

Chairman's Statement

Opportunities from industry-wide restructuring being closely explored to gain benefits of scale

Dear Shareholders:

I am pleased to report the Group's financial and operating results for 2000. Net profit attributable to shareholders was RMB502 million in 2000, representing an increase of 509% as compared with RMB82 million in 1999 notwithstanding the unfavourable operating environment faced by the Group as a result of inflated fuel prices.

During 2000, with the Asian economies on their course of recovery, and the PRC economy gradually picking up under a series of positive financial and monetary policies, demand for aviation services was on the rise. Such demand was particularly keen during holidays, including the Chinese New Year, the Labor Day and the National Day. Amid the improved market environment, the Group experienced increases in load factors and aircraft utilisation rate during the period. As a result, the passenger revenue increased from RMB11,819 million in 1999 to RMB13,255 million in 2000. However, the Group's operating profit was reduced as the Group's operation was under tremendous pressure due to high fuel prices.

The Group managed to achieve its cost control targets. Despite the higher costs caused by inflated fuel prices, the operating cost per unit of available tonne kilometre remains unchanged from last year.

In the second half of 2000, the Civil Aviation Administration of China (the "CAAC") introduced a policy with the principle of restructuring the PRC aviation industry on a voluntary basis under government directives and taking advantage of economies of scale. Domestic airlines are encouraged to consolidate, centering around the Southern Airlines (Group) (the "SA Group"), Air China Group and Eastern Air Group (the "Merger and Restructuring"). In line with such policy, the SA Group entered into an agreement to acquire Zhongyuan Airlines, a regional airline with base in Henan Province, the PRC in August 2000. While the completion of the SA Group's acquisition of Zhongyuan Airlines is currently pending for approval of relevant PRC authorities, the aircraft of Zhongyuan Airlines together with its flying-route operating rights have been wet-leased to the Group.



Yan Zhi Qing
Chairman of the Board of Directors

Such transactions not only helped expand the Group's domestic route network, but also gave a boost to the operation efficiency and market share of the Group in the area. In future, the Group will continue to explore business opportunities arising from the Merger and Restructuring in pursuit of economies of scale.

The CAAC continued its stringent prohibition on discounting domestic airfares and strengthened its control over the agency market during the year. Beginning in April 2000, under the promotion of the CAAC, domestic airlines participated in revenue-sharing schemes on more than 100 domestic routes, of which, the Group has participated in 87 routes. These policies regulate competition in the domestic market and to a certain extent stabilize the domestic airfares. However, competition in some areas and on certain routes is still intense. As such, the Group's passenger yield on domestic routes fell 3% in 2000 as compared with 1999.

There was a substantial increase in the Group's cargo revenue in 2000, particularly for the international routes. In order to satisfy the strong demand for international cargo transportation from the region, in April 2000, the Group opened a new cargo route servicing between Shenzhen and Chicago, the United States of America, with a Boeing 747-400 freighter flying between the two destinations three times a week. As a result, the cargo revenue of the Group increased by 46.4% in 2000 as compared with 1999.

The Group maintains its strategy of focusing on expanding its domestic market share. At the same time, it also positively extends its international routes in a prudent manner. Two international routes between Guangzhou and Sydney and Melbourne, Australia with three flights per week, were launched in late 2000. The Group has also entered into code-sharing agreements with several airlines such as Asiana Airlines, Japan Air System and Vietnam Airlines. Such operating measures expand the Group's route network.

To improve the management quality, the Group has developed a number of advanced computerized management systems, including the Management Information System, the Passenger Revenue Management System, the Aircraft Engine Performance Control System and Aircraft Technology Data Management System. The Group has also further upgraded the existing Financial Management System. It is believed that the deployment and continued upgrade of such systems will substantially improve the operation and management efficiency of the Group.

The construction of the new Guangzhou airport commenced in 2000 and the construction of the Group's facilities in the airport began at the same time. As at 31 December, 2000, the Group invested a total of RMB19.55 million in this regard. It is believed that the facilities will help enhance the Group's overall operation capacity in Southern China.

The continued pursuit of delivering higher quality and unique services is one of the long-term strategies of the Group. In fact, we are one of the first airlines in the PRC that introduced electronic tickets for domestic passengers. Currently, the Group offers electronic tickets in all domestic routes originated from Guangzhou. Meanwhile, we will continue to optimize and promote the use of those e-commerce systems which are already in place, including online seat reservation, online ticket sales and online freight reservation. Responding to the satisfactory responses to the "Business 2000" passenger service program, the Group has launched two additional service programs, the "Easy Cargo 5000" Program and "Warm Heart 9000" Program. The former program focuses on door-to-door air freight services while the latter program is targeted at the first-class passengers. In addition, new uniforms have been



designed for the flight attendants in order to present a brand new image of service. In 2000, Group's two frequent-flyer programs, the CHINA SOUTHERN AIRLINES SKY PEARL CLUB and the EGRET MILEAGE PLUS, continued to draw favorable responses from passengers. As of 31 December, 2000, there were approximately 731,000 members. A series of unique services are offered by the Group to members of such programs in order to meet the demand of passengers and adapt to the changing market conditions.

Year 2001 is a year of hopes and challenges. With the upcoming entry of the PRC into the World Trade Organization and implementation of the PRC government's plans to develop Midwest China, domestic demand for aviation services is expected to receive further boost. As such, it is expected that the business of the Group is likely to increase. In particular, the Group's capacity for regional flights and cargo traffic capacity on international route will be further improved and strengthened.

The Group will continue to actively seek expansion opportunities arising from the Merger and Restructuring in pursuit of economies of scale with more extensive route network, higher operation efficiency and better service quality to strive for a larger market share.

The members of the Board of Directors of the Company have changed recently. On behalf of the new Board of Directors, I would like to take this opportunity to express our gratitude to the former Board of Directors and our hardworking staff, and to our shareholders for their support to the Group. Meanwhile, with the abundant opportunities in the PRC aviation industry, I am fully confident of the future prospects of the Group.

Yan Zhi Qing

Chairman of the Board of Directors

Guangzhou, the PRC
17 April, 2001

