred tax for these timing differences.

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NOTES TO THE FINANCIAL STATEMENTS (Cont'd)  
(Prepared under PRC Accounting Rules and Regulations)

32 DEFERRED TAXATION (cont'd)

Note: (cont'd)

(c) ROTABLE REPAIR CHARGES CAPITALISED

Pursuant to relevant tax regulations, repair charges for rotables are initially capitalised and amortised over five years for taxation purposes. According to the accounting policies adopted in these financial statements, repair charges for rotables are expensed as and when incurred. The Group and the Company recognised deferred tax for these timing differences.

(d) ACCRUED EXPENSES

Certain of the Group's and the Company's expenses are deductible on a cash payment basis for taxation purposes. In the preparation of these financial statements, these expenses are accounted for on an accrual basis. The Group and the Company recognised a deferred tax for these timing differences.

(e) GAINS ON SALE AND LEASEBACK TRANSACTIONS

Pursuant to relevant tax regulations, gains on sale and

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leaseback transactions are taxable in the period they arise. According to the accounting policies adopted in these financial statements, these gains are recorded as deferred credits and amortised over the terms of the leases. The Group and the Company recognised deferred tax on these timing differences.

(f) UNDISTRIBUTED PROFITS OF SUBSIDIARIES

In 2002, the Company was required to pay additional tax on the dividends or profits received from certain subsidiaries that enjoyed preferential tax rates at a rate representing the difference between the Company's applicable rate of 33% and the subsidiaries' applicable tax rates. As stated in Note 1 to the financial statements, the Company's status has changed to a foreign investment enterprise in 2003. Accordingly, this deferred tax liability has been written back in 2003.

(g) DEPRECIATION OF FIXED ASSETS

This deferred tax was recognised for the timing difference arising from the difference between the aircraft depreciation rates for accounting purposes and the rates used for taxation purposes.

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NOTES TO THE FINANCIAL STATEMENTS (Cont'd)  
(Prepared under PRC Accounting Rules and Regulations)

33 SHARED CAPITAL

|   | 2003          |
|---|---------------|
|   | RMB'          |
| -----   |               |
| Registered capital:                           |               |
| 2,200,000,000 domestic shares of RMB1.00 each | 2,200,000,000 |
| 1,174,178,000 H shares of RMB1.00 each        | 1,174,178,000 |
| 1,000,000,000 A shares of RMB1.00 each        | 1,000,000,000 |
|   | -----         |
|   | 4,374,178,000 |
| =====   |               |
| Issued and paid up capital:                   |               |
| 2,200,000,000 domestic shares of RMB1.00 each | 2,200,000,000 |
| 1,174,178,000 H shares of RMB1.00 each        | 1,174,178,000 |
| 1,000,000,000 A shares of RMB1.00 each        | 1,000,000,000 |
|   | -----         |
|   | 4,374,178,000 |
|   | =====         |

Pursuant to an extraordinary general meeting of shareholders held on 21 May, 2002, a resolution was passed authorising the Company to issue not more than 1,000,000,000 A shares of par value of RMB1.00 each. Pursuant to an approval document[2003] No. 70 from the China Securities Regulatory Commission, the Company issued and listed its 1,000,000,000



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A shares with a par value of RMB1.00 each on the Shanghai Stock Exchange in July 2003.

The receipts of above paid-in capital were verified by KPMG Huazhen which issued capital verification reports on 31 December, 1994, 10 September, 1997 and 17 July, 2003 respectively.

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NOTES TO THE FINANCIAL STATEMENTS (Cont'd)  
(Prepared under PRC Accounting Rules and Regulations)

34 CAPITAL RESERVES

THE GROUP AND THE COMPANY

|   | 2003<br>RMB' |
|---|--------------|
| Balance at 1 January,                                       | 4,160        |
| Share premium from A shares issue,<br>net of issuance costs | 1,640        |
| Balance at 31 December,                                     | 5,801        |

35 SURPLUS RESERVES

|                               | THE GROUP        |                  | 2003<br>RMB' |
|-------------------------------|------------------|------------------|--------------|
|                               | 2003<br>RMB' 000 | 2002<br>RMB' 000 |              |
| Statutory surplus reserve     |                  |                  | 337,195      |
| Balance at 1 January,         | 337,195          | 285,860          | 337,195      |
| Add: Profit appropriations    | 23,856           | 51,335           | 1,640        |
| Balance at 31 December,       | 361,051          | 337,195          | 338,835      |
| Statutory public welfare fund |                  |                  | 171,574      |
| Balance at 1 January,         | 171,574          | 145,907          | 171,574      |
| Add: Profit appropriations    | 1,113            | 25,667           | 1,113        |
| Balance at 31 December,       | 172,687          | 171,574          | 172,687      |
| Discretionary surplus reserve |                  |                  | 76,603       |
| Balance at 1 January,         | 76,603           | 69,867           | 76,603       |
| Add: Profit appropriations    | -                | 6,736            | -            |
| Balance at 31 December,       | 76,603           | 76,603           | 76,603       |
| Total                         | 610,341          | 585,372          | 587,021      |

NOTES TO THE FINANCIAL STATEMENTS (Cont'd)  
(Prepared under PRC Accounting Rules and Regulations)

36 PROFIT APPROPRIATION

(a) Appropriations to various reserves

Pursuant to the Board of Directors' resolution on 23 April, 2004, the Company made appropriations to the following funds for year 2003:

(i) Statutory surplus reserve 10%

(ii) Statutory public welfare fund 5%

(b) On 23 April, 2004, the Board of Directors did not recommend the payment of a final dividend to ordinary shareholders.

37 REVENUE FROM PRINCIPAL OPERATIONS

|                | THE GROUP  |            | TH         |
|----------------|------------|------------|------------|
|                | 2003       | 2002       | 2003       |
|                | RMB' 000   | RMB' 000   | RMB' 000   |
| Passenger      | 15,342,458 | 16,899,811 | 10,183,596 |
| Cargo and mail | 2,008,548  | 1,905,699  | 1,734,297  |
|                | 17,351,006 | 18,805,510 | 11,917,893 |

Revenue from principal operations represent revenues from airline businesses. The Group's geographical information is set out in Note 46.

The total revenue from the Group's and the Company's top five customers and their percentage of the total revenue are analysed as follows:

|                    | THE GROUP |          | 2        |
|--------------------|-----------|----------|----------|
|                    | 2003      | 2002     | 2003     |
|                    | RMB' 000  | RMB' 000 | RMB' 000 |
| Amounts (RMB' 000) | 259,668   | 293,548  | 223,548  |
| % of total revenue | 1.5%      | 1.6%     | 1.5%     |

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NOTES TO THE FINANCIAL STATEMENTS (Cont'd)  
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38 BUSINESS TAXES AND SURCHARGES

|                       | THE GROUP |          |          |
|-----------------------|-----------|----------|----------|
|                       | 2003      | 2002     | 2001     |
|                       | RMB' 000  | RMB' 000 | RMB' 000 |
| Business tax          | 175,598   | 482,200  | 121,818  |
| City construction tax | 10,134    | 28,318   | 8,318    |
| Education surcharge   | 4,950     | 14,732   | 3,818    |
|                       | 190,682   | 525,250  | 132,954  |

39 PROFIT FROM OTHER OPERATIONS

|                         | THE GROUP |          |          |
|-------------------------|-----------|----------|----------|
|                         | 2003      | 2002     | 2001     |
|                         | RMB' 000  | RMB' 000 | RMB' 000 |
| Sales commission income | 145,810   | 137,928  | 125,810  |
| General aviation income | 3,006     | (11,394) | 8,318    |
| Ground services income  | 78,683    | 38,156   | 78,683   |
| Aircraft lease income   | -         | 38,712   | 8,618    |
| Air catering income     | 15,812    | 8,618    | 47,812   |
| Others                  | 82,638    | 113,307  | 47,812   |
| Total                   | 325,949   | 325,327  | 253,851  |

40 FINANCIAL EXPENSES

|                                    | THE GROUP |           |          |
|------------------------------------|-----------|-----------|----------|
|                                    | 2003      | 2002      | 2001     |
|                                    | RMB' 000  | RMB' 000  | RMB' 000 |
| Interest expense incurred          | 906,802   | 1,023,379 | 792,000  |
| Less: Capitalised interest expense | 83,077    | 64,186    | 83,077   |
| Net interest expense               | 823,725   | 959,193   | 708,923  |
| Interest income                    | (13,061)  | (52,618)  | (7,661)  |
| Net foreign exchange loss          | 164,443   | 175,451   | 169,800  |
| Bank charges                       | 20,443    | 13,193    | 16,571   |
|                                    | 995,550   | 1,095,219 | 887,640  |

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Net foreign exchange loss arose mainly from the Group's and the Company's Japanese Yen denominated finance lease obligations due to fluctuations in the exchange rate of Japanese Yen.

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### NOTES TO THE FINANCIAL STATEMENTS (Cont'd) (Prepared under PRC Accounting Rules and Regulations)

41 INVESTMENT INCOME

|   | THE GROUP        |                  | 2002<br>RMB' 000 | 2003<br>RMB' 000 |
|---|------------------|------------------|------------------|------------------|
|   | 2002<br>RMB' 000 | 2003<br>RMB' 000 |                  |                  |
| INVESTMENT INCOME ACCOUNTED FOR               |                  |                  |                  |                  |
| Under cost method                             | 3,765            | 17,140           |                  |                  |
| Under equity method                           | 6,708            | 44,536           | 264              |                  |
| Amortisation of equity investment differences | -                | -                | 2                |                  |
|   | 10,473           | 61,676           | 266              |                  |

There are no major restrictions on the remittance of the Group's and the Company's investment returns.

42 NON-OPERATING INCOME

|                              | THE GROUP        |                  | 2002<br>RMB' 000 | 2003<br>RMB' 000 |
|------------------------------|------------------|------------------|------------------|------------------|
|                              | 2002<br>RMB' 000 | 2003<br>RMB' 000 |                  |                  |
| Gain on sale of fixed assets | 1,995            | 21,560           | 2                |                  |
| Others                       | 6,632            | 21,523           | 15               |                  |
|                              | 8,627            | 43,083           | 17               |                  |

43 NON-OPERATING EXPENSES

|                              | THE GROUP        |                  | 2002<br>RMB' 000 | 2003<br>RMB' 000 |
|------------------------------|------------------|------------------|------------------|------------------|
|                              | 2002<br>RMB' 000 | 2003<br>RMB' 000 |                  |                  |
| Loss on sale of fixed assets | 30,649           | 40,574           |                  |                  |
| Fines and compensations      | 474              | 338              |                  |                  |
| Donations                    | 1,447            | 2,106            |                  |                  |
| Others                       | 7,961            | 28,462           | 23               |                  |

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71,480

40,531

23

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NOTES TO THE FINANCIAL STATEMENTS (Cont'd)  
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44 INCOME TAX

|                             | THE GROUP |          | 2002  |
|-----------------------------|-----------|----------|-------|
|                             | 2003      | 2002     |       |
|                             | RMB' 000  | RMB' 000 | RMB'  |
| Provision for income tax    | 46,938    | 71,651   |       |
| Deferred taxation (Note 32) | (651,665) | 281,579  | (671, |
|                             | (604,727) | 353,230  | (671, |

45 RELATED PARTIES AND RELATED PARTY TRANSACTIONS

(a) RELATED PARTY WITH CONTROLLING RELATIONSHIP

|                                |   |
|--------------------------------|---|
| Name of company:               | China Southern Air Holding Company  |
| Registered address:            | Guangzhou Baiyun International Airport, Guangdong Province                        |
| Principal business:            | Management of the companies' operations within the group and the sale of products |
| Relationship with the Company: | The ultimate holding company  |
| Nature of ownership:           | State-owned   |
| Legal representative:          | Yan Zhi Qing  |
| Registered capital:            | RMB2,198,980,000  |

At 31 December, 2003 and 2002, CSAHC held 2,200,000,000 Legal Person Shares of the Company totalling RMB2,200,000,000.

(b) RELATIONSHIP BETWEEN THE COMPANY AND RELATED PARTIES WITHOUT CONTROLLING RELATIONSHIP

(i) Companies that are under the control of CSAHC, i.e. subsidiaries of CSAHC:

- Southern Airlines (Group) Import and Export Trading Company
- Zhongyuan Airlines Company
- Southern Airlines (Group) Economic Development Company
- Nanlung Travel & Express (H.K.) Ltd.

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- Golden Royal International Travel Ltd.
- Shenzhen Baiyun Air Service Co. Ltd.
- SA Finance
- Xinjiang Airlines Company
- China Northern Airlines Company

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NOTES TO THE FINANCIAL STATEMENTS (Cont'd)  
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45 RELATED PARTIES AND RELATED PARTY TRANSACTIONS (cont'd)

(b) RELATIONSHIP BETWEEN THE COMPANY AND RELATED PARTIES WITHOUT CONTROLLING RELATIONSHIP (CONT'D)

(ii) Companies that are under the significant influence of CSAHC

- Shenzhen Air Catering Company Limited

(iii) Jointly controlled entities of the Group:

- Guangzhou Aircraft Maintenance Engineering Company Limited
- MTU Maintenance Zhuhai Co. Ltd.
- China Postal Airlines Limited

(iv) Associated companies of the Group:

- Hong Kong Business Aviation Centre Company Limited
- Sichuan Airlines Corporation Limited

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NOTES TO THE FINANCIAL STATEMENTS (Cont'd)  
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45 RELATED PARTIES AND RELATED PARTY TRANSACTIONS (cont'd)

(c) THE PRINCIPAL RELATED PARTY TRANSACTIONS CARRIED OUT DURING THE YEAR WERE AS FOLLOWS:

Note

2003  
RMB' 000

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EXPENSES

|                                      |      |         |
|--------------------------------------|------|---------|
| Handling charges                     | (1)  | 27,051  |
| Wet lease rentals                    | (2)  | 35,751  |
| Sundry aviation supplies             | (3)  | 42,849  |
| Advertising expenses                 | (4)  | -       |
| Commission expenses                  | (5)  | 4,896   |
| Air catering expenses                | (6)  | 28,199  |
| Repairing charges                    | (7)  | 346,652 |
| Housing benefits                     | (8)  | 85,000  |
| Lease charges for land and buildings | (9)  | 15,224  |
| Trademark                            | (10) | -       |

INCOME

|                   |      |       |
|-------------------|------|-------|
| Interest income   | (11) | 3,100 |
| Wet lease rentals | (12) | -     |

OTHERS

|   |      |         |
|---|------|---------|
| Short-term loans                        | (13) | 165,995 |
| Refund of medical benefit payments      | (14) | 58,120  |
| Acquisition of interest in subsidiaries | (15) | -       |
| Acquisition of fixed assets             | (16) | -       |

Notes:

- (1) Handling charges represent fees payable to Southern Airlines (Group) Import and Export Trading Company in connection with the procurement of aircraft and flight equipment on the Group's behalf. The purchase amount was RMB1,154,553,000 for the year. Handling charges are calculated based on a fixed percentage of the procurement value by reference to market rates. The fees are generally paid by the end of the following month.
- (2) Pursuant to a wet lease agreement effective October 2002, the Group paid rentals to Xinjiang Airlines Company in respect of one Boeing 757-200 aircraft. The wet lease rentals are calculated by reference to market rates. The rentals payable were settled on the 14th day of the following month. The wet lease agreement was terminated in April 2003.
- (3) Sundry aviation supplies represent purchases of sundry aviation supplies from Southern Airlines (Group) Economic Development Company. Prices are determined by reference to market prices. The payable is generally settled by the end of the following month.

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NOTES TO THE FINANCIAL STATEMENTS (Cont'd)  
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45 RELATED PARTIES AND RELATED PARTY TRANSACTIONS (cont'd)

- (c) THE PRINCIPAL RELATED PARTY TRANSACTIONS CARRIED OUT DURING THE YEAR WERE AS FOLLOWS: (cont'd)

Notes: (cont'd)

(4) Advertising expenses represent advertising fees payable to Southern Airlines Advertising Company ("SAAC") for advertising and promotional services rendered to the Group. The fees are determined by reference to market rates. Annual budgeted advertising expenses are paid in a lump sum at the beginning of every year. Other advertising expenses are generally paid by the end of the following month. SAAC became a subsidiary of the Company in August 2002 and has been consolidated into the Group's consolidated financial statements since then.

(5) Commission expenses represent commission payable to Nanlung Travel & Express (H.K.) Ltd., South China International and Aviation and Travel Services Company, Golden Royal International Travel Ltd. and Shenzhen Baiyun Air Service Co. Ltd. in connection with air tickets sold by them on the Group's behalf. The Group's aggregate amount of ticket sales conducted through these agents was RMB143,016,000 for the year ended 31 December, 2003. The commission rates are based on the rates stipulated by the CAAC. The commission expense payable is offset directly against the sales proceeds receivable from them.

South China International and Aviation and Travel Services Company became a subsidiary of the Company in August 2002 and has been consolidated in the Group's consolidated financial statements since then.

(6) Air catering expenses represent fees payable to Shenzhen Air Catering Company Limited for providing inflight meals to the Group. CSAHC holds a 33% equity interest in the company. Prices are determined by reference to market prices. The payable is generally settled by the end of the following month.

(7) Repair charges represent fees payable to Guangzhou Aircraft Maintenance Engineering Company Limited and MTU Maintenance Zhuhai Co. Ltd. in connection with comprehensive aircraft maintenance services rendered to the Group. Fees are charged based on market prices. Fees amounting to RMB346,652,000 were eliminated upon the proportional consolidation of these companies.

(8) Housing benefits payable to CSAHC represent the difference between the carrying amounts of the quarters sold to the employees of the Group and the proceeds from sales of these quarters by CSAHC. The payment is determined based on number of quarter allocated and the construction cost of the housing sold over the sales prices, and is payable in accordance with the related agreement.

(9) Lease charges for land and buildings represent rentals payable to CSAHC by the Group under certain lease agreements in respect of certain land and buildings of CSAHC. The rentals are determined based



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on market rents. The rental payments are due in June and December of each year.

- (10) The Company and CSAHC have entered into a 10-year Trademark Licence Agreement dated 22 May 1997, pursuant to which CSAHC acknowledged that the Company has the right to use the name "China Southern" and "China Southern Airlines" in both Chinese and English, and granted to the Company a renewable royalty-free licence to use the kapok logo on a world-wide basis in connection with the Company's airline and airline-related businesses. Unless CSAHC gives written notice of termination three months before the expiration of the agreement, the agreement will be automatically extended for another 10-year term.

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NOTES TO THE FINANCIAL STATEMENTS (Cont'd)  
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45 RELATED PARTIES AND RELATED PARTY TRANSACTIONS (cont'd)

- (c) THE PRINCIPAL RELATED PARTY TRANSACTIONS CARRIED OUT DURING THE YEAR WERE AS FOLLOWS:(cont'd)

Notes: (cont'd)

- (11) Interest income represents the interest received from deposits placed with SA Finance by the Group (Note 6). The applicable interest rate is determined in accordance with the deposit rate published by the People's Bank of China. Interest income is received quarterly. Please refer to Note 45(d) for the balance of deposits at the end of each year.
- (12) Pursuant to a wet lease agreement, the Company received wet lease rentals from wet leasing an Airbus 320-200 aircraft to Sichuan Airlines Corporation Limited. The rentals were determined by reference to market rentals. The rentals payable were settled on the 10th day of the following month.
- (13) During the year, CSAHC made short term cash advances to the Group. These advances were unsecured, interest free and repayable on demand. As at 31 December, 2003, the advances amounted to RMB165,995,000.
- (14) The Group provides retirees with medical benefits, transportation subsidies and other welfare facilities. Previously, the Group paid a fixed annual fee to CSAHC in return for CSAHC providing such benefits to the retired employees of the Group. With effect from 1 January, 2002, such arrangement was terminated. During 2003, CSAHC refunded to the Group the difference between the aggregate fixed annual fees received from the Group and the aggregate cost of services incurred by CSAHC.

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- (15) In August 2002, the Company acquired a 90% equity interest in each of Guangzhou Aviation Hotel, Southern Airlines Advertising Company and South China International Aviation & Travel Services Company from CSAHC at an aggregate cash consideration of approximately RMB107,846,000. The consideration was determined by reference to the valuation reports dated 18 March, 2002, prepared by Guangzhou Asset Appraisal Corp.. The consideration was settled in 2002.
- (16) During 2002, the Group acquired five Boeing 737-300/37K aircraft and related spare parts and certain vehicles from Zhongyuan Airlines, a subsidiary of CSAHC, at a consideration of approximately RMB1,096,866,000. The consideration was satisfied by cash of approximately RMB132,130,000 together with an assumption by the Group of Zhongyuan Airlines' debts of approximately RMB964,736,000. This consideration was determined by reference to the valuation reports prepared by Zhongfeng Valuation Company Limited.

In addition to the above, certain business undertakings of CSAHC provided transportation, hotel and other services to the Group during the year. The total amount involved was not material to the results of the Group for the year.

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NOTES TO THE FINANCIAL STATEMENTS (Cont'd)  
(Prepared under PRC Accounting Rules and Regulations)

45 RELATED PARTIES AND RELATED PARTY TRANSACTIONS (cont'd)

(d) THE BALANCES WITH RELATED PARTIES ARE SET OUT BELOW:

|  | RELATIONSHIP        | 2003<br>RMB' 000 |
|--|---------------------|------------------|
| Cash at bank and in hand               |                     |                  |
| SA Finance                             | Other related party | 370,978          |
| Trade receivables                      |                     |                  |
| Nanlung Tranve & Express               |                     |                  |
| (H.K.) Ltd.                            | Other related party | 54,161           |
| Golden Royal International Travel Ltd. | Other related party | 7,545            |
| Shenzhen Baiyun Air Service Co. Ltd.   | Other related party | 338              |
| Other receivables                      |                     |                  |
| Southern Airlines (Group) Import       |                     |                  |
| and Export Trading Company             | Other related party | 17,280           |
| Long-term receivable                   |                     |                  |
| Hong Kong Business Aviation            |                     |                  |
| Centre Company Limited                 | Associated company  | -                |
| Trade accounts payable                 |                     |                  |

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|  |                           |         |
|--|---------------------------|---------|
| Southern Airlines (Group) Import                           |                           |         |
| and Export Trading Company                                 | Other related party       | 693,345 |
| Guangzhou Aircraft Maintenance Engineering Company Limited | Jointly controlled entity | 155,716 |
| Xinjiang Airlines Company                                  | Other related party       | 80,891  |
| China Northern Airlines Company                            | Other related party       | 336,783 |
| Other payables   |                           |         |
| CSAHC  | Ultimate holding company  | 165,995 |
| Accrued expenses   |                           |         |
| MTU Maintenance Zhuhai Co. Ltd                             | Jointly controlled entity | 46,990  |

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(e) GUARANTEES PROVIDED BY RELATED PARTIES AND OTHER CONTINGENT LIABILITIES:

- (i) Other than the guarantees provided by CSAHC and SA Finance to banks in respect of certain loans of the Group (Note 19 and Note 28), there were no guarantees provided by related parties.

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NOTES TO THE FINANCIAL STATEMENTS (Cont'd)  
(Prepared under PRC Accounting Rules and Regulations)

45 RELATED PARTIES AND RELATED PARTY TRANSACTIONS (cont'd)

(e) GUARANTEES PROVIDED BY RELATED PARTIES AND OTHER CONTINGENT LIABILITIES: (cont'd)

- (ii) The Demerger Agreement dated 25 March, 1995 (such Agreement was amended by Amendment No. 1 dated 22 May, 1997) was entered into between the CSAHC and the Company for the purpose of defining and allocating the assets and liabilities between CSAHC and the Company. Under the Demerger Agreement, CSAHC and the Company have agreed to indemnify the other party against, among other things, claims, liabilities and expenses incurred by the other party but relating to the businesses, assets and liabilities held or assumed by CSAHC or the Company pursuant to the Demerger Agreement. From the date of the Demerger Agreement to the date on which these financial statements are authorised for issue, there have been no incidences of compensation in respect of claims, assets or liabilities held or assumed by CSAHC or the Company.
- (iii) The Company leases from CSAHC certain land in Guangzhou and certain land and buildings in Wuhan and Haikou. The Group has significant investments in buildings and other leasehold improvements located on such land. However, such land in Guangzhou and such land and buildings in Wuhan and Haikou lack adequate documentation evidencing the SA Group's ownership thereto.

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Pursuant to Compensation Agreement dated 22 May, 1997, CSAHC agrees to indemnify the Group against any loss or damage caused by any challenge or interference with the Group's use of any of above land and buildings.

The directors of the Company are of the opinion that the above transactions with related parties were entered into in the normal course of business and on normal commercial terms or in accordance with the agreements governing such transactions.

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NOTES TO THE FINANCIAL STATEMENTS (Cont'd)  
(Prepared under PRC Accounting Rules and Regulations)

46 GEOGRAPHICAL INFORMATION

The Group engages in a single operation, i.e. the provision of airline services. Geographic information about the Group's profit from principal operation are as follows:

|                                       | DOMESTIC<br>RMB' 000 | HONG KONG<br>RMB' 000 | (NOTE)<br>INTERNATIO<br>RMB' 000 |
|---------------------------------------|----------------------|-----------------------|----------------------------------|
| -----                                 |                      |                       |                                  |
| 2003                                  |                      |                       |                                  |
| Net revenue from principal operations | 13,242,875           | 793,047               | 3,064,                           |
| Less:Cost of principal operations     | 10,935,717           | 699,536               | 2,586,                           |
| Business taxes and surcharges         | 155,935              | 4,789                 | 29,                              |
| -----                                 |                      |                       |                                  |
| Profit from principal operations      | 2,151,223            | 88,722                | 447,                             |
| =====                                 |                      |                       |                                  |
| 2002                                  |                      |                       |                                  |
| Net revenue from principal operations | 13,647,250           | 1,137,928             | 3,221,                           |
| Less:Cost of principal operations     | 9,796,521            | 618,917               | 2,702,                           |
| Business taxes and surcharges         | 449,679              | 19,233                | 56,                              |
| -----                                 |                      |                       |                                  |
| Profit from principal operations      | 3,401,050            | 499,778               | 462,                             |
| =====                                 |                      |                       |                                  |

Note: Mainly routes between the PRC and Asian countries, the United States of America, the Netherlands, Belgium and Australia.

The major revenue-earning assets of the Group is its aircraft fleet, most of which is registered in the PRC. Since the Group's aircraft fleet is employed flexibly across its route network, there is no suitable basis for allocating its assets to geographic segments. Substantially all of the Group's non-aircraft identifiable assets are located in the PRC.

47 CONTINGENT LIABILITIES

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New Link Consultants Limited filed a lawsuit with the High Court in Hong Kong against the Company alleging violation of certain agreements in respect of the procurement of aviation inventories, and lodged a claim. The Company has conducted a detailed assessment of the claim and concluded that the Company will be successful in defending itself, and as the lawsuit is still at a preliminary stage, no provision for contingent liabilities is required in these financial statements.

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NOTES TO THE FINANCIAL STATEMENTS (Cont'd)  
(Prepared under PRC Accounting Rules and Regulations)

48 COMMITMENTS

(i) CAPITAL COMMITMENTS

|  | THE GROUP  |            | THE COMPANY |           |
|--|------------|------------|-------------|-----------|
|  | 2003       | 2002       | 2003        | 2002      |
|  | RMB' 000   | RMB' 000   | RMB' 000    | RMB' 000  |
|  |            |            |             |           |
| Commitments in respect of aircraft and related equipment           |            |            |             |           |
| - authorised and contracted for                                    | 10,615,079 | 5,875,996  | 7,739,290   | 5,875,996 |
|  |            |            |             |           |
| Commitments in respect of investments in the Guangzhou new airport |            |            |             |           |
| - authorised and contracted for                                    | 617,277    | 525,700    | 617,277     | 525,700   |
| - authorised but not contracted for                                | 1,454,661  | 2,601,720  | 1,454,661   | 2,601,720 |
|  |            |            |             |           |
|  | 2,071,938  | 3,127,420  | 2,071,938   | 3,127,420 |
|  |            |            |             |           |
| Other commitments  |            |            |             |           |
| - authorised and contracted for                                    | 256,707    | 107,610    | 29,628      | 42,857    |
| - authorised but not contracted for                                | 991,860    | 1,121,545  | 229,302     | 245,857   |
|  |            |            |             |           |
|  | 1,248,567  | 1,229,155  | 258,930     | 288,714   |
|  |            |            |             |           |
|  | 13,935,584 | 10,232,571 | 10,070,158  | 9,291,930 |
|  |            |            |             |           |

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NOTES TO THE FINANCIAL STATEMENTS (Cont'd)  
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48 COMMITMENTS (cont'd)

(i) CAPITAL COMMITMENTS (cont'd)

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At 31 December, 2003, the Group had on order 2 Boeing 757-200 aircraft, 13 Boeing 737-700 aircraft, 4 Airbus 330-200 aircraft, 6 Embraer ERJ-145 aircraft and certain flight equipment, scheduled for deliveries in 2004 and 2005. Deposits of RMB2,494,853,000 have been made towards the purchase of these aircraft and related equipment. At 31 December, 2003, the approximate total future payments, including estimated amounts for price escalation through anticipated delivery dates for these aircraft and related equipment are as follows:

|              | THE GROUP<br>RMB' 000 | THE COMPANY<br>RMB' 000 |
|--------------|-----------------------|-------------------------|
| -----        |                       |                         |
| Payments due |                       |                         |
| In 2004      | 4,584,823             | 3,248,674               |
| In 2005      | 6,030,256             | 4,490,616               |
| -----        |                       |                         |
|              | 10,615,079            | 7,739,290               |
| =====        |                       |                         |

(ii) OPERATING LEASE COMMITMENTS

The Group's and the Company's commitments under non-cancellable aircraft and flight equipment operating leases were as follows:

|                      | THE GROUP        |                  | THE              |
|----------------------|------------------|------------------|------------------|
|                      | 2003<br>RMB' 000 | 2002<br>RMB' 000 | 2003<br>RMB' 000 |
| -----                |                  |                  |                  |
| Payments due:        |                  |                  |                  |
| Within one year      | 1,482,888        | 1,280,060        | 1,193,892        |
| In the second year   | 1,411,520        | 1,327,631        | 1,169,104        |
| In the third year    | 1,143,745        | 1,245,150        | 969,189          |
| After the third year | 4,081,704        | 4,683,797        | 3,718,788        |
| -----                |                  |                  |                  |
|                      | 8,119,857        | 8,536,638        | 7,050,973        |
| =====                |                  |                  |                  |

(iii) INVESTING COMMITMENTS

As at 31 December, 2003, the Company was committed to making a capital contribution of approximately RMB446,000,000 (2002: RMB201,000,000) to its jointly controlled entities.

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NOTES TO THE FINANCIAL STATEMENTS (Cont'd)  
(Prepared under PRC Accounting Rules and Regulations)

49 PRINCIPAL SUBSIDIARIES, ASSOCIATED COMPANIES, AND JOINTLY CONTROLLED ENTITIES

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The particulars of the Company's principal subsidiaries, and the Group's associated companies and jointly controlled entities as at 31 December, 2003 are as follows:

(i) PRINCIPAL SUBSIDIARIES

| NAME OF COMPANY   | PLACE AND DATE OF ESTABLISHMENT/ OPERATION | ATTRIBUTABLE/ EQUITY INTEREST |            | ISSUED/ REGISTERED CAPITAL (NOTE a) | PRINCIPAL ACTIVITIES |
|---|--|-------------------------------|------------|-------------------------------------|----------------------|
|   |  | DIRECT %                      | INDIRECT % |                                     |                      |
| China Southern Airlines (Group) Zhuhai Helicopter Company Limited | PRC<br>31 August, 1983                     | 100                           | -          | 100,000,000                         | Helicopter Transport |
| Guangxi Airlines Company Limited                                  | PRC<br>28 April, 1994                      | 60                            | -          | 170,900,000                         | Airline              |
| China Southern Airlines (Group) Shantou Airlines Company Limited  | PRC<br>20 July, 1993                       | 60                            | -          | 280,000,000                         | Airline              |
| Zhuhai Airlines Company Limited                                   | PRC<br>8 May, 1995                         | 60                            | -          | 250,000,000                         | Airline              |
| Xiamen Airlines Company Limited                                   | PRC<br>11 August, 1984                     | 60                            | -          | 588,434,000                         | Airline              |
| Guizhou Airlines Company Limited                                  | PRC<br>12 November, 1991                   | 60                            | -          | 80,000,000                          | Airline              |
| Guangzhou Nanland Air Catering Company Limited (Note b)           | PRC<br>21 November, 1989                   | 51                            | -          | 55,980,000                          | Air catering         |
| Hunan Southern China Aviation & Travel Services Company (Note d)  | PRC<br>6 August, 1998                      | 54                            | -          | 1,000,000                           | Travel serv          |
| Guangzhou Aviation Hotel  | PRC<br>8 January, 1997                     | 90                            | -          | 63,290,000                          | Hotel opera          |
| Southern Airlines Advertising Company                             | PRC<br>3 March, 1994                       | 90                            | -          | 2,000,000                           | Aviation ad          |
| Southern China International Aviation & Travel Services Company   | PRC<br>11 May, 1992                        | 90                            | -          | 2,100,000                           | Travel serv          |
| Guangzhou Baiyun International Logistic Company Ltd.              | PRC<br>23 July, 2002                       | 61                            | -          | 20,000,000                          | Logistic op          |

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NOTES TO THE FINANCIAL STATEMENTS (Cont'd)  
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49 PRINCIPAL SUBSIDIARIES, ASSOCIATED COMPANIES, AND JOINTLY CONTROLLED ENTITIES (cont'd)

(i) PRINCIPAL SUBSIDIARIES (cont'd)

ATTRIBUTABLE/

ISSUED/

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| NAME OF COMPANY   | PLACE AND DATE OF ESTABLISHMENT/ OPERATION | EQUITY DIRECT % | INTEREST INDIRECT % | REGISTERED CAPITAL (NOTE A) |
|---|--|-----------------|---------------------|-----------------------------|
| Zhuhai Xiang Yi Aviation Technology Company Limited       | PRC<br>10 July, 2002                       | 51              | -                   | USD 29,800,000              |
| CSN-ETC e-commerce (Note d)                               | PRC<br>10 October, 2002                    | 51              | -                   | 5,880,000                   |
| China Southern West Australian Flying College Pty Limited | Australia<br>26 January, 1971              | 65              | -                   | AUD 100,000                 |
| CZ Flamingo Limited                                       | Cayman Islands<br>8 December, 1993         | 100             | -                   | USD 1,000                   |
| CZ Skylark Limited  | Cayman Islands<br>17 November, 1993        | 100             | -                   | USD 1,000                   |
| CZ Kapok Limited  | Cayman Islands<br>26 October, 1993         | 100             | -                   | USD 1,000                   |
| CSA-I Limited   | Cayman Islands<br>1 September, 1993        | 100             | -                   | USD 1,000                   |
| CZ93B Limited   | Cayman Islands<br>11 May, 1993             | 100             | -                   | USD 1,000                   |
| CZ97A Limited   | Cayman Islands<br>2 January, 1997          | 100             | -                   | USD 1,000                   |
| Zhong Yuan 99A Limited                                    | Cayman Islands<br>15 February, 1999        | 100             | -                   | USD 1,000                   |
| CXA92A Limited  | Cayman Islands<br>3 August, 1992           | -               | 60                  | USD 1,000                   |
| CXA93A Limited  | Cayman Islands<br>1 July, 1993             | -               | 60                  | USD 1,000                   |
| CXA95B Limited  | Cayman Islands<br>7 July, 1995             | -               | 60                  | USD 1,000                   |
| CXA95C Limited  | Cayman Islands<br>16 October, 1995         | -               | 60                  | USD 1,000                   |
| CXA98A Limited  | Cayman Islands<br>20 March, 1998           | -               | 60                  | USD 1,000                   |
| Xiamen Aviation Property Development Company              | PRC<br>22 June, 1993                       | -               | 60                  | 5,000,000                   |

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NOTES TO THE FINANCIAL STATEMENTS (Cont'd)  
(Prepared under PRC Accounting Rules and Regulations)

49 PRINCIPAL SUBSIDIARIES, ASSOCIATED COMPANIES, AND JOINTLY CONTROLLED ENTITIES (cont'd)

(i) PRINCIPAL SUBSIDIARIES (cont'd)

| NAME OF COMPANY                             | PLACE AND DATE OF ESTABLISHMENT/ OPERATION | ATTRIBUTABLE/ EQUITY DIRECT % | INTEREST INDIRECT % | ISSUED/ REGISTERED CAPITAL (NOTE A) | PR ACT  |
|---|--|-------------------------------|---------------------|-------------------------------------|---------|
| Xiamen Aviation Advertising Company Limited | PRC<br>17 December, 1992                   | -                             | 60                  | 620,218                             | Aviatio |
| Xiamen Aviation Supplies                    | PRC  | -                             | 60                  | 8,560,000                           | Aviatio |



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|  |                    |   |      |               |         |
|--|--------------------|---|------|---------------|---------|
| Limited  | 30 July, 1997      |   |      |               |         |
| Xiamen Aviation Development Company Limited                                  | PRC                | - | 54   | 5,000,000     | Hotel o |
| Bai Lu Finance Limited   | 18 February, 1998  |   |      |               |         |
|  | Hong Kong          | - | 54   | HKD10,000,000 | Investm |
| Xiamen Air Holidays Limited  | 22 February, 1996  |   |      |               |         |
|  | Hong Kong          | - | 54   | HKD3,000,000  | Travel  |
| Xiamen Macau Holidays Limited (Note c)                                       | 28 April, 1994     |   |      |               |         |
|  | Macau              | - | 27.5 | MOP1,000,000  | Travel  |
| Shantou Hua Kang Air Catering Company Ltd (Note c)                           | 11 May, 1995       |   |      |               |         |
|  | PRC                | - | 42   | 10,000,000    | Air cat |
| Zhuhai Air Holidays Limited  | 22 June, 1994      |   |      |               |         |
|  | PRC                | - | 54.6 | 1,200,000     | Travel  |
| Zhuhai Aviation Advertising Company Limited (Note d)                         | 19 September, 2001 |   |      |               |         |
|  | PRC                | - | 36   | 1,500,000     | Adverti |
| Guangzhou Baiyun International Express Customs Supervision Co. Ltd. (Note d) | 3 August, 1995     |   |      |               |         |
|  | PRC                | - | 55   | 5,000,000     | Logisti |
|  | 28 July, 2003      |   |      |               |         |

### Notes:

- (a) Expressed in RMB, unless otherwise stated.
- (b) These subsidiaries are Sino-foreign equity joint venture companies
- (c) The Company holds over 51% equity interests in these companies through its non-wholly owned subsidiaries. The Company has a controlling interest in these companies through these non-wholly owned subsidiaries. These companies are therefore consolidated in the Group's consolidated financial statements.
- (d) Notwithstanding that the Group holds over 50% of the registered capital of these companies, the Company does not consolidate these companies into its consolidated financial statements because their assets and results of operation are not significant and have no significant effect on the Group's consolidated financial statements. Accordingly, the Group accounts for the investments in these companies under the cost method.

Other than those stated in Note (d) above, the Group has consolidated all of the above subsidiaries into its consolidated financial statements during the year ended 31 December, 2003.

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NOTES TO THE FINANCIAL STATEMENTS (Cont'd)  
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49 PRINCIPAL SUBSIDIARIES, ASSOCIATED COMPANIES, AND JOINTLY CONTROLLED ENTITIES (cont'd)

- (ii) PRINCIPAL ASSOCIATED COMPANIES AND JOINTLY CONTROLLED ENTITIES

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| NAME OF COMPANY   | PLACE AND DATE OF ESTABLISHMENT/ OPERATION | ATTRIBUTABLE/ EQUITY INTEREST |            | ISSUED/ REGISTERED CAPITAL (NOTE A) |                    |
|---|--|-------------------------------|------------|-------------------------------------|--------------------|
|   |  | DIRECT %                      | INDIRECT % |                                     |                    |
| Guangzhou Aircraft Maintenance Engineering Company Limited (Note b) | PRC<br>28 October, 1989                    | 50                            | -          | USD27,500,000                       | Pro<br>r<br>m<br>s |
| Southern Airlines Group Finance Company Limited                     | PRC<br>28 June, 1995                       | 32                            | 15.42      | 300,000,000<br>USD15,000,000        | Pro<br>a           |
| Hainan Phoenix Information System Limited                           | PRC<br>12 March, 1994                      | 45                            | -          | USD16,360,000                       | Pro<br>r<br>s      |
| Hong Kong Business Aviation Centre Company Limited                  | Hong Kong<br>7 January, 1998               | 20                            | -          | HKD1,000,000                        | Pro<br>f<br>s      |
| MTU Maintenance Zhuhai Co. Ltd (Note b)                             | PRC<br>6 April, 2001                       | 50                            | -          | USD63,100,000                       | Pro<br>r<br>m<br>s |
| Zhuhai Air Express Co. Ltd (Note c)                                 | PRC<br>26 February, 1997                   | -                             | 18         | 3,000,000                           | Air                |
| Guilin Guangsheng Development Co. Ltd. (Note c)                     | PRC<br>18 January, 2000                    | -                             | 18         | 2,100,000                           | Who<br>r           |
| Civil Aviation Cares of Xiamen Ltd. (Note c)                        | PRC<br>14 September, 2001                  | -                             | 17.1       | 2,000,000                           | Com<br>a<br>s      |
| China Postal Airlines Limited (Note b)                              | PRC<br>25 November, 1996                   | 49                            | -          | 306,000,000                         | Air                |
| Sichuan Airlines Corporation Limited                                | PRC<br>28 August, 2002                     | 39                            | -          | 350,000,000                         | Air                |

Notes:

- (a) Expressed in RMB, unless otherwise stated.
- (b) These are jointly controlled entities. They have been proportionately consolidated in the Group's consolidated financial statements.

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NOTES TO THE FINANCIAL STATEMENTS (Cont'd)  
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49 PRINCIPAL SUBSIDIARIES, ASSOCIATED COMPANIES, AND JOINTLY CONTROLLED ENTITIES (cont'd)

Notes: (cont'd)

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- (c) The results of the operations of these companies were not significant and had no significant effect on the Group's consolidated financial statements. Accordingly, the Group accounted for the investments in these companies under the cost method.

Other than those stated in Note (c) above, the associated companies were accounted for under the equity method in the Group's consolidated financial statements for the year ended 31 December, 2003.

### 50 EXTRAORDINARY GAIN AND LOSS

In accordance with the requirements of "Questions and answers on the preparation of information disclosures of companies issuing public shares No. 1 - Extraordinary gain and loss" (revised 2004), the extraordinary gain and loss of the Group are set out below:

|   | 2003<br>RMB' 000 |
|---|------------------|
| -----   |                  |
| Effect of change in income tax rate (Note 32)   | 516,245          |
| Refund of medical benefit payments (Note 45(c)) | 58,120           |
| Loss on sale of fixed assets                    | (19,014)         |
| Various subsidies                               | 3,880            |
| Others, net                                     | (13,263)         |
| -----   |                  |
| Total   | 545,968          |
| =====   |                  |

### 51 POST BALANCE SHEET EVENTS

In April 2004, the Company entered into a purchase agreement with Airbus SNC for the acquisition of fifteen Airbus 320-200 aircraft and six Airbus 319-100 aircraft, scheduled for deliveries in 2005 and 2006.

### 52 COMPARATIVE FIGURES

Certain comparative figures have been reclassified to confirm with current year's presentation.

Certain comparative figures have been adjusted as a result of the change in accounting policy for profits appropriation, details of which are set out in note 2 to the financial statements.

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SUPPLEMENTARY INFORMATION FOR PRC SHAREHOLDERS  
(Expressed in Renminbi)

Effects of significant differences between PRC Accounting Rules and Regulations and IFRS on net (loss)/profit are analysed as follows:

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|  | Note | RMB' 000 |
|--|------|----------|
| Net profit under PRC Accounting Rules and Regulations    |      | 14,4     |
| Adjustments:   |      |          |
| Gains on aircraft sale and leaseback transactions        | (a)  | (30,7    |
| Losses on staff housing allocation                       | (b)  | (111,0   |
| Adjustment for revaluation of land use rights            | (c)  | 3,8      |
| Effect of the above adjustments on taxation              |      | 4,0      |
| Effect of change in income tax rate on deferred taxation |      | (122,2   |
| Adjustment for unrealised deferred tax assets            | (d)  | (116,6   |
| Net (loss)/profit under IFRS                             |      | (358,2   |

Effects of significant differences between PRC Accounting Rules and Regulations and IFRS on shareholders' equity are analysed as follows:

|   | Note | 2003<br>RMB' 000 |
|---|------|------------------|
| Shareholders' equity under PRC Accounting Rules and Regulations |      | 11,549,849       |
| Adjustments:  |      |                  |
| Gains on aircraft sale and leaseback transactions               | (a)  | 213,846          |
| Losses on staff housing allocation                              | (b)  | 308,167          |
| Adjustment for revaluation of land use rights                   | (c)  | (165,420)        |
| Effect of the above adjustments on taxation                     |      | (10,735)         |
| Shareholders' equity under IFRS                                 |      | 11,895,707       |

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SUPPLEMENTARY INFORMATION FOR PRC SHAREHOLDERS (Cont'd)  
(Expressed in Renminbi)

Notes:

- (a) In accordance with PRC accounting rules and regulations, gains on aircraft sale and leaseback transactions are recorded as deferred credits and amortised over the lease terms on a straight line basis. Under IFRS, gains on sale and leaseback transactions where the subsequent lease is an operating lease are recognised as income immediately, if the transactions are established at fair value. Differences between the sale price and fair value are deferred and amortised over the lease term.
- (b) In accordance with PRC accounting rules and regulations, losses on staff housing allocation executed by CSAHC on the Company's behalf are charged to retained profits as and when incurred. In addition, lump sum housing benefits are charged to retained profits as of 1 January, 2001 pursuant to the relevant regulations. Under IFRS, losses on staff housing allocations and lump sum housing benefits are charged to the

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income statement in the obligatory periods stipulated by the relevant contracts.

- (c) In accordance with PRC accounting rules and regulations, land use rights are carried at revalued amounts. Under IFRS, land use rights are carried at cost with effect from 1 January, 2002. Accordingly, the unamortised surplus on revaluation of the land use rights was reversed against the shareholders equity.
  
- (d) In the financial statements prepared under IFRS, an adjustment has been made to reverse certain unrealised deferred tax assets upon the annual assessment performed by the Group for the year. Such items were adjusted for in the financial statements of the Group prepared under PRC accounting rules and regulations in respect of the prior years.
  
- (e) The Group's consolidated financial statements prepared under IFRS for the two years ended 31 December, 2002 and 2003 were audited by KPMG, a firm of certified public accountants in Hong Kong.

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SUPPLEMENTARY INFORMATION FOR NORTH AMERICAN SHAREHOLDERS  
(Expressed in Renminbi)

Effects on the consolidated (loss)/profit attributable to shareholders and shareholders' equity of significant differences between IFRS and accounting principles generally accepted in the United States of America ("U.S. GAAP") are summarised below.

Notes

-----  
 Consolidated (loss)/profit attributable to shareholders  
 under IFRS

U.S. GAAP adjustments:

|   |     |
|---|-----|
| Sale and leaseback accounting   | (a) |
| Lease arrangements  | (b) |
| Capitalised interest  | (c) |
| Reversal of additional depreciation arising from<br>the revaluation of fixed assets | (d) |
| Investments in associated company<br>and jointly controlled entity                  | (e) |
| Deferred tax effects  |     |

-----  
 Consolidated (loss)/profit attributable to shareholders  
 under U.S. GAAP

=====

Basic (loss)/earnings per share under U.S. GAAP

=====

Basic (loss)/earnings per ADS under U.S. GAAP\*

=====

\* Basic (loss)/earnings per American Depositary Share ("ADS") is calculated on the basis that one ADS is equivalent to 50 H shares.

## Notes

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|  |     |
|--|-----|
| Shareholders' equity under IFRS                                    |     |
| U.S. GAAP adjustments:   |     |
| Sale and leaseback accounting                                      | (a) |
| Lease arrangements   | (b) |
| Lease obligations  | (b) |
| Lease deposits   | (b) |
| Capitalised interest   | (c) |
| Revaluation of fixed assets, net of depreciation                   | (d) |
| Investments in associated company and jointly<br>controlled entity | (e) |
| Deferred tax effects   |     |

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Shareholders' equity under U.S. GAAP

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SUPPLEMENTARY INFORMATION FOR NORTH AMERICAN SHAREHOLDERS (Cont'd)  
(Expressed in Renminbi)

## NOTES:

## (a) SALE AND LEASEBACK ACCOUNTING

Under IFRS, gains on sale and leaseback transactions where the subsequent lease is an operating lease are recognised as income immediately, if the transactions are established at fair value. Differences between the sale price and fair value are deferred and amortised over the period for which the assets are expected to be used. Under U.S. GAAP, such gains are deferred and amortised over the term of the lease.

## (b) LEASE ARRANGEMENTS

As disclosed in Note 10 to the consolidated financial statements, during 2002 and 2003, the Group entered into two separate arrangements with certain independent third parties under which the Group sold aircraft and then immediately leased back the aircraft for a pre-determined period. As a result of the arrangements, the Group received a net cash benefit of RMB51,682,000 and RMB69,121,000 in 2002 and 2003 respectively which has been recognised as income under IFRS. Under U.S. GAAP, such benefits are deferred and amortised over the minimum lease period.

In addition, under the lease arrangements, the commitments by the Group to make long-term lease payments have been defeased by the placement of security deposits. As such, under IFRS, such commitments and deposits are not recognised on the consolidated balance sheet. Under U.S. GAAP, such commitments and deposits would be recognised on the consolidated balance sheet, as such commitments are not deemed as extinguished by the placement of security deposits.

## (c) CAPITALISED INTEREST

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Under IFRS, the Group capitalises interest costs to the extent the related borrowings are directly attributable to the acquisition or construction of an asset.

Under U.S. GAAP, interest costs capitalised are determined based on specific borrowings related to the acquisition or construction of an asset, if an entity's financing plans associate a specific new borrowing with a qualifying asset. If average accumulated expenditures for the asset exceed the amounts of specific new borrowings associated with the asset, additional interest costs capitalised are based on the weighted average interest rate applicable to other borrowings of the entity.

### (d) REVALUATION OF FIXED ASSETS

In connection with the Reorganisation in 1996, the fixed assets of the Group were revalued as of 31 December, 1996. Such fixed asset revaluation resulted in an increase in shareholders' equity with respect to the increase in carrying amount of certain fixed assets above their historical cost bases, while an exceptional charge to profit and loss account was recorded with respect to the reduction in carrying amount of certain fixed assets below their historical cost bases. In addition, the revalued fixed asset amounts serve as the tax bases of fixed assets for years beginning in 1997. Accordingly, the fixed asset revaluation eliminated certain of the temporary differences which gave rise to a deferred tax asset as at 31 December, 1996. Such deferred tax asset was offset against the revaluation surplus.

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SUPPLEMENTARY INFORMATION FOR NORTH AMERICAN SHAREHOLDERS (Cont'd)  
(Expressed in Renminbi)

NOTES: (cont'd)

### (d) REVALUATION OF FIXED ASSETS (cont'd)

Under U.S. GAAP, fixed assets are stated at their historical cost unless an impairment loss has been recorded. An impairment loss on fixed assets is recorded under U.S. GAAP if the carrying amount of such asset exceeds its future undiscounted cash flows, excluding finance costs. The future undiscounted cash flows, excluding finance costs, of the Group's fixed assets whose carrying amount was reduced in connection with the Reorganisation, exceed their historical cost carrying amount and, therefore, impairment of such assets is not appropriate under U.S. GAAP. Accordingly, the revaluation reserve recorded directly to shareholders' equity and the exceptional charge recorded under IFRS in 1996 and the additional depreciation charges recorded in the seven years ended 31 December, 2003, as a result of the Reorganisation are reversed for U.S. GAAP purposes. However, as a result of the tax deductibility of the net revaluation reserve, a deferred tax asset related to the reversal of the net revaluation reserve is created under U.S. GAAP with a corresponding increase in shareholders' equity as at 31 December, 1996. Such deferred tax asset will be reversed upon depreciation of the net revaluation surplus included in the fixed assets beginning 1997.

### (e) INVESTMENTS IN ASSOCIATED COMPANY AND JOINTLY CONTROLLED ENTITY

During 2002, the Company invested in an affiliated company and a

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jointly controlled entity, which were PRC state-owned enterprises. Under IFRS, such investments are initially recorded on a fair value basis at the cost of purchases borne by the Company. In the consolidated profit and loss account, the equity share of results of the investees are measured based on the fair value of underlying net assets determined on the date of acquisitions.

Under U.S. GAAP, such transactions would be considered to be "combinations of businesses under common control". Under U.S. GAAP, such investments are initially recorded at the Company's equity share of net assets of the investees determined on a historical cost basis. The differences between such amounts and the cost of purchases are reflected as movements in the shareholders' equity. In the consolidated profit and loss account, the equity share of results of the investees are measured based on the historical cost basis.

### (f) FINANCIAL STATEMENTS PRESENTATION AND DISCLOSURES

In the consolidated profit and loss account presented under IFRS, (loss)/gain on sale of fixed assets is classified under "Non-operating income/(expenses)". Under U.S. GAAP, such (loss)/gain would be classified under "Operating income/ (expenses) - General and administrative".

As disclosed in note 16 to the consolidated financial statements, deferred tax assets are presented on a net basis under IFRS. Under U.S. GAAP, the gross amount of such deferred tax assets and any applicable valuation allowance would be separately disclosed.

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SUPPLEMENTARY INFORMATION FOR NORTH AMERICAN SHAREHOLDERS (Cont'd)  
(Expressed in Renminbi)

NOTES: (cont'd)

### (g) RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

#### FIN 46R

In December 2003, the FASB issued FASB Interpretation No. 46 (revised December 2003) "Consolidation of Variable Interest Entities" which addresses how a business enterprise should evaluate whether it has a controlling financial interest in an entity through means other than voting rights and accordingly should consolidate the entity. FIN 46R replaces FASB Interpretation No. 46 "Consolidation of Variable Interest Entities" which was issued in January 2003. The Company will be required to apply FIN 46R to variable interests in VIEs created after 31 December, 2003. For variable interests in VIEs created before 1 January, 2004, the Interpretation will be applied beginning on 1 January, 2005. For any VIEs that must be consolidated under FIN 46R that were created before 1 January, 2004, the assets, liabilities and noncontrolling interests of the VIE initially would be measured at their carrying amounts with any difference between the net amount added to the balance sheet and any previously recognised interest being recognised as the cumulative effect of an accounting change. If determining the carrying amounts is not practicable, fair value at the date FIN 46R first applies may be used to measure the assets, liabilities and noncontrolling interest of the VIE. The Company is evaluating the impact of applying FIN 46R to existing VIEs in which it



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has variable interests and has not yet completed this evaluation.

FASB No. 150

FASB Statement No. 150 "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity" was issued in May 2003. This Statement establishes standards for the classification and measurement of certain financial instruments with characteristics of both liabilities and equity. The Statement also includes required disclosures for financial instruments within its scope. For the Company, the Statement was effective for instruments entered into or modified after 31 May, 2003 and otherwise will be effective as of 1 January, 2004, except for mandatorily redeemable financial instruments. For certain mandatorily redeemable financial instruments, the Statement will be effective for the Company on 1 January, 2005. The effective date has been deferred indefinitely for certain other types of mandatorily redeemable financial instruments. The Company currently does not have any financial instruments that are within the scope of this Statement.

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### FIVE YEAR SUMMARY

The following consolidated financial information is extracted from the consolidated financial statements of the Group, prepared under IFRS.

#### CONSOLIDATED PROFIT AND LOSS ACCOUNT DATA (in million, except per share data)

|  | YEAR ENDED 31 DECEMBER |             |             |
|--|------------------------|-------------|-------------|
|  | 2003<br>RMB            | 2002<br>RMB | 2001<br>RMB |
| Operating revenue                                    | 17,470                 | 18,019      | 16,880      |
| Operating expenses                                   | (17,014)               | (15,993)    | (15,479)    |
| Operating profit                                     | 456                    | 2,026       | 1,401       |
| Share of associated companies' results               | 48                     | 37          | 53          |
| Share of jointly controlled entities results         | (39)                   | (3)         | (4)         |
| Gain on sale of long term investments                | -                      | -           | -           |
| (Loss)/gain on sale of fixed assets                  | (22)                   | 171         | (56)        |
| Interest income                                      | 13                     | 53          | 50          |
| Interest expense                                     | (824)                  | (959)       | (934)       |
| Exchange (loss)/gain, net                            | (164)                  | (176)       | 297         |
| Other, net   | 21                     | (10)        | (11)        |
| (Loss)/profit before taxation and minority interests | (511)                  | 1,139       | 796         |
| Taxation credit/(expense)                            | 324                    | (398)       | (321)       |
| Minority interests                                   | (171)                  | (165)       | (135)       |
| (Loss)/profit attributable to shareholders (Note 1)  | (358)                  | 576         | 340         |
| Basic (loss)/earnings per share (Note 2)             | (0.09)                 | 0.17        | 0.10        |

Notes:

1. During 1999, the Group changed its IFRS accounting policy in respect of the recognition of aircraft overhaul expense. Such change was reflected in the consolidated financial statements on a retrospective basis with restatement of the relevant balances for the relevant prior periods. The restatement resulted in a decrease in an increase in profit attributable to shareholders for 1999 of RMB22 million.
2. Basic (loss)/earnings per share for year 2003 and for years 1999 to 2002 are computed by dividing (loss)/profit attributable to shareholders for the respective years by the weighted average number of shares in issue of 3,831,712,000 for year 2003 and 3,374,178,000 for years 1999 to 2002 respectively.

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FIVE YEAR SUMMARY (Cont'd)

CONSOLIDATED BALANCE SHEET DATA  
(in million)

|   | 2003<br>RMB | 2002<br>RMB | AS AT 31 DECEMBER<br>2001<br>RMB |
|---|-------------|-------------|----------------------------------|
| Cash and cash equivalents                             | 2,080       | 3,771       | 2,818                            |
| Other current assets                                  | 1,921       | 1,835       | 1,560                            |
| Fixed assets  | 28,536      | 26,921      | 22,352                           |
| Total assets  | 39,062      | 37,188      | 30,653                           |
| Bank and other loans, current portion                 | 7,097       | 5,241       | 2,178                            |
| Obligations under finance leases, current portion     | 1,298       | 1,567       | 1,452                            |
| Bank and other loans, non-current portion             | 4,522       | 5,835       | 3,628                            |
| Obligations under finance leases, non-current portion | 5,543       | 6,632       | 7,692                            |
| Shareholders' equity                                  | 11,896      | 9,613       | 9,222                            |

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THE BOARD OF DIRECTORS, SUPERVISORY COMMITTEE  
AND SENIOR ADMINISTRATIVE OFFICERS

BOARD OF DIRECTORS

MR. YAN ZHI QING is the Chairman of the Board of Directors. He became an employee of the Company in February 1996. Administrative positions which Mr. Yan has held include Director of Flight Operations of the Hunan Provincial Civil

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Aviation Administration, Director of the Guangxi Provincial Civil Aviation Administration, Director of the Central and Southern China Civil Aviation Administration, Director of the Political Department of the CAAC and Party Secretary and Managing Vice President of the CSAHC Group. Mr. Yan is currently the President and Vice Party Secretary of the CSAHC. Mr. Yan graduated from the School of Aviation Administration and Flight Control in 1962. Save as disclosed above, Mr. Yan is not connected with any directors, senior management, substantial shareholders or controlling shareholders of the Company.

MR. LIU MING QI is the Vice Chairman of the Board of Directors of the Company and joined the Company since May 2003. Mr. Liu graduated from South China Normal University and obtained a master's degree in economics from Fudan University. Mr. Liu is currently the Party Secretary and the Vice President of CSAHC. Mr. Liu began his career in 1968, and has successively served as the Municipal Secretary and Mayor of Sanya city of Hainan province, the Vice Governor of Hainan province, the Vice Director of Hong Kong and Macao Affairs office of the State Council and the Vice Director of Macao Liaison Office of the Central Government. Save as disclosed above, Mr. Liu is not connected with any directors, senior management, substantial shareholders or controlling shareholders of the Company.

MR. WANG CHANG SHUN is the Vice Chairman of the Board of Directors and the President of the Company and joined the Company in April 2001. He began his career in civil aviation in February 1976, mainly involved in air traffic control. He has held positions as Director of the Flight Operations Office of the Urumqi Civil Aviation Administration, Director of the Flight Meteorology and Flight Safety Monitoring Division, Deputy General Manager of Xinjiang Airlines and Deputy Director of Urumqi Civil Aviation Administration, Party Secretary and Deputy General Manager of Xinjiang Airlines and Party Secretary of Urumqi Civil Aviation Administration. Mr. Wang is also the Vice President of the CSAHC. Mr. Wang graduated from the School of the Chinese Academy of Social Sciences as a post graduate in Business Management and is qualified as a Senior Expert of Political Science. Save as disclosed above, Mr. Wang is not connected with any directors, senior management, substantial shareholders or controlling shareholders of the Company.

MR. PENG AN FA is currently a Director of the Company and the Vice President of CSAHC and became the employee of the Company since March, 1995 after the establishment of the Company. Mr. Peng graduated from the pilot department of China Civil Aviation Flying College and the department of Chinese language and literature of South China Normal University. Mr. Peng began his career in civil aviation in 1969, and successively served as the Pilot Director, Vice Party Secretary and Party Secretary of the Sixth Squadron of the Civil Aviation Administration. In July 1994, Mr. Peng held office as the Party Secretary of the Flight Operation Department of China Southern Airlines. In March 1998, Mr. Peng served as the President and Vice Secretary of China Southern Airlines Shenzhen Co. From August 2001 to October 2002, Mr. Peng served as the Vice President of CSAHC. Mr. Peng is concurrently the Vice Chairman of Shenzhen Air Catering Co., Ltd and CATIC (Hong Kong). Save as disclosed above, Mr. Peng is not connected with any directors, senior management, substantial shareholders or controlling shareholders of the Company.

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THE BOARD OF DIRECTORS, SUPERVISORY COMMITTEE  
AND SENIOR ADMINISTRATIVE OFFICERS (Cont'd)

BOARD OF DIRECTORS (cont'd)

MR. WANG QUAN HUA is currently a Director of the Company and Vice President of

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CSAHC and became the employee of the Company since March 1995 after the establishment of the Company. Mr. Wang graduated from the Economic Management Department of Central Communist Party College. Mr. Wang began his career in civil aviation in 1972, and successively served as the Director of Planning Department of Guangzhou Civil Aviation Administration, the Office Director of China Southern Airlines Shenzhen Co., the Director of the Planning and Operation Division of CSAHC, the President of Strategy and Development Department of China Southern Airlines Company Limited and the Vice President of CSAHC. Save as disclosed above, Mr. Wang is not connected with any directors, senior management or substantial shareholders or controlling shareholders of the Company.

MR. ZHAO LIU AN is a Director of the Company, the Vice President of CSAHC and the President of Xinjiang Airlines and joined the Company since May 2003. Mr. Zhao began his career in civil aviation in 1966, and successively served as the Director of Flight Meteorology and Flight Safety Monitoring Division, Director of Science Education Division, the Director of Flying Model Division of Urumqi Civil Aviation Administration, Captain of the Ninth Squadron of the Civil Aviation Administration, the Vice President of Urumqi Civil Aviation Administration and Xinjiang Airlines. Mr. Zhao is currently a President. Save as disclosed above, Mr. Zhao is not connected with any directors, senior management or substantial shareholders or controlling shareholders of the Company.

ZHOU YONG QIAN is currently a Director of the Company and the Vice President of CSAHC and the President of China Northern Airlines. Mr. Zhou joined the Company since May 2003. Mr. Zhou graduated from Nanjing Institute of Meteorology. Mr. Zhou began his career in civil aviation in 1990, and successively served as Minister of the Organization Division of the Northeastern Civil Aviation Administration, Vice Secretary of Shenyang Taoxian International Airport, Vice Secretary of the Northeastern Civil Aviation Administration and the President of China Northern Airlines. Save as disclosed above, Mr. Zhou is not connected with any directors, senior management or substantial shareholders or controlling shareholders of the Company.

ZHOU YONG JIN is a Director of the Company. He joined the CSAHC in January 1991 and became an employee of the Company upon its establishment in March 1995, and has successively served as a Director of the Propaganda Department of the CSAHC, Party Secretary of the Transportation Department (Guangzhou) of the Company, and Party Secretary of the Company's Shenzhen branch. He is currently Chairman of the Labour Union of the Company. Mr. Zhou is not connected with any directors, senior management or substantial shareholders or controlling shareholders of the Company.

MR. XU JIE BO is a Director and the Chief Financial Officer of the Company. He joined the Company in July 1998. Mr. Xu graduated from the Management Department of Tianjin University and then served the Financial Department of Guangzhou Civil Aviation Administration. He was a supervisor of the Financial Management Office for Infrastructure Projects and from December 1992, he was a Deputy Director and Director of the Financial Department of Central and Southern China Civil Aviation Administration. In July 1998 he became General Manager of the Financial Department of the Company. He is a Director and the Chief Financial Officer of the Company. In addition, he is also a Director of Southern Airlines Group Shantou Airlines Company Limited and Guangxi Airlines Company Limited. Mr. Xu is not connected with any directors, senior management or substantial shareholders or controlling shareholders of the Company.

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### BOARD OF DIRECTORS (cont'd)

MR. WU RONG NAN is a Director of the Company. He joined the CSAHC in January 1991 and became an employee of the Company upon its establishment in March 1995. Mr. Wu is an air traffic control engineer. He was once employed as the Director of Flight Operations of the Guangzhou Civil Aviation Administration and has been President of Xiamen Airlines since 1986. Mr. Wu is not connected with any directors, senior management or substantial shareholders or controlling shareholders of the Company.

MR. SIMON TO has been an Independent Non-Executive Director of the Company since June 1999. Mr. To is currently a Managing Director of Hutchison Whampoa (China) Limited, and also serves as director of several companies in Hong Kong and Foreign-invested companies in China. Mr. To has managed investment projects in China since early 1980's and is familiar with the laws and regulations of Hong Kong and China. Mr. To graduated from the Stanford University with a Master degree in Business Administration. Mr. To is not connected with any directors, senior management or substantial shareholders or controlling shareholders of the Company.

MR. PETER LOK has been an Independent Non-Executive Director of the Company since June 2001. He is also a veteran in the civil aviation industry. Mr. Lok joined the Civil Aviation Department of Hong Kong in 1956 and became its Assistant Director in 1982, Deputy Director in 1988, and Director from 1990 to 1996. From 1997 to 2000, Mr. Lok was an advisor and president of Hong Kong Commercial Airlines Center. Mr. Lok has sat on various Committees such as the Evaluation Committees for the Design of Shanghai's Pudong Airport, Committee for China's Zhuhai Aviation and Spaceflight Fair, Evaluation Committees for the IATA Eagle Award. He is also independent director of several listed airline companies. Mr. Lok is not connected with any directors, senior management or substantial shareholders or controlling shareholders of the Company.

MR. WEI MING HAI has been an Independent Non-Executive Director of the Company since June 2001. He is a Professor and Dean of the School of Management of Zhongshan University. Professor Wei has worked in Jiangxi Provincial Accounting Association, and he started working in Zhongshan University from 1991. In 1993 he became the chairman of the Accounting Department in the School of Management of Zhongshan University. In 1996 he became the Deputy Dean of the School of Management in Zhongshan University. In January 2000, he became Dean of the School of Management in Zhongshan University. Since 1998, Professor Wei has been a doctorate advisor for Accounting Information and Investment Analysis. Professor Wei is also on the board of directors of China Accountants Association, Vice Chairman of Accountants Association of Guangdong Province, Vice Chairman of Auditors Association of Guangzhou, Executive Member of the Research Institute of Financial Costs for Young and Middle-aged Accountants, member of American Accounting Association. Professor Wei holds a Ph.D degree in economics and has an MBA degree from Tulane University in the United States of America. He has published over ten academic books or textbooks, and over 60 academic papers. Mr. Wei is not connected with any directors, senior management or substantial shareholders or controlling shareholders of the Company.

MR. WANG ZHI has been an Independent Non-Executive Director of the Company since May 2003. Mr. Wang graduated from the Aircraft Design Department of Harbin Institute of Technology. Mr. Wang began his career in 1965, and has successively served as the Director and Senior Engineer of Aeronautics Research Institute of China, the Vice Director and Vice secretary of the First Research Institute of Civil Aviation, the Vice Director and Director of the Planning Bureau of CAAC and the Director of the Planning Technology System Reform Department and the Planning Technology Department of CAAC. Mr. Wang is also professor in several universities. Mr. Wang is not connected with any directors, senior management or substantial shareholders or controlling shareholders of the Company.

THE BOARD OF DIRECTORS, SUPERVISORY COMMITTEE  
AND SENIOR ADMINISTRATIVE OFFICERS (Cont'd)

## BOARD OF DIRECTORS (cont'd)

MR. SUI GUANG JUN has been an Independent Non-Executive Director of the Company since May 2003. Mr. Sui graduated from the Economic Department of Jinan University and obtained a master degree. Mr. Sui obtained a doctor degree in the Management of Organizations of Jinan University. He has successively served as the Vice Director of the Research Institute of Hong Kong and Macao Economies and the Dean of corporate administration department of Jinan University. Mr. Sui is currently the Chief of the Post-doc Committee of Applied Economics and the Dean of Manage College in Jinan University. Mr. Sui is not connected with any directors, senior management or substantial shareholders or controlling shareholders of the Company.

## SUPERVISORY COMMITTEE

As required by the Company Law and the Articles of Association, the Company has a supervisory committee (the "Supervisory Committee") which is primarily responsible for the supervision of senior management of the Company, including the Board of Directors, executive officers and other senior management personnel, to ensure that they act in the interests of the Company, its shareholders and employees, as well as in compliance with applicable law. The Supervisory Committee consists of three Supervisors. Two of the Supervisors are shareholder representatives appointed by shareholders, and one Supervisor is a representative of the Company's employees. The Supervisors serve terms of three years and may serve consecutive terms.

LIANG HUA FU is the Chairman of the Supervisory Committee of the Company. He became an employee of the Company since its establishment in March, 1995. Mr. Liang held numerous positions in the Guangzhou Civil Aviation Administration, including Chief of the Navigation Division, Party Secretary of the Transportation Department, Secretary of the Disciplinary Department and Director of Administration and Supervision. Mr. Liang attended Tianjin Aviation School and Guangzhou Political Science College. Mr. Liang is not connected with any directors, senior management or substantial shareholders or controlling shareholders of the Company.

GAN YU HUA is a Supervisor of the Company. He became an employee of the Company since its establishment in March, 1995. Mr. Gan held various positions in the Chinese commercial aviation industry, including Deputy Director of the Finance Department, Deputy Chief Accountant and Director of the Audit Department of the Guangzhou Civil Aviation Administration. He holds a Senior Account Certificate and is a member of the International Auditors Association. Mr. Gan graduated from Shanghai Li Xin Accounting College in 1948. Mr. Gan is not connected with any directors, senior management or substantial shareholders or controlling shareholders of the Company.

LI QI HONG is a Supervisor of the Company and the Representative of the Labour Union of the Company. He became an employee of the Company since its establishment in March, 1995. Mr. Li graduated from the CAAC Aviation College in 1968, and held various administrative positions in the commercial aviation industry in China. Mr. Li is not connected with any directors, senior management or substantial shareholders or controlling shareholders of the Company.

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### THE BOARD OF DIRECTORS, SUPERVISORY COMMITTEE AND SENIOR ADMINISTRATIVE OFFICERS (Cont'd)

#### SENIOR ADMINISTRATIVE OFFICERS

JIANG PING is a Vice President of the Company. He graduated from the CAAC Aviation Collage. During the period from 1988 to 1991, Mr Jiang was the Director of Flying Safety and Technology Department of Air China. During the period from 1995 to 2000, he was the Director of the Flight Brigade of the Flight Technology Training Department of Air China. Mr Jiang has been holding the position as a Vice President of the Company since 2000.

LI KUN is a Vice President of the Company. He graduated from the CAAC Management Institute specializing in Air Transport Management. Mr Li was the General Manager of the Thailand Office, China Southern Airlines from 1993 to 1995. He became the General Manager of Transportation Department of the Company from 1998 to 2000. Mr Li has been holding the position as a Vice President of the Company since 2000.

YUAN XIN AN is a Vice President of the Company. He graduated from the Air Engineering College. Mr. Yuan has over 25 years of experience in the Chinese aviation industry. He has been the Manager of Quality Assurance and Deputy Controller of Quality Control of Guangzhou Aircraft Maintenance Engineering Company Limited, Deputy General Manager of the Aircraft Engineering Department of the Company, and Vice President of Guangzhou Aircraft Maintenance Engineering Company Limited. Mr. Yuan has become the Chief Engineer of the Company since 2000, and he has been appointed as a Vice President of the Company from April 2002.

ZHENG EN REN is a Vice President of the Company. He graduated from the CAAC Advanced Flying College and possesses the qualification as a First Class Pilot. Mr. Zheng has over 40 years of experience in the Chinese aviation industry. He served as the Captain of the Sixth Squadron of the Civil Aviation Administration, Chairman of the Labour Union and Deputy Chief Captain. During the period from 1996 to 1999, he held the position as President of Southern Airlines (Group) Shantou Airlines Company Limited. Mr. Zheng was an Assistant to the President of the Company from 1999 to April 2002. He has been appointed as a Vice President of the Company from April, 2002.

YANG GUANG HUA is currently a Vice President of the Company. Mr. Yang has almost 30 years of experience in the Chinese aviation industry. From 1990 to 1992, Mr. Yang was the Director of Safety of the Hunan Civil Aviation Administration. From 1992 to 1998, he held the position as Vice President of China Southern Airlines (Group) Hunan Co.. Mr. Yang was the President of the Southern Airlines (Group) Zhuhai Helicopters Company Limited from 1998 to 1999. He then served as the President of Southern Airlines Henan branch from 1999 to April 2002. Mr. Yang has been appointed as a Vice President of the Company from April 2002 to July 2003.

HAO JIAN HUA is currently the Vice President and Chief Pilot of the Company. He completed his piloting at the CAAC Advanced Flying College. Mr. Hao has held positions as Captain, then Deputy Chief Captain, and subsequently Chief Captain of the Sixth Squadron of the Civil Aviation Administration during the period from 1989 to 1994. He then became a Deputy General Manager, from 1994 to 1998, and the General Manager, from 1998 to 1999, of the Flying Aviation Department of the Company. He has been the Chief Pilot of the Company from 1999, and the Vice President of the Company since 31 July, 2003.

SU LIANG is currently holding the position as Company Secretary. He was a graduate of the Cranfield College of Aeronautics, University of Cranfield,

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United Kingdom, specializing in Air Transport Management Engineering. Mr. Su is a holder of master degree. During the period from 1998 to 1999, Mr. Su held the position as Deputy Manager of the Flight Operations Department, China Southern Airlines Shenzhen Co. and from 1999 to 2000, he was the Manager of the Planning and Administration Department of China Southern Airlines Shenzhen Co.. Mr. Su was in charge of the international cargo project of the Company, responsible for the planning and development of the Company's North American cargo business. From 2000 to date, Mr. Su is the Company Secretary.

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### GLOSSARY

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

#### CAPACITY MEASUREMENTS

|  |   |
|--|---|
| "available seat kilometres" or "ASKs"  | the number of seats made available for sale multiplied by the kilometres flown  |
| "available tonne kilometres" or "ATKs" | the tonnes of capacity available for the transportation of revenue load (passengers and cargo) multiplied by the kilometres flown |

#### TRAFFIC MEASUREMENTS

|  |  |
|--|--|
| "revenue passenger kilometres" or "RPKs" | the number of passengers carried multiplied by the kilometres flown          |
| "cargo tonne kilometres"                 | the load in tonnes multiplied by the kilometres flown                        |
| "revenue tonne kilometres" or "RTKs"     | the load (passengers and cargo) in tonnes multiplied by the kilometres flown |

#### YIELD MEASUREMENTS

|                   |   |
|-------------------|---|
| "passenger yield" | revenue from passenger operations divided by RPKs                     |
| "cargo yield"     | revenue from cargo operations divided by cargo tonne kilometres       |
| "average yield"   | revenue from airline operations (passenger and cargo) divided by RTKs |
| "tonne"           | a metric ton, equivalent to 2,204.6 pounds                            |

#### LOAD FACTORS

|                         |  |
|-------------------------|--|
| "passenger load factor" | RPKs expressed as a percentage of ASKs |
| "overall load factor"   | RTKs expressed as a percentage of ATKs |

#### UTILISATION

|                     |   |
|---------------------|---|
| "utilisation rates" | the actual number of flight and taxi hours per aircraft operating day |
|---------------------|---|



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(a joint stock limited company incorporated in the Peoples Republic of China with limited liability)

(STOCK CODE: 1055)

### NOTICE OF 2003 ANNUAL GENERAL MEETING

NOTICE IS HEREBY GIVEN that pursuant to the resolutions passed by the Board of Directors of China Southern Airlines Company Limited (the Company ) at the Board Meeting held on Friday, 23 April 2004, the 2003 Annual General Meeting of the Company will be held at the headquarters of China Southern Airlines Company Limited, No. 278 Ji Chang Road, Guangzhou, Guangdong Province, the PRC at 9:00 a.m., on 16 June, 2004 for the following purposes:

- I. TO EXAMINE AND APPROVE THE FOLLOWING RESOLUTIONS AS ORDINARY RESOLUTIONS:
1. Report of the Directors of the Company for the year 2003;
  2. Report of the Supervisory Committee of the Company for the year 2003;
  3. Audited consolidated financial statements of the Company for the year 2003;
  4. Profit distribution budget of the Company for the year 2003;
  5. Appoint KPMG as the international auditors of the Company for the year 2004 and KPMG Huazhen as the PRC auditors of the Company for the year 2004 and authorize the Board to determine their remuneration;
  6. To elect members of the fourth Board of Directors, with Yan Zhi Qing, Liu Ming Qi, Wang Chang Shun, Peng An Fa, Wang Quan Hua, Zhao Liu An, Zhou Yong Qian, Zhou Yong Jin, Xu Jie Bo and Wu Rong Nan as executive Directors, and Simon To, Peter Lok, Wei Ming Hai, Wang Zhi and Sui Guang Jun as independent non-executive Directors and authorize the Board of Directors to determine their remuneration thereof (the details of the relevant candidates are disclosed in the 2003 Annual Report of the Company);
  7. To elect members of the fourth Supervisory Committee with Sun Xiao Yi, Yang Guang Hua and Yang Yi Hua as Supervisors and authorize the Supervisory Committee to determine their remuneration, and consider and approve the resignation of Liang Hua Fu, Gan Yu Hua and Li Qi Hong as members of the Supervisory Committee (the details of the relevant candidates are disclosed in Note V to this Notice);
  8. Proposal of the Board of Directors for amendments to the Rules of Procedures for Shareholders General Meetings as stated below:
    - a. Article 2 of the Rules of Procedures for Shareholders General Meetings shall be replaced by the following provision:

ARTICLE 2 The shareholders general meeting is the organ of authority of the Company and shall exercise the following functions and powers in accordance with law:

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- (1) to decide on the Companys operational policies and investment plans;
  - (2) to elect and replace directors and decide on matters relating to the remuneration of directors;
  - (3) to elect and replace independent directors and decide the standard of allowance of independent directors;
  - (4) to elect and replace the supervisors who are representatives of shareholders and decide on matters relating to the remuneration of supervisors;
  - (5) to examine and approve reports of the board of directors;
  - (6) to examine and approve reports of the supervisory committee;
  - (7) to examine and approve the Companys proposed annual preliminary and final financial budgets;
  - (8) to examine and approve the Companys profit distribution plans and plans for making up losses;
  - (9) to decide on increases or reductions in the Company registered capital;
  - (10) to decide on the issue of debentures by the Company;
  - (11) TO DECIDE ON MATTERS RELATING TO EXTERNAL SECURITY (INCLUDING PLEDGE) ACCORDING TO THE  
  
RELEVANT PROVISIONS OF THE ARTICLES OF ASSOCIATION;
  - (12) to decide on matters such as merger, division, dissolution and liquidation of the Company;
  - (13) to amend the articles of association;
  - (14) TO DECIDE ON THE APPOINTMENT AND DISMISSAL OF THE ACCOUNTANTS OF COMPANY;
  - (15) to consider motions raised by shareholders who represent five percent or more of the total shares of the Company carrying the right to vote;
  - (16) to decide on other matters which require resolutions of the shareholders general meeting according to relevant laws, administrative regulations and provisions of the articles of association.;
- b. Article 47 of the Rules of Procedures for Shareholders General Meeting shall be replaced by the following provision:

ARTICLE 47 Resolutions of shareholders general meetings shall be divided into ordinary resolutions and special resolutions.

To adopt an ordinary resolution, votes representing one half

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or more of the voting rights represented by the shareholders (including proxies) present at the meeting must be exercised in favor of the resolution in order for it to be passed.

To adopt a special resolution, votes representing two thirds or more of the voting rights represented by the shareholders (including proxies) present at the meeting must be exercised in favor of the resolution in order for it to be passed.

SHAREHOLDERS PRESENT AT THE MEETING (INCLUDING PROXIES) SHALL EXPRESSLY STATE THEIR AGREEMENT WITH OR OBJECTION TO EVERY MATTER TO BE DETERMINED BY VOTING. ANY VOTES MADE BY ANY SHAREHOLDERS GIVING UP OR ABSTAINING FROM VOTING SHALL NOT BE COUNTED AS VOTES HAVING VOTING RIGHTS.

WHEN ANY SHAREHOLDERS PROXY SHALL ABSTAIN FROM VOTING OR BE LIMITED TO VOTE IN FAVOR OF OR AGAINST ANY DESIGNATED RESOLUTION, ANY VOTES MADE BY SUCH PROXY IN CONTRAVENTION OF THE AFORESAID REGULATION OR LIMITATION SHOULD NOT BE COUNTED AS VOTES HAVING VOTING RIGHTS.;

- c. Article 51 of the Rules of Procedures for Shareholders General Meeting shall be replaced by the following provision:

ARTICLE 51 Method of voting:

- (1) disclosed ballot;
- (2) SHOW OF HANDS FOR MATTERS NOT CURRENTLY REQUIRED TO BE VOTED BY BALLOT;
- (3) unconditional ballot, that is, no additional conditions are attached to voting;
- (4) a resolution shall be made after voting.

THE FOLLOWING MATTERS SHALL BE APPROVED BY VOTING UNDER THE SCRUTINEERS SUPERVISION AT SHAREHOLDERS GENERAL MEETING:

- (1) CONNECTED TRANSACTIONS;
- (2) TRANSACTIONS THAT SHALL BE APPROVED BY INDEPENDENT SHAREHOLDERS;
- (3) OPTIONS GRANTED TO MAJOR SHAREHOLDERS OR INDEPENDENT DIRECTORS OR ANY OTHER RELATED PARTIES;
- (4) ANY OTHER TRANSACTIONS IN WHICH SHAREHOLDERS ARE MATERIALLY INTERESTED AND ACCORDINGLY ARE REQUIRED TO REFRAIN FROM VOTING AT SHAREHOLDERS GENERAL MEETING.

SAVE AS STATED ABOVE WHICH SHALL BE VOTED BY BALLOT, AT ANY SHAREHOLDERS GENERAL MEETING A RESOLUTION SHALL BE DECIDED ON A SHOW OF HANDS, UNLESS A BALLOT IS (BEFORE OR AFTER ANY VOTE BY SHOW OF HANDS) DEMANDED:

- (1) BY THE CHAIRMAN OF THE MEETING;
- (2) BY AT LEAST TWO VOTING SHAREHOLDERS PRESENT IN PERSON OR BY PROXIES;

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- (3) BY ONE OR MORE SHAREHOLDERS PRESENT IN PERSON OR BY PROXY AND REPRESENTING (ALONE OR IN AGGREGATE) 10 PER CENT OR MORE (INCLUDING THE 10 PER CENT) OF ALL SHARES CARRYING THE RIGHT TO

VOTE AT THE MEETING.;

THE DEMAND FOR A BALLOT MAY BE WITHDRAWN BY THE PERSON WHO MAKES SUCH DEMAND.;

9. Proposal of the Board of Directors for amendments to the Rules of Procedures for Board of Directors as stated below;

- a. The Companys Article 21 of Rules of Procedures for Board of Directors shall be replaced by the following provision:

ARTICLE 21 Apart from the powers granted by the Company Law, the articles of association of the Company and other relevant laws and regulations to the directors, the independent directors shall have the following special powers:

- (1) CONNECTED TRANSACTIONS OF WHICH THE AGGREGATE CONSIDERATION IS IN COMPLIANCE WITH THE RELEVANT PROVISIONS OF EXISTING LISTING RULES AND OTHER SUPERVISORY REGULATIONS IN PLACES WHERE THE COMPANY IS LISTED, SHALL FIRST BE APPROVED BY THE INDEPENDENT DIRECTORS BEFORE SUBMISSION TO THE BOARD OF DIRECTORS FOR DISCUSSION.

Before making the decision with respect to such transactions, the independent directors may engage a professional institution to prepare independent financial advisor s reports as a basis of their decision;

- (2) propose to the board of directors with respect to engaging or disengaging accounting firms;
- (3) propose to the board of directors with respect to the convening of extraordinary shareholders general meetings;
- (4) propose the convening of board meetings;
- (5) engage external auditing firms or consultancy firms;
- (6) publicly solicit proxies from shareholders before shareholders general meetings.

The Independent Director shall obtain the consent of over half of the independent directors in exercising any of the above powers.;

- b. Article 22 of the Rules of Procedures for Board of Directors shall be replaced by the following provision:

ARTICLE 22 In addition to the above obligations, the independent directors shall provide their independent opinions to the board of directors or the shareholders general meeting on the following matters:

- (1) nomination, appointment and removal of Directors;
- (2) appointment and dismissal of senior administrative officers;
- (3) remuneration of directors and senior administrative officers;
- (4) NEWLY OCCURED CONNECTED TRANSACTION, LOAN AND OTHER FORMS OF FUND TRANSFER BETWEEN THE COMPANY AND ITS SHAREHOLDERS, ACTUAL CONTROLLERS OR THEIR AFFILIATES FOR WHICH THE AGGREGATE CONSIDERATION IS IN COMPLIANCE WITH THE RELEVANT PROVISIONS OF THE EXISTING LISTING RULES AND OTHER SUPERVISORY REGULATIONS IN PLACES WHERE THE COMPANY IS LISTED, AND WHETHER THE COMPANY HAS TAKEN EFFECTIVE MEASURES TO COLLECT THE AMOUNTS DUE;
- (5) matters which may harm the interests of the minority shareholders;
- (6) other matters provided for in the articles of association of the Company.

The independent director shall choose to provide any of the following opinions with respect to the above matters: agree, reserve opinion and the reasons therefor, dissent and the reasons therefor, or unable to comment and the reasons therefor.

If the matters concerned fall under those which require disclosure, the Company shall publicly disclose the opinions of the independent directors. When the independent directors cannot reach a consensus, the Company shall publicly disclose the opinions of each of the independent directors.;

- c. Article 33 of the Rules of Procedures for Board of Directors shall be replaced by the following provision:

ARTICLE 33 The board of directors shall exercise the following powers:

- (1) Be responsible for the convening of the shareholders general meeting and to report on its work  
  
to the shareholders general meeting;
- (2) Implement the resolutions of the shareholders general meetings;
- (3) DECIDE ON THE COMPANYS BUSINESS PLANS AND ANY INVESTMENT PROJECT WHICH IS BELOW 50% OF THE COMPANYS RECENTLY AUDITED NET ASSETS, INCLUDING ENTERING INTO MAJOR CONTRACTS OF LOANS, TRUST, COMMISSION, DONATION, CONTRACTING AND LEASE AGREEMENTS, AND INVESTMENT, ETC.;
- (4) Decide on the following purchases or sales of assets:
  - (i) The aggregate amount or value of the consideration for the proposed disposition, and the amount or

value of the consideration for any such disposition of any fixed assets of the Company that has been completed in the period of four (4) months immediately preceding the proposed disposition, exceed 33% of the value of the Companys fixed assets as shown in the Companys most recent audited account;

- (ii) The total amount of the assets to be purchased or sold according to the most recently audited financial report, evaluation report or verification report (including the debts and expenses) is below 50% of the Companys most recently audited net assets;
  - (iii) The absolute value of the net profit or loss of the asset to be purchased (according to the audited financial report of the pervious year) is below 50% of the absolute value of the Companys audited net profit or loss in the preceding year;
  - (iv) The absolute value of the net profit or loss of the asset to be sold or the absolute value of the profit or loss of the transaction is below 50% of the absolute value of the listed Companys audited net profit or loss in the preceding year;
- (5) Undertake risk investments, the amount of which shall be less than 10% of the Companys most recent audited net assets (as shown in the Companys most recent audited account). Investment in such undertaking show follow stringent procedures of examination and decision making. Major investment projects which exceed the aforesaid amount shall be examined by relevant specialists and then submitted to the shareholders general meeting for approval.

The above risky investments are those which involve areas the Company has never ventured into in the past, and are outside the Companys scope of normal business, or those which the board of directors considers as highly risky and uncertain, including but not limited to investment on shares, futures or foreign exchanges transactions, etc.;

- (6) Cancel less than 10% of the Companys most recently audited net assets (as shown in the Companys most recent audited account). When the assets to be cancelled are more than 10% of the Companys net assets, the board of directors should submit the proposal to the shareholders general meetings for approval;
- (7) Formulate the Companys annual preliminary and financial budgets;
- (8) Formulate the Companys profit distribution plan and plan for making up losses;
- (9) DETERMINE MATTERS RELATING TO EXTERNAL SECURITY (INCLUDING PLEDGING OF ASSETS) REPRESENTING LESS THAN 50% OF THE AUDITED NET ASSETS ACCORDING TO THE AUDITED

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FINANCIAL REPORT OF THE PREVIOUS YEAR;

- (10) Formulate proposals for increases or reductions in the Companys registered capital and for issue of debentures or other instruments of the Company;
- (11) PREPARE PLANS FOR MAJOR ACQUISITION, REPURCHASE OF THE COMPANYS SHARES OR MERGERS, DIVISION AND DISSOLUTION OF THE COMPANY;
- (12) Decide on the establishment of the Companys internal management structure;
- (13) Pursuant to the Chairmans nomination to appoint or dismiss the Companys president, the secretary of the board of directors and decide the remunerations thereof, and pursuant to the president s nominations to appoint or dismiss the vice-presidents, the financial controller, the general economic officer, chief engineer and the chief flying officer of the Company;
- (14) Establish the Companys following basic management system:
  - (i) asset management system and the supervision system;
  - (ii) labor employment system, wages and compensation system, welfare system, reward system and the supplementary social security system;
  - (iii) financial accounting system;
  - (iv) other important systems that should be established by the board of directors;
- (15) Prepare proposals for any amendment to the Companys articles of association;
- (16) Manage the release of the Companys information;
- (17) Propose to the shareholders general meeting the engagement or replacement of the Companys accounting firm;
- (18) Hear the reports of the Companys president, and examine the work of the president (if the president is also a director, the president-director shall abstain from exercising his rights as director when the board examines his work as president);
- (19) Formulate proposals on the remuneration and subsidies of the directors;
- (20) Formulate proposals on the rate of subsidies for the independent directors;
- (21) Exercise any other powers granted by laws, regulations or the Companys articles of association or conferred by the shareholders general meetings.

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The board shall exercise its powers by holding board meetings and passing resolutions for implementation.;

- d. Article 35 of the Rules of Procedures for Board of Directors shall be replaced by the following provision:

ARTICLE 35 THE BOARD OF DIRECTORS MAY SET UP STRATEGY, NOMINATION, REMUNERATION AND EVALUATION, AND INDEPENDENT BOARD COMMITTEES ACCORDING TO THE COMPANYS ACTUAL NEEDS. MEMBERS OF THESE SPECIAL COMMITTEES SHALL ALL BE DIRECTORS, AND IN THE AUDITING COMMITTEE, THE NOMINATION COMMITTEE, THE REMUNERATION AND EVALUATION COMMITTEE, THE INDEPENDENT DIRECTORS SHALL FORM THE MAJORITY AND SHALL BE RESPONSIBLE FOR CONVENING THE COMMITTEE MEETINGS. IN THE AUDITING COMMITTEE AT LEAST ONE INDEPENDENT DIRECTOR SHALL BE AN ACCOUNTING PROFESSIONAL.

- (1) The strategy committee shall primarily be responsible for research and proposal with regard to the Companys long term development and major investment decisions.
  - (2) The auditing committee shall primarily be responsible for (i) proposing the engagement and replacement of the external auditor; (ii) supervising the Companys internal auditing system and implementation thereof; (iii) liaison between internal and external auditors; (iv) verifying and disclosing the Companys financial information; (v) checking the internal control system of the Company.
  - (3) The nomination committee shall primarily be responsible for (i) formulating the standards and procedure for selecting directors, managers, and making proposals in connection therewith, (ii) search for competent candidates of directors and managers; (iii) evaluating the candidates of directors and managers and making proposals in connection therewith.
  - (4) The remuneration and evaluation committee shall primarily be responsible for (i) formulating the standard for evaluation of directors and managers, evaluating directors and managers and making proposals in connection therewith; (ii) deliberating on and reviewing the directors and senior administrative officers remuneration policy and plan.
  - (5) THE INDEPENDENT BOARD COMMITTEE SHALL PRIMARILY BE RESPONSIBLE FOR (i) EXAMINING CONNECTED TRANSACTIONS OF THE COMPANY; (ii) EXAMINING THE COMPANYS CAPITAL USED BY SHAREHOLDERS AND CAPITAL RECOVERY STATUS; (iii) EXAMINING MATTERS ON PROVISION OF EXTERNAL SECURITY BY THE COMPANY; (iv) EXAMINING WHETHER THE COMPANY HAS IMPAIRED THE INTERESTS OF ITS MINORITY SHAREHOLDERS.;
- e. Article 54 of the Rules of Procedures for Board of Directors shall be replaced by the following provision:

ARTICLE 54 MEETINGS OF THE BOARD OF DIRECTORS SHALL BE HELD FOUR TIMES EVERY YEAR, AND THESE MEETINGS SHALL BE HELD WITHIN TWO DAYS BEFORE THE RELEASE OF THE COMPANYS ANNUAL REPORT FOR THE PREVIOUS YEAR, THE RELEASE OF THE COMPANYS



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INTERIM REPORT AND THE RELEASE OF THE COMPANYS QUARTERLY REPORTS RESPECTIVELY TO DISCUSS AND EXAMINE THE RELEVANT REPORTS.;

- f. Article 62 of the Rules of Procedures for Board of Directors shall be replaced by the following provision:

ARTICLE 62 The boards motions shall be submitted according to the following procedures:

- (1) Proposing the motions: According to the powers of the board, a motion shall be put forward by the Chairman, the supervisory committee, or the president. They may also be put forward by a director or jointly by several directors.
  - (2) Preparing the motions: The motions proposed by the Chairman, the supervisory committee or by the president may be prepared by themselves or be handed over by the secretary to relevant department. The motion proposed by one director or by several directors may be prepared by the director or directors proposing such motions, or be handed over by the secretary upon approval by the Chairman to relevant department.
  - (3) Submission of motions: After the motions are prepared, the secretary of the board of directors shall collect comments and opinions among relevant persons. After elaboration, evaluation, modification by relevant parties and persons, a sufficiently sophisticated resolution will be submitted to the board for deliberation.
  - (4) CONNECTED TRANSACTIONS THE TOTAL CONSIDERATION OF WHICH EXCEEDS THE RELEVANT PROVISIONS OF THE EXISTING LISTING RULES AND OTHER SUPERVISORY REGULATIONS IN PLACES WHERE THE COMPANY IS LISTED SHALL BE APPROVED AND SIGNED BY THE INDEPENDENT DIRECTORS BEFORE SUBMISSION TO THE BOARD OF DIRECTORS FOR DELIBERATION AS A PROPOSED MOTION.;
- g. Article 65 of the Rules of Procedures for Board of Directors shall be replaced by the following provision:

ARTICLE 65 Directors participating in a board meeting vote for or against the board resolutions by casting a written and open ballot. Each of the resolutions shall be voted for or against and each director shall have one vote. The directors may either vote for or against a resolution and usually they are not allowed to abstain. If a director chooses to abstain, he must give reasons for such abstention and such reasons shall be kept in record.

RESOLUTION TO BE MADE BY THE BOARD OF DIRECTORS SHALL BE PASSED BY ONE HALF OR MORE OF ALL DIRECTORS PRESENT AT THE MEETING EXCEPT THAT PROVISION 9 IN ARTICLE 33 SHALL BE SUBJECT TO WRITTEN CONSENT BY TWO THIRDS OR MORE OF ALL DIRECTORS PRESENT AT THE MEETING.;

- h. Article 87 of the Rules of Procedures for Board of Directors

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shall be replaced by the following provision:

ARTICLE 87 CONNECTED TRANSACTIONS THE TOTAL CONSIDERATION OF WHICH EXCEEDS THE RELEVANT PROVISIONS OF THE EXISTING LISTING RULES AND OTHER SUPERVISORY REGULATIONS IN PLACES WHERE THE COMPANY IS LISTED SHALL BE DEALT WITH AS FOLLOWS:

- (1) Proposal by the president;
  - (2) The president shall cause relevant departments to collect materials for and prepare a draft plan;
  - (3) The president shall examine the plans to be submitted to the board;
  - (4) The secretary of the board of directors shall make arrangements for a meeting at which relevant departments of the Company shall report to the independent non-executive directors about the transaction;
  - (5) The secretary of the board of directors shall collect materials and make arrangements for a board meeting;
  - (6) Board discussion;
  - (7) BOARD RESOLUTION. THE SECRETARY OF THE BOARD OF DIRECTORS SHALL MAKE A PUBLIC ANNOUNCEMENT REGARDING THE RESOLUTION IN ACCORDANCE WITH THE RELEVANT PROVISIONS OF EXISTING LISTING RULES AND OTHER SUPERVISORY REGULATIONS IN PLACES WHERE THE COMPANY IS LISTED;
  - (8) The secretary of the board of directors shall notify relevant authorities,
- i. Article 90 of the Rules of Procedures for Board of Directors shall be followed with this new Article:

ARTICLE 91 MATTERS ON EXTERNAL SECURITY:

- (1) TO BE PROPOSED BY LEGAL AUTHORIZED PERSON;
- (2) THE SECRETARY OF THE BOARD OF DIRECTORS AND RELEVANT DEPARTMENT OF THE COMPANY SHALL PREPARE MATERIALS;
- (3) THE CHAIRMAN AND GENERAL MANAGER SHALL EXAMINE THE MATERIALS;
- (4) THE SECRETARY OF THE BOARD OF DIRECTORS SHALL COLLECT MATERIALS AND MAKE ARRANGEMENTS FOR A BOARD MEETING;
- (5) BOARD DISCUSSION;
- (6) TO BE PASSED AS RESOLUTION OF THE BOARD OF DIRECTORS. THE SECRETARY OF THE BOARD OF DIRECTORS SHALL MAKE A DISCLOSURE TO THE PUBLIC IN ACCORDANCE WITH SUCH RESOLUTION OR THE BOARD OF DIRECTORS SHALL PROPOSE SUCH RESOLUTION TO THE SHAREHOLDERS GENERAL MEETING FOR EXAMINATION IN ACCORDANCE WITH THE RELEVANT PROVISIONS

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OF THE EXISTING LISTING RULES AND OTHER SUPERVISORY REGULATIONS.;

- j. The item numbers of articles of the Rules of Procedures for Board of Directors are deferred subsequent to the original Article 91. The original Article 99 shall be replaced by the following provision:

ARTICLE 100 When persons, who are seconded by the Company to act as directors of affiliated companies are called upon to vote at a board meeting or a shareholders general meeting of the affiliated Company on matters involving the above provisions, especially Articles 84-88 and 90-95 hereunder. The seconded director shall seek authorization from the Companys board of director for the said matters:

- (1) Report to the president by the director who is seconded by the Company on the matter to be voted on;
  - (2) The president shall cause relevant departments of the Company to prepare materials;
  - (3) The president shall examine the materials;
  - (4) The secretary of the board of directors shall collect materials and make arrangements for a board meeting;
  - (5) Board discussion;
  - (6) Board resolution;
  - (7) The office of the secretary of the board of directors shall notify the seconded director and the relevant departments.;
- k. No amendment is made subsequent to the Companys original Article 100 of Procedures of Board Meeting except that the item numbers of articles are deferred.

II. TO CONSIDER AND APPROVE THE FOLLOWING RESOLUTIONS AS SPECIAL RESOLUTION

1. Proposals of the Board of Directors for amending the Articles of Association of the Company as stated below be and is hereby approved, and the Board of Directors is authorized to amend appropriately the wordings of the following amendment proposals and to deal with any other matters as required by any PRC relevant auditing authorities and the listing rules of any stock exchange in which the securities of the Company are listed:

- a. Article 3 of the Articles of Association shall be replaced by the following provision:

ARTICLE 3 The Companys address: GUANGZHOU ECONOMIC AND TECHNOLOGY DEVELOPMENT ZONE, GUANGZHOU, CHINA

Telephone: (020) 86123303  
Facsimile: (020) 86644623;

- b. Article 6 of the Articles & Association shall be replaced by the following provision:

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ARTICLE 6: THE COMPANY AMENDS THE COMPANYS ARTICLES OF ASSOCIATION IN ACCORDANCE WITH THE COMPANY LAW, THE SPECIAL REGULATIONS, MANDATORY PROVISIONS FOR THE ARTICLES OF ASSOCIATION OF COMPANIES TO BE LISTED OUTSIDE CHINA (THE MANDATORY PROVISIONS), MANDATORY PROVISIONS FOR THE ARTICLES OF ASSOCIATION OF LISTED COMPANIES AND OTHER RELEVANT LAWS AND ADMINISTRATIVE REGULATIONS.;

- c. Article 12 of the Articles of Association shall be replaced by the following provision:

ARTICLE 12: FOR THE PURPOSE OF THESE ARTICLES OF ASSOCIATION, OTHER SENIOR ADMINISTRATIVE OFFICERS OF THE COMPANY REFER TO VICE PRESIDENT, CHIEF FINANCIAL OFFICER, BOARD SECRETARY, GENERAL ECONOMIST, CHIEF ENGINEER, CHIEF PILOT, AND GENERAL LEGAL COUNSEL.;

- d. Article 59 of the Articles of Association shall be replaced by the following provision:

ARTICLE 59 The shareholders general meeting shall exercise the following functions and powers:

- (1) to decide on the Companys operational policies and investment plans;
- (2) to elect and replace directors and decide on matters relating to the remuneration of directors;
- (3) to elect and replace the supervisors who are representatives of shareholders and decide on matters

relating to the remuneration of supervisors;

- (4) to examine and approve reports of the board of directors;
- (5) to examine and approve reports of the supervisory committee;
- (6) to examine and approve the Companys proposed annual preliminary and final financial budgets;
- (7) to examine and approve the Companys profit distribution plans and plans for making up losses;
- (8) to decide on increases or reductions in the Company registered capital;
- (9) to decide on matters such as merger, division, dissolution and liquidation of the Company;
- (10) to decide on the issue of debentures by the Company;
- (11) TO DECIDE ON MATTERS RELATING TO EXTERNAL SECURITY ACCORDING TO THE RELEVANT PROVISIONS OF THE ARTICLES OF ASSOCIATION OF THE COMPANY;
- (12) to decide on the appointment, dismissal and

disengagement of the accountants of the Company;

- (13) to amend these articles of association;
- (14) to consider motions raised by shareholders who represent 5 percent or more of the total shares of the Company carrying the right to vote;
- (15) to decide on other matters which require resolutions of the shareholders in general meeting according to relevant laws, administrative regulations and provisions of the these articles of association;
- (16) to decide on matters which the board of directors may be delegated or authorized to deal with by the shareholders in general meeting.

When the shareholders general meeting decide on matters which the board of directors may be delegated or authorized to deal with, the shareholders general meeting shall maintain the legitimate rights and interests of the Company according to law and abide by laws and regulations strictly in order to ensure the Companys principle of efficient operation and scientific decision making. Matters delegated or authorized to the board of directors to deal with include (without limitation):

- (1) to modify the language of these articles of association after the shareholders general meeting passed the resolution on the amendment of these articles of association in principle;
  - (2) to distribute the interim profit;
  - (3) to decide on matters in connection with the issue of new shares and equity convertible bonds;
  - (4) TO DEAL WITH, MORTGAGE AND SECURE THE FIXED ASSETS UNDER THE CURRENT OPERATION POLICY AND INVESTMENT PLAN PASSED BY THE SHAREHOLDERS GENERAL MEETING, EXCLUDING DIRECT OR INDIRECT PROVISION OF SECURITY FOR THE SECURED PARTY WITH A GEARING RATIO EXCEEDING 70%;
  - (5) other matters delegated or authorized by the shareholders general meeting to the board of directors to deal with at times in accordance with laws, regulations and these articles of association.;
- e. Article 75 of the Articles of Association will be replaced by the following provision:

ARTICLE 75 Resolutions of shareholders general meetings shall be divided into ordinary resolutions and special resolutions.

To adopt an ordinary resolution, votes representing more than one half of the voting rights represented by the shareholders (including proxies) present at the meeting must be exercised in favor of the resolution in order for it to be passed.

To adopt a special resolution, votes representing more than

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two thirds of the voting rights represented by the shareholders (including proxies) present at the meeting must be exercised in favor of the resolution in order for it to be passed.

The shareholders (including proxies) present at the meeting shall expressly state their agreement with or objection to every matter to be determined by voting. If a shareholder abstains from voting or casts an abstention vote, the Company shall disregard such vote as a voting share when counting the result of voting.

WHEN ANY SHAREHOLDERS PROXY SHALL ABSTAIN FROM VOTING OR BE LIMITED TO VOTE IN FAVOR OF OR AGAINST ANY DESIGNATED RESOLUTION, ANY VOTES MADE BY SUCH PROXY IN CONTRAVENTION OF THE AFORESAID REGULATION

OR LIMITATION SHOULD NOT BE COUNTED AS VOTES HAVING VOTING RIGHTS.;

- f. Article 77 of the Articles of Association will be replaced by the following provision:

ARTICLE 77: THE FOLLOWING ISSUES SHALL BE APPROVED BY VOTE ON A POLL UNDER THE SUPERVISOR S SUPERVISION AT SHAREHOLDERS GENERAL MEETING:

- (1) CONNECTED TRANSACTIONS;
- (2) TRANSACTIONS THAT SHALL BE APPROVED BY INDEPENDENT SHAREHOLDERS;
- (3) OPTIONS GRANTED TO MAJOR SHAREHOLDERS OR INDEPENDENT DIRECTORS OR ANY OTHER RELATED PARTIES;
- (4) ANY OTHER TRANSACTIONS IN WHICH SHAREHOLDERS ARE MATERIALLY INTERESTED AND ACCORDINGLY ARE REQUIRED TO REFRAIN FROM VOTING AT SHAREHOLDERS GENERAL MEETING.

NOTWITHSTANDING THE ABOVE REGULATIONS, at any general meeting of shareholders, a resolution shall be decided on a show of hands unless a poll is (before or after any vote by show of hands) demanded:

- (1) by the chairman of the meeting;
- (2) by at least two shareholders entitled to vote present in person or by proxy;
- (3) by one or more shareholders present in person or by proxy and representing 10 per cent or more of all shares carry the rights to vote at the meeting.

Unless a poll be so demanded, a declaration by the chairman that a resolution has on a show of hands been carried unanimously, or carried by a particular majority, or lost, and an entry to that effect in the minutes of the meeting shall be conclusive evidence of the fact without proof of the number or proportion of the votes recorded in favor of or against such resolution.

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The demand for a poll may be withdrawn by the person who makes such demand.;

- g. Article 81 of the Articles of Association will be replaced by the following provision;

ARTICLE 81: The following matters shall be resolved by an ordinary resolution at a shareholders general meeting:

- (1) work reports of the board of directors and the supervisory committee;
  - (2) plans formulated by the board of directors for distribution of profits and for making up losses;
  - (3) removal of the members of the board of directors and members of the supervisory committee, their remuneration and method of payment;
  - (4) annual preliminary and final budgets, balance sheets and profit and loss accounts and other financial statements of the Company;
  - (5) ANNUAL REPORT OF THE COMPANY;
  - (6) matters other than those required by the laws and administrative regulations or by these articles of association to be adopted by special resolutions.;
- h. Article 101 of the Articles of Association of will be replaced by the following provision:

ARTICLE 101 DIRECTORS SHALL BE ELECTED AND REPLACED BY THE SHAREHOLDERS GENERAL MEETING. THE TERM OF OFFICE OF THE DIRECTORS IS THREE (3) YEARS, RENEWABLE BY RE-ELECTION UPON EXPIRY.

DIRECTORS SHALL BE ELECTED BY THE SHAREHOLDERS GENERAL MEETING FROM THE BOARD OF DIRECTORS OR CANDIDATES NOMINATED BY SHAREHOLDERS REPRESENTING 5% (INCLUDING THE 5%) OR MORE OF THE ISSUED SHARES. AT LEAST 7 DAYS NOTICE OF NOMINATION OF A CANDIDATE FOR ELECTION AS A DIRECTOR AND PARTICULARS OF SUCH CANDIDATE SHALL BE GIVEN TO THE COMPANY, AND SUCH 7 DAYS PERIOD SHALL START NO SOONER THAN THE FIRST DAY AFTER THE DATE OF GIVING THE NOTICE AND END NO LATER THAN 7 DAYS PRIOR TO THE DATE OF THE SUCH SHAREHOLDERS GENERAL MEETING.

THE CANDIDATES FOR ELECTION AS DIRECTORS SHALL GIVE AT LEAST 7 DAYS PRIOR WRITTEN CONFIRMATION TO THE COMPANY, AND SUCH 7 DAYS PERIOD SHALL START NO SOONER THAN THE DAY AFTER THE DATE OF GIVING THE NOTICE AND END NO LATER THAN 7 DAYS PRIOR TO THE DATE OF SUCH SHAREHOLDERS GENERAL MEETING. THE WRITTEN CONFIRMATION SHALL INDICATE THE WILLINGNESS OF THE CANDIDATE TO BE NOMINATED, AND CONFIRM THAT INFORMATION OF THE CANDIDATE PUBLICLY DISCLOSED ARE TRUE AND COMPLETE, THAT THE CANDIDATE WILL FAITHFULLY DISCHARGE ITS DUTIES AS A DIRECTOR IF HE IS ELECTED.

WHERE SHAREHOLDERS SEVERALLY OR JOINTLY HOLDING 5% OR MORE OF THE VOTING RIGHTS OR THE SUPERVISORY COMMITTEE OF THE

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COMPANY PROPOSE ANY SPECIAL RESOLUTIONS FOR ELECTION OF NON-INDEPENDENT DIRECTORS AT THE COMPANYS ANNUAL GENERAL MEETING, WRITTEN NOTICE OF THE INTENTION TO PROPOSE A CANDIDATE FOR ELECTION AS A DIRECTOR, NOTICE BY SUCH CANDIDATE OF HIS WILLINGNESS TO BE ELECTED AND DETAILS AND CONFIRMATION OF THE CANDIDATE SHALL BE GIVEN TO THE COMPANY NOT MORE THAN 7 DAYS PRIOR TO THE DATE OF THE MEETING APPOINTED FOR SUCH ELECTION. THE 7 DAYS PERIOD SHALL START NO SOONER THAN THE FIRST DAY AFTER THE DATE OF GIVING THE NOTICE AND END NO LATER THAN 7 DAYS PRIOR TO THE DATE OF SUCH SHAREHOLDERS GENERAL MEETING.

The Chairman and the Vice-chairman shall be elected and removed by more than one half of all the members of the board of directors. The term of office of each of the Chairman and the Vice-chairman is three (3) years, renewable upon re-election.

The shareholders general meeting may be ordinary resolution remove any director before the expiration of his term of office (but without prejudice to such directors right to claim damages based on any contract) on the condition that all the relevant laws and administrative regulations are fully complied with.

The Directors shall not be required to hold shares of the Company.;

- i. Article 102 of the Articles of Association will be replaced by the following provision;

ARTICLE 102: The board of directors is responsible to the shareholders general meeting and exercises the following powers:

- (1) to be responsible for the convening of the shareholders general meeting and to report on its work to the shareholders general meeting;
- (2) to implement the resolutions of the shareholders general meetings;
- (3) to decide on the Companys business plans and investment plans;
- (4) to formulate the Companys annual preliminary and financial budgets;
- (5) to formulate the Companys profit distribution plan and plan for making up losses;
- (6) to formulate proposals for increases or reductions in the Companys registered capital and the issue of debentures of the Company;
- (7) to draw up plans for the merger, division or dissolution of the Company;
- (8) TO DECIDE ON MATTERS RELATING TO THE COMPANYS EXTERNAL SECURITY (INCLUDING ASSETS PLEDGE) ACCORDING TO AUTHORIZATION OF SHAREHOLDERS GENERAL MEETINGS;



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- (9) TO DECIDE ON THE COMPANYS ACQUISITION AND SALES OF ASSETS AND RISK INVESTMENTS;
- (10) to decide on the establishment of the Companys internal management structure;
- (11) to appoint or dismiss the Companys president, and pursuant to the presidents nominations to appoint or dismiss the vice president, the financial controller and other senior administrative officers of the Company and decide on their remuneration;
- (12) to establish the Companys basic management system;
- (13) to formulate proposals for any amendments of the Companys articles of association;
- (14) to exercise any other powers conferred by these articles of association or the shareholders general meetings.

Except the board of directors resolutions in respect of the matters specified in sub-paragraphs (6), (7), (8) and (13) of this Article which shall be passed by more than two-thirds of all the directors, the board of directors resolutions in respect of all other matters may be passed by more than one half of all the directors.;

- j. Article 106 of the Articles of Association shall be replaced by the following provision:

ARTICLE 106: MEETINGS OF THE BOARD OF DIRECTORS SHALL BE HELD AT LEAST TWICE EVERY YEAR AND BE CONVENED BY THE CHAIRMAN OF THE BOARD OF DIRECTORS BY SERVING NOTICE OF EACH BOARD MEETING ON ALL OF THE DIRECTORS BY TELEX, TELEGRAM, FACSIMILE, EXPRESS DELIVERY, REGISTERED MAIL OR PERSONAL DELIVERY TEN DAYS BEFORE THE DATE OF THE PROPOSED MEETING. AN EXTRAORDINARY MEETING OF THE BOARD OF DIRECTORS MAY BE HELD UPON REQUISITION BY EITHER THE CHAIRMAN, ONE THIRD OR MORE OF THE DIRECTORS (INCLUDING THE ONE THIRD), THE SUPERVISORY COMMITTEE OR THE PRESIDENT OF THE COMPANY.

The board meetings shall be held in principle at the place where the Company is located. It may be held at

other places both at home and abroad upon resolution by the board of directors.;

- k. Article 108 of the Articles of Association shall be replaced by the following provision:

ARTICLE 108: Meeting of the board of directors shall be held only if more than half of the directors are present.

Each director shall have one vote. A resolution of the board of directors must be passed by more than half of all the directors.

Where the number of votes cast for and against a resolution is equal, the Chairman of the board of the directors shall have a casting vote.

Where a directors (or its associate) is interested in any resolution proposed at a board meeting, such director shall not be present and shall not have a right to vote. Such director shall not be counted in the quorum of the relevant meeting.;

1. Article 121 of the Articles of Association shall be replaced by the following provision:

ARTICLE 121 Rights and Obligations of Independent Directors:

- (1) To facilitate the independent directors in performing their function more efficiently, the independent directors shall have the following special powers, in addition to having those powers granted by the Company Law and other relevant laws and regulations to directors:
    - (i) APPROVE CONNECTED TRANSACTIONS THE AGGREGATE CONSIDERATION OF WHICH IS IN COMPLIANCE WITH THE RELEVANT PROVISIONS OF THE EXISTING LISTING RULES AND OTHER SUPERVISORY REGULATION IN PLACES WHERE THE COMPANY IS LISTED;
    - (ii) propose to the board of directors with respect to engaging or disengaging accounting firms;
    - (iii) propose to the board of directors with respect to the convening of extraordinary shareholders meetings;
    - (iv) propose the convening of board meetings;
    - (v) engage external auditing firms or consultancy firms;
    - (vi) publicly solicit and collect proxies before the convening of the shareholders general meetings.
  - (2) The independent director shall obtain the consent of over half of the independent directors in exercising any of the above powers.
  - (3) If any of the above proposal has not been adopted or if any the above powers cannot be exercised, the Company shall disclose the relevant information.
  - (4) Apart from the powers of an ordinary director and the special powers of an independent director, an independent director shall comply with all the obligations of a director set forth in these articles of association.;
- m. Article 122 of the Articles of Association shall be replaced by the following provision:

ARTICLE 122 The independent directors shall provide their opinions on all the important matters of the Company.

- (1) In addition to the above obligation, the independent directors shall provide their independent opinions to

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the board of directors or the shareholders general meeting on the following matters:

- (i) nomination, appointment and removal of directors;
- (ii) appointment and dismissal of senior administrative officers;
- (iii) remuneration of directors and senior administrative officers;
- (iv) NEWLY OCCURRED TRANSACTIONS, LOANS AND OTHER FORMS OF FUND TRANSFER BETWEEN THE COMPANY AND ITS SHAREHOLDERS, ACTUAL CONTROLLERS OR THEIR AFFILIATES, THE AGGREGATE AMOUNT OF WHICH IS IN COMPLIANCE WITH THE RELEVANT PROVISIONS OF THE EXISTING LISTING RULES AND OTHER SUPERVISORY REGULATIONS IN PLACES WHERE THE COMPANY IS LISTED, AND WHETHER THE COMPANY HAS TAKEN EFFECTIVE MEASURES TO COLLECT THE AMOUNTS DUE;
- (v) matters which may harm the interests of the minority shareholders;
- (VI) MATTERS RELATING TO SECURITY PROVIDED TO EXTERNAL PARTIES BY THE COMPANY;
- (vii) other matters provided for in these articles of association.

(2) The independent directors shall choose to provide any of the following opinions in respect of the above matters:

- (i) agree;
- (ii) reserve opinion and the reasons therefor;
- (iii) dissent and the reasons therefor;
- (iv) unable to comment and the reasons therefor.

(3) If the matters concerned fall under those which require disclosure, the company shall publicly disclose the opinions of the independent directors. If the independent directors cannot reach a consensus, the Company shall publicly disclose the opinions of each of the independent directors.;

n. Article 124 of the Articles of Association shall be replaced by the following provision:

ARTICLE 124 The Company may set up several special committees according to the resolutions of shareholders general meeting (INCLUDING STRATEGY, AUDIT, NOMINATION, REMUNERATION AND EVALUATION, AND INDEPENDENT BOARD COMMITTEES). Members of these special committees shall all be directors, and in the audit committee, the remuneration committee and the evaluation committee, the independent directors shall form the majority and shall be responsible for convening the committee meetings. In the auditing

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committee at least one independent director shall be an accounting professional.;

- o. Article 171 of the Articles of Association shall be replaced by the following provision:

ARTICLE 171 THE COMPANY SHALL PUBLISH ITS QUARTERLY FINANCIAL REPORT, INTERIM FINANCIAL REPORT AND ANNUAL FINANCIAL REPORT EVERY FISCAL YEAR. THE QUARTERLY REPORTS SHALL BE PREPARED WITHIN THIRTY (30) DAYS AFTER THE FIRST QUARTER AND THE THIRD QUARTER, RESPECTIVELY. THE INTERIM REPORT SHALL BE PUBLISHED WITHIN SIXTY (60) DAYS AFTER THE FIRST SIX MONTHS OF THE FISCAL YEAR AND THE ANNUAL REPORT SHALL BE PUBLISHED WITHIN ONE HUNDRED AND TWENTY (120) DAYS AFTER THE EXPIRATION OF THE FISCAL YEAR;

- p. Chapter 18 of the Articles of Association shall be replaced by the following provision (new addition):

CHAPTER 18 CAPITAL FLOW BETWEEN THE COMPANY AND ITS RELATED PARTY AND EXTERNAL SECURITY PROVIDED BY THE COMPANY

ARTICLE 190 FUND TRANSACTIONS BETWEEN THE COMPANY AND CONTROLLING SHAREHOLDERS AND OTHER CONNECTED PARTIES SHALL BE SUBJECT TO THE FOLLOWING REGULATIONS:

- (1) USE OF FUNDS OF THE COMPANY SHALL BE STRICTLY LIMITED DURING TRANSACTION OF OPERATING FUNDS BETWEEN THE COMPANY AND CONTROLLING SHAREHOLDERS AND OTHER CONNECTED PARTIES. CONTROLLING SHAREHOLDERS AND OTHER CONNECTED PARTIES SHALL NOT REQUEST THE COMPANY TO PAY FOR THEIR SALARIES, BENEFITS, INSURANCE AND ADVERTISEMENT DURING THE PERIOD, NOR SHALL THE PARTIES UNDERTAKE ANY COST OR OTHER OUTGOINGS FOR EACH OTHER.
- (2) THE COMPANY SHALL NOT DIRECTLY OR INDIRECTLY PROVIDE FUNDS FOR USE BY CONTROLLING SHAREHOLDERS OR OTHER CONNECTED PARTIES BY:
  - (i) LENDING THE COMPANYS FUNDS WITH OR WITHOUT CONSIDERATION FOR USE BY CONTROLLING SHAREHOLDERS OR OTHER CONNECTED PARTIES;
  - (ii) ASSIGNMENT OF LOANS FOR CONNECTED PARTIES THROUGH BANKS OR NON-BANKING FINANCIAL BODIES;
  - (iii) ENTRUSTING CONTROLLING SHAREHOLDERS OR OTHER CONNECTED PARTIES TO CARRY OUT INVESTMENTS;
  - (iv) ISSUANCE OF COMMERCIAL ACCEPTANCE NOTES WITHOUT REAL TRANSACTIONS BACKGROUND FOR CONTROLLING SHAREHOLDERS OR OTHER CONNECTED PARTIES;
  - (v) REPAYING DEBTS FOR CONTROLLING SHAREHOLDERS OR OTHER CONNECTED PARTIES;
  - (vi) OTHER MEANS AS REQUIRED BY CSRC.
- (3) DURING AUDITING WORK FOR THE COMPANY S ANNUAL FINANCIAL REPORTS, THE CERTIFIED PUBLIC

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ACCOUNTANTS SHALL, BASED ON THE AFORESAID REGULATIONS, PRESENT THEIR SPECIFIC EXPLANATION ON PARTICULARS OF THE USAGE OF FUND OF THE COMPANY BY CONTROLLING SHAREHOLDERS OR OTHER CONNECTED PARTIES, WHILE THE COMPANY SHALL ACCORDINGLY PUBLISH THE SPECIFIC EXPLANATION.

ARTICLE 191 ALL DIRECTORS OF THE COMPANY SHALL PERFORM DUE DILIGENCE ON AND STRICTLY CONTROL LIABILITY RISKS INCURRED AS A RESULT OF EXTERNAL SECURITY, AND SHALL BY LAW ACCEPT RELATED LIABILITY FOR LOSS ARISING FROM CONTRAVENING OR IMPROPER EXTERNAL SECURITY.

ARTICLE 192 THE COMPANY SHALL PROVIDE EXTERNAL SECURITY (INCLUDING ASSETS PLEDGE) BASED ON THE PRINCIPLES OF FAIRNESS, WILLINGNESS, FIDUCIARY AND MUTUAL BENEFITS, AND SHALL OBSERVE THE FOLLOWING REGULATIONS:

- (1) THE COMPANY SHALL NOT, WITH ITS OWN ASSETS, PROVIDE SECURITY TO ITS SHAREHOLDERS, PRINCIPAL SUBSIDIARIES AND SUBSIDIARIES OF SHAREHOLDERS, AND OTHER CONNECTED PARTIES, ANY NON-LEGAL ENTITIES OR INDIVIDUALS IN WHICH THE COMPANY HOLDS LESS THAN 50% SHARES;
- (2) TOTAL AMOUNT OF THE COMPANYS EXTERNAL SECURITY SHALL NOT EXCEED 50% OF NET ASSETS AS SHOWN IN ITS LATEST CONSOLIDATED FINANCIAL STATEMENT;
- (3) PROCEDURES FOR APPROVAL OF EXTERNAL SECURITY:
  - (i) AS REQUIRED BY THE PRC LAWS AND REGULATIONS AND THE LISTING RULES OF STOCK EXCHANGE IN THE PLACE WHERE THE COMPANYS SHARES LISTED, THE COMPANY EXTERNAL SECURITY SHALL BE SUBJECT TO WRITTEN CONSENT BY TWO THIRDS OF ALL MEMBERS OF THE BOARD OF DIRECTORS OR APPROVAL FROM SHAREHOLDERS GENERAL MEETINGS. SCOPE OF AUTHORITY OF THE BOARD OF DIRECTORS IS PROVIDED IN THE COMPANY S RULES OF PROCEDURES FOR BOARD OF DIRECTORS;
  - (ii) PRIOR TO DECISION ON PROVISION OF SECURITY TO EXTERNAL PARTIES, THE BOARD OF DIRECTORS OF THE COMPANY SHALL BE WELL INFORMED OF PARTICULARS OF THE DEBTORS, AND COMPLETELY ANALYSE AND FULLY DISCLOSE IN RELEVANT ANNOUNCEMENTS THE BENEFITS AND RISKS FROM SUCH SECURITY;
  - (iii) WHEN A RESOLUTION IN RELATION TO EXTERNAL SECURITY IS TO BE PASSED AT THE SHAREHOLDERS GENERAL MEETING OR BY THE BOARD OF DIRECTORS, ANY SHAREHOLDERS OR DIRECTORS THAT HAVE A CONFLICT OF INTERESTS WITH SUCH SECURITY SHALL ABSTAIN FROM VOTING.
- (4) THE COMPANY SHALL NOT DIRECTLY OR INDIRECTLY PROVIDE LOAN SECURITY FOR SECURED SUBJECTS WITH A GEARING RATIO EXCEEDING 70%;
- (5) WHERE THE COMPANY PROVIDES SECURITY TO ANY EXTERNAL PARTIES, ANTI-SECURITY SHALL BE SOUGHT FROM THE SECURED PARTY WHO IN TURN SHALL BE ABLE TO UNDERTAKE THE ANTI-SECURITY;

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- (6) THE COMPANY SHALL DULY PERFORM ITS DUTY TO STRICTLY DISCLOSE INFORMATION ON EXTERNAL SECURITY ACCORDING TO THE RELEVANT PROVISIONS OF LISTING RULES AND ARTICLES OF ASSOCIATION, AND SHALL TRUTHFULLY PROVIDE ALL INFORMATION RELATING TO EXTERNAL SECURITY OF THE COMPANY TO THE CERTIFIED PUBLIC ACCOUNTANTS;
  - (7) THE COMPANYS INDEPENDENT DIRECTORS SHALL IN THE ANNUAL REPORT PRESENT SPECIFIC EXPLANATION AND INDEPENDENT OPINIONS ON THE COMPANYS ACCUMULATED AND CURRENT EXTERNAL SECURITY AND IMPLEMENTATION OF REGULATIONS AS REFERRED ABOVE;
- q. Wordings in sections subsequent to Chapter 18 D Insurance (inclusive of Chapter 18) of the original Articles of Association are kept the same except that item numbers of articles are deferred.

By order of the Board  
SU LIANG  
Company Secretary

Guangzhou, the PRC. April 23, 2004

As at the date of this Notice, the Directors of the Company include Yan Zhi Qing, Liu Ming Qi, Wang Chang Shun, Peng An Fa, Wang Quan Hua, Zhao Liu An, Zhou Yong Qian, Zhou Yong Jin, Xu Jie Bo and Wu Rong Nan as executive Directors; and Simon To, Peter Lok, Wei Ming Hai, Wang Zhi and Sui Guang Jun as independent non-executive Directors.

Note:

I. Shareholders eligible for attending the general meeting:

1. Holders of H shares of the Company who are registered with Hong Kong Registrars Limited, the registrar of H shares of the Company, at or before the close of business on Monday, 17 May 2004 are entitled to attend the Annual General Meeting (AGM) after duly completion of the required registration procedures in

accordance with Section 4 of Registration Procedures for Attending General Meeting . Holders of A shares of the Company shall receive a notice separately.

II. Registration procedures for attending a general meeting:

1. Registered shareholders who intend to attend the AGM either in person or by proxy must deliver to the Company, on or before 27 May 2004, either in person, by post or by fax, the reply slip for attending the AGM.
2. Registered shareholders of H shares of the Company who intend to attend the Annual General Meeting and who are entitled to the final dividend must deliver their instruments of transfer together with the relevant share certificates to Hong Kong Registrars Limited, the registrar of H shares of the Company, before 4:00 p.m. on 17 May 2004.
3. The register of H shares of the Company will be closed from 18 May

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2004 to 16 May 2004 (both days inclusive), during which period no transfer of H shares will be registered.

4. When attending the AGM, a shareholder or his proxy shall produce proof of identity. If a corporate shareholder appoints its legal representative to attend the meeting, such legal representative shall produce proof of his own identity, together with a notarized copy of the resolution or power of attorney issued by the Board of Directors or other governing body to appoint such legal representative to attend the meeting.

### III. Proxies:

1. A registered shareholder has the right to appoint one or more proxies to attend the AGM and vote on his behalf by completing a form of proxy. A proxy need not be a shareholder of the Company.
2. A proxy must be appointed by a shareholder or his attorney by way of a form of proxy. If the proxy is appointed by the shareholder's attorney, the power of attorney or other authorization document authorizing such attorney to appoint the proxy must be notarized.
3. To be valid, the duly completed proxy form(s), together with the notarized power of attorney or other authorization document (if any), must be lodged with Hong Kong Registrars Limited 24 hours before the time designated for the holding of the AGM.

### IV. Miscellaneous:

1. The AGM is expected to last not more than one day. Shareholders who attend shall bear their own traveling and accommodation expenses.
2. The address of Hong Kong Registrars Limited is:

Room 1901-5, 19th Floor  
Hopewell Centre  
183 Queens Road East  
Hong Kong

3. The registered address of the Company is:

Baiyun International Airport  
Guangzhou 510405  
PRC  
Telephone No.: (+86) 20-8612 4737  
Facsimile No.: (+86) 20-8665 9040  
Website: www.cs-air.com  
Contact persons: Su Liang and Lei Bin

### V. Brief biography of nominated supervisors:

MR. SUN XIAO YI is a member of Party Committee and head of Discipline Supervision Team of China Southern Air Holding Company. He became an employee of the Company in March 1995 since the establishment of the Company. Born in 1954, Mr. Sun is a senior expert of Political Science and Economics with an associate degree. Mr. Sun has successively served as Vice Party Secretary of the Hubei branch of the Company, Party Secretary of the Flight Operations Department of the Company, and Vice Party Secretary of China Southern Air Holding Company.

MR. YANG GUANG HUA is the Vice Party Secretary and Discipline Supervision Secretary of the Company. He became an employee of the Company in March

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1995 since the establishment of the Company. Born in 1953, Mr. Yang is an engineer with university qualification. Mr. Yang has successively served as deputy general manager of the Hunan branch of the Company, general manager of Southern Airlines (Group) Zhuhai Helicopters Company Limited, general manager of the Hunan branch of the Company, and deputy general manager of the Company.

MS. YANG YI HUA is the general manager of the Audit Department of the Company. She became an employee of the Company in March 1995 since the establishment of the Company. Born in 1960, Ms. Yang is an accountant. She has successively served as deputy manager of the Clearance and Settlement Office of the Financial Division of the Guangzhou Civil Aviation Administration, manager of the Financial Office of the Companys Financial Division, and deputy general manager of the Companys Audit Department.

None of the three candidates above has any interests or short positions in the shares, underlying shares or debentures of the Company or its associated corporations (within the meaning of Part XV of the Securities and Futures Ordinance) which is notifiable to the Company and the Hong Kong Stock Exchange pursuant to the Securities and Futures Ordinance (including interests or short positions which are taken or deemed to have under such provisions of the Securities and Futures Ordinance) or required to be recorded in the register maintained by the Company pursuant to Section 352 of the Securities and Futures Ordinance or which is notifiable to the Company and the Hong Kong Stock Exchange pursuant to the Model Code for Securities Transactions by Directors of the Listed Companies in Schedule 10 of the Listing Rules. Further, save as disclosed, none of the three candidates above is connected with any directors, senior management, substantial shareholders or controlling shareholders of the Company.

(a joint stock limited company incorporated in the Peoples Republic of China with limited liability)  
(STOCK CODE: 1055)

-----  
ATTACHMENT A

REPLY SLIP

TO: CHINA SOUTHERN AIRLINES COMPANY LIMITED

I/we intend to attend (in person/by proxy) (1) the AGM of the Company to be held on 16 June, 2004.

Name (2)  
-----

Number of ordinary shares registered in my name (3)  
-----

Identity card/passport number (1, 4)  
-----

Share account number  
-----

Mailing address  
-----



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Telephone number

Signature (5):

Date: 2004

Notes:

1. Please delete the option which is not applicable.
2. Please insert your full name in both English and Chinese in block capital letters.
3. Please attach a photocopy of proof of ownership of your shares.
4. Please attach a photocopy of your identity card/passport.
5. This reply slip must be signed by the registered shareholder. If the registered shareholder is a company or an organization, then this reply slip must be sealed with the common seal of such company or organization or under hand by any directors or agents duly appointed by such company or organization.

(a joint stock limited company incorporated in the Peoples Republic of China  
with limited liability)  
(STOCK CODE: 1055)

-----  
ATTACHMENT B

The number of H Shares to which this proxy form relates(1)

FORM OF PROXY FOR ANNUAL GENERAL MEETING

I/We(2),, holder of share account number,  
residing at,  
being the registered holder of(3) ordinary shares of the Company, HEREBY  
APPOINT(4) , residing at

,  
as my/our proxy/proxies to attend on my/our behalf the AGM of the Company to be held at the headquarters of China Southern Airlines Company Limited, No. 278 Ji Chang Road, Guangzhou, Guangdong Province, the PRC at 9:00 a.m., on 16 June, 2004 and to act and vote on my/our behalf at the AGM in respect of the resolutions listed below, in accordance with my/our instructions below(5).

|                         |     |         |
|-------------------------|-----|---------|
| I. ORDINARY RESOLUTIONS | FOR | AGAINST |
|-------------------------|-----|---------|

-----  
1. To approve the Report of the Directors of the Company for the year 2003;

-----  
2. To approve the Report of the Supervisory Committee of the Company for the year 2003;

-----  
3. To approve the audited consolidated financial statements of the Company for the year 2003;

-----  
4. To approve the profit distribution budget of the Company for the year 2003;

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5. To approve the appointment of KPMG as the international auditors for the year 2004 and KPMG Huazhen as the PRC auditors of the Company for the year 2004 and authorize the Board to determine their remuneration;

6. To elect members of the fourth Board of Directors, with Yan Zhi Qing, Liu Ming Qi, Wang Chang Shun, Peng An Fa, Wang Quan Hua, Zhao Liu An, Zhou Yong Qian, Zhou Yong Jin, Xu Jie Bo and Wu Rong Nan as executive Directors and Simon To, Peter Lok, Wei Ming Hai, Wang Zhi and Sui Guang Jun as independent non-executive Directors, and authorize the Board of Directors to determine their remuneration (the details of the relevant candidates are disclosed in the 2003 Annual Report of the Company);

7. To elect members of the fourth Supervisory Committee with Sun Xiao Yi, Yang Guang Hua and Yang Yi Hua as Supervisors and authorize the Supervisory Committee to determine their remuneration, and consider and approve the resignation of Liang Hua Fu, Gan Yu Hua and Li Qi Hong as members of the Supervisory Committee (the details of the relevant candidates are disclosed in the Notice of 2003 Annual General Meeting of the Company);

8. To approve the resolution on the proposed amendments to the Rules of Procedures for Shareholders General Meetings of the Company as set out in section I, no.8 (a) to (c) of the Notice of 2003 Annual General Meeting of the Company;

9. To approve the resolution on the proposed amendments to the Rules of Procedures for Board of Directors of the Company as set out in section I, no.9 (a) to (k) of the Notice of 2003 Annual General Meeting of the Company;

II. SPECIAL RESOLUTIONS

1. To approve the resolution on the proposed amendments to the Articles of Association of the Company as set out in section II, no.1 (a) to (q) of the Notice of 2003 Annual General Meeting of the Company.

Signature (5):

Date: 2004

Notes:

1. Please insert the number of shares in the Company registered in your name(s) and to which this proxy form relates. If no such number is inserted, this form of proxy will be deemed to relate to all the shares in the Company registered in your name(s).
2. Please insert the name(s) and address(es) (as shown in the register of members) in block capital(s).
3. Please insert the number of all the Shares in the Company registered in your name(s).
4. If no person is appointed as proxy, the Chairman of the AGM will be deemed to have been appointed by you as your proxy.

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5. If you wish to vote for any of the resolutions, please insert a [X] in the box marked FOR or if you wish to vote against any of the resolutions, please insert a [X] in the box marked AGAINST if no indication is given, then your proxy/proxies may vote in such manner as he/she/they think(s) fit.
6. This form of proxy must be signed by you or your attorney duly authorised in writing or, in the case of a company or an organization, either under the common seal or under the hand of any director or attorney duly authorised in writing. In any event, the execution shall be made in accordance with the articles of association of such company or organization.
7. To be valid, this proxy form and, if such proxy form is signed by a person under a power of attorney or authority on behalf of the appointer, a notarised copy of that power of attorney or other authority, must be delivered to Hong Kong Registrars Limited at Room 1901-5, 19th Floor, Hopewell Centre, 183 Queens Road East, Hong Kong in not less than 24 hours before the time appointed for the holding of the AGM.
8. A proxy, on behalf of the Shareholder, attending AGM shall bring along the proxy form duly completed and signed as well as the proof of identification of the proxy, in the case of a company or an organization, the proxy shall also bring along a notarised copy of the resolution of the board of directors or other governing body of the appointer or a letter of authorization.
9. This proxy form shall be completed in form of a set of two copies, one of which shall be lodged to the Company pursuant to Note 7; and the other copy shall be produced upon the AGM by the proxy of the Shareholder pursuant to Note 8.
10. Completion and return of the form of proxy will not preclude you from attending and voting in person at the AGM or any adjourned AGM should you so wish.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

CHINA SOUTHERN AIRLINES COMPANY LIMITED

By /s/ Su Liang

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Name: Su Liang  
Title: Company Secretary

Date: April 30, 2004