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, 2001.

Principal Activities, Operating Results and Financial Position

The Group is principally engaged in airline operations and related activities including aircraft maintenance and air catering operations. The Group is one of the largest airlines in China. In 2001, 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, 2001, and the financial position of the Company and the Group as of that date in accordance with IAS. See pages 33 to 83 of this Annual Report.

Five Year Summary

A summary of the results and the assets and liabilities of the Group for the five-year period ended 31 December, 2001 are set out on pages 87 and 88 of this Annual Report.

Wet Leases of Aircraft

Pursuant to four wet lease agreements dated 4 August, 2000, the Company wet leased four Boeing 737-300/37K aircraft from Zhongyuan Airlines, a regional airline with base in Henan Province, the PRC for a period of one year. Such wet lease agreements were renewed on 4 August, 2001. Pursuant to a wet lease agreement dated 8 November, 2000, the Company wet leased another Boeing 737-300 aircraft from Zhongyuan Airlines. Such agreement was renewed on 8 November, 2001. The aforesaid wet lease agreements are collectively referred to the "Wet Lease Agreements".

Very Substantial Acquisition

On 3 October, 2001 the Company entered into an agreement with the Boeing Company for acquiring twenty Boeing 737-800 aircraft and two Boeing 747-400 freighters during the period between 2002 and 2005 (the "Transactions"). The aggregate consideration in the Transactions exceeds 100% of the net tangible assets of the Company as published in its annual report dated 31 December, 2000 and constitutes very substantial transactions under the Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong Limited (the "Listing Rules"). The PRC government and SA Group, the 65.2% controlling shareholder of the Company, have approved the Transactions. SA Group does not have any interest in the Transactions other than as a shareholder of the Company.

The twenty Boeing 737-800 aircraft acquired pursuant to the Transactions will replace twenty existing Boeing 737 series aircraft that the Company currently operates under operating leases. The Board considered that the Transactions are in the best interest of the Company and its shareholders as a whole.

Acquisition of Assets from the SA Group

On 29 January, 2002, the Company entered into a sale and purchase agreement (the "S&P Agreement") to acquire assets from the SA Group which comprised five Boeing 737-300/37K aircraft (the "Aircraft"), the associated spare parts and forty-two special purpose vehicles in connection with the ground support of the Aircraft (collectively, the "Assets"). Prior to Completion (as defined in the Company's announcement dated 29 January, 2002 and circular dated 18 February, 2002), all of the Aircraft were leased from Zhongyuan Airlines by the Company under the Wet Lease Agreements.

The total value of the Assets is RMB1,096,886,000, which is based on an independent valuation as at 30 June, 2001 as performed by Zhongfeng Asset Valuation LLC, an independent valuer approved by the Ministry of Finance in the PRC.

The total consideration of RMB1,096,886,000 will be satisfied by cash payment of RMB132,150,000 and the assumption of Zhongyuan Airlines' debts due to commercial banks amounting to RMB964,736,000 by the Company. All terms and conditions under the existing legal documentation of debts between each of the creditors and Zhongyuan Airlines will remain unchanged.

As part of the acquisition, the SA Group has agreed to reimburse the Company the full amount of the lease rental payments made or to be made by the Company to Zhongyuan Airlines under the Wet Lease Agreements for the period from 1 July, 2001 up to the date of Completion. It has also been agreed that the Wet Lease Agreements will be terminated on the date of Completion. During the period of 1 July, 2001 to 31 December, 2001, the Company has paid RMB150,000,000 to Zhongyuan Airlines in the form of lease rental payments.

Reasons for the Acquisition

The Company's principal business is civil aviation within the PRC as well as providing commercial flights between cities in the PRC and international destinations. Pursuant to the Wet Lease Agreements, the Group has already been operating the Aircraft as part of Group's aviation business and has been expanding its aviation business and enhancing its market position.

The Board believes that the Company will benefit from the acquisition because the ownership control will allow the Company to further integrate the Aircraft into its overall aviation business in the PRC. This is in line with the consolidation strategy that the Company has adopted in light of the proposed restructuring of the aviation industry in the PRC. In addition, the acquisition is in line with the non-competition undertaking granted by the SA Group to the Company when the Company's shares were listed on the stock exchanges of Hong Kong and New York in 1997.

Connected Transaction

The SA Group is the controlling shareholder that owns a 65.2% interest in the Company. Since the value of the Assets and the consideration of the acquisition represents approximately 12.35% of the Company's net tangible assets as reported in the published annual report for the year ended 31 December, 2000, the entry into the S&P Agreement between the Company and the SA Group constitutes a connected transaction under Chapter 14 of the Listing Rules, and was subject to approval by independent shareholders at the EGM. Approval was obtained in the Company's first extraordinary general meeting by independent shareholders held on 26 March, 2002.

Waiver from the Stock Exchange of Hong Kong Limited

In March 2002, the Stock Exchange of Hong Kong Limited (the "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 acquisition and disposal of aircraft.

The 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.

4. The Company's ATKs figure will be disclosed in the Company's annual report and be reviewed by auditors who will confirm 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 the acquisition of an aircraft.

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:

    (i) 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;

    (ii) 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

    (iii) details of the waiver granted pursuant to the application.

11. The Company remains a subsidiary of the SA Group. Should there be any change in control of the Company, the 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. Three Boeing 757-200 aircraft were subject to options exercisable and had been exercised during the period to which this annual report relates.

Dividends

No interim dividend was paid during the year ended 31 December, 2001 (2000: Nil).

Pursuant to a resolution passed at a directors' meeting on 12 April, 2002, a final dividend of RMB0.02 (before tax) (2000: Nil) per share totalling RMB67,484,000 (before tax) (2000: Nil) was recommended to be paid to shareholders on the Registers of Members on 25 May, 2002, subject to shareholders' approval at the forthcoming annual general meeting.

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 financial statements.

Interest Capitalisation

For the year ended 31 December, 2001, RMB5,227,000 interest (2000: Nil) 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, 2001 are set out in note 10 to the financial statements.

Major Customers and Suppliers

The Group's five largest customers in the aggregate did not exceed 30% of the Group's total operating revenue (i.e., turnover) for the year ended 31 December, 2001.

The largest supplier and the aggregate of the five largest suppliers represented approximately 59% and 66%, respectively, of the Group's total purchases (not including purchases of items which are of a capital nature) for the year ended 31 December, 2001.

At no time during the year ended 31 December, 2001 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 had 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 financial statements.

Reserves

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

Employees and Employees' Pension Scheme

As at 31 December, 2001, the Group had an aggregate of 16,368 employees (2000: 15,837). Details of the employees' pension schemes and other welfare are set out in note 28 to the financial statements.

Subsidiaries

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

Share Capital Structure

As at 31 December, 2001, the total share capital of the Company was 3,374,178,000 shares, of which approximately 65.2% (2,200,000,000 domestic shares) is held by the SA Group and approximately 34.8% (1,174,178,000 H shares) is held by Hong Kong and overseas shareholders.

Substantial Shareholders

As at 31 December, 2001, the following shareholders had an interest of 10% or more in the Company's shares:

Name	Number of Shares	Approximate Percentage of the Total Number of Shares
SA Group	2,200,000,000 domestic shares	65.20%
HKSCC Nominees Limited	1,145,217,999 H shares	33.94%

The following persons have informed the Company that the Company's H shares held by them as at 31 December, 2001 in CCASS's stock accounts of HKSCC Nominees Limited were more than 10% of the total number of H shares issued by the Company.

Name	Number of H Shares	Approximate Percentage of the Total Number of H Shares
The Hongkong and Shanghai Banking Corporation Limited	446,834,797	38.06%
CEF Brokerage Ltd	194,336,000	16.55%
Standard Chartered Bank	156,831,432	13.36%

Save for the information disclosed above, as at 31 December, 2001, the Company is not aware of any interests which are required to be reported pursuant to Section 16(1) of the Securities (Disclosure of Interests) Ordinance (Chapter 396 of the Laws of Hong Kong) (the "SDI Ordinance").

Purchase, Sale or Redemption of Shares

Neither the Company nor any of its subsidiaries purchased, sold or redeemed any shares of the Company during 2001.

Use of Proceeds from H Share Offering

As stated in the 2000 Annual Report of the Company, as of 31 December, 2000, the Company had RMB529 million remaining from the proceeds of the Company's initial public offering. During the year ended 31 December, 2001, RMB489 million of the remaining proceeds were used for the following purposes:

1. Approximately RMB478 million for the exercise of purchase options on three Boeing 757-200 aircraft; and

2. Approximately RMB11 million for various projects including the development of the computerised accounting system.

Consistent with the disclosure in the Prospectus of the Company dated July, 1997, the Company intends to use the remaining proceeds of RMB40 million (held as at 31 December, 2001 as short-term deposits with Southern Airlines Group Finance Company Limited, a PRC authorised financial institution and an associated company of the Group) for various projects, including the development of the computerised accounting system.

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

The Directors of the Company confirm that in the year ended 31 December, 2001, the Group was in compliance with the Code of Best Practice set out in Appendix 14 to the Listing Rules issued by the Hong Kong Stock Exchange.

Directors, Supervisors and Senior Administrative Officers

Directors, Supervisors and Senior Administrative Officers of the Company in 2001 were as follows:

Name	Age	Position
Yan Zhi Qing	59	Chairman of the Board of Directors
Wang Chang Shun	44	Vice Chairman of the Board of Directors; President
Li Feng Hua	52	Director; Vice President
Wang Shao Xi	60	Director
Zhang Rui Ai	60	Director
Zhou Yong Jin	58	Director
Xu Jie Bo	36	Director; Chief Financial Officer
Wu Rong Nan	60	Director
Simon To	50	Independent Non-Executive Director
Peter Lok	65	Independent Non-Executive Director
Wei Ming Hai	37	Independent Non-Executive Director
Liang Hua Fu	60	Chairman of the Supervisory Committee
Gan Yu Hua	73	Supervisor
Li Qi Hong	54	Supervisor
Jiang Ping	51	Vice President
Li Kun	41	Vice President
Su Liang	39	Company Secretary

In an extraordinary general meeting held on 16 April, 2001, it was resolved that the resignation of Mr. Yu Yan En, Mr. Han Ma Zhang, Mr. Hu Yun Qi, Mr. Huo Di An, Mr. Liu Wen Bo and Mr. Tong Kai Sheng as directors of the Company was approved. It was also resolved that Mr. Gao Shang Quan ceased as a director of the Company upon expiry of his term of directorship. Mr. Wang Chang Shun, Mr. Zhou Yong Jin, Mr. Xu Jie Bo, Mr. Peter Lok and Mr. Wei Ming Hai were elected as directors of the Company during the same meeting. In addition, Mr. Yan Zhi Qing, Mr. Li Feng Hua, Mr. Wang Shao Xi, Mr. Zhang Rui Ai, Mr.Wu Rong Nan and Mr. Simon To were re-appointed as directors of the company upon expiry of their respective term of directorship.

Mr. Yan Zhi Qing and Mr. Wang Chang Shun were elected as the chairman and vice chairman of the Board of Directors of the Company respectively at the meeting of the Board of Directors on 17 April, 2001. Mr. Xu Jie Bo was appointed as the chief financial officer of the Company following the resignation of Mr. Liu Wen Bo during the same meeting.

On 12 April, 2002, the Board of Directors by resolutions appointed Mr. Yuan Xin An, Mr. Zheng En Ren and Mr. Yang Guang Hua respectively as vice president of the Company.

Biographical details of the Board of Directors, members of the Supervisory Committee and Senior Administrative Officers are set out on pages 89 and 91 of this Annual Report.

Equity Interests in the Company Held by the Directors and Supervisors

As at 31 December, 2001, none of the Directors or Supervisors of the Company held any interest in the Company or any associated corporation of the Company, which is required to be notified to the Company and the Hong Kong Stock Exchange pursuant to Section 28 of the SDI Ordinance, or which is required, pursuant to Section 29 of the SDI Ordinance, to be entered in the register of the Company.

At no time during 2001 or before has any Director, Supervisor or member of the Senior Administrative Officers or any of their spouses or minor children, been granted or exercised or subscribed for shares or debentures or options of the Company.

Service Contracts of the Directors

All Directors of the Company have entered into service contracts with the Company for a term of three years commencing on 16 April, 2001. Except for such service contracts, none of the Directors of the Company has entered or has proposed to enter into any other service contracts with the Company or its subsidiaries. In addition, none of the Directors has entered into any service contracts with the Company which is not determinable by the Company within one year without payment of compensation, other than statutory compensation.

Interests of the Directors and Supervisors in Contracts

In 2001, 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 the SA Group 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 Hong Kong Stock Exchange. The Hong Kong Stock Exchange has granted a waiver 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) Demerger Agreement

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

Neither the Company nor the SA Group has been required to make any payments in respect of such indemnification obligations from the date of the Demerger Agreement up to the date of this report.

(B) Connected Business Transactions

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

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

The Company and SAIETC 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 extending from 22 May, 1997 to 22 May, 2000 (renewable by the parties). The agreement has been extended to 22 May, 2003.

For the year ended 31 December, 2001, the amount incurred by the Group for the import and export of the above equipment was RMB324,998,000, inclusive of agency commission of 1.5% above the contract prices paid to SAIETC.

(ii) Southern Airlines Advertising Company, a wholly-owned subsidiary of the SA Group

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. The agreement has been extended to 22 May, 2003.

For the year ended 31 December, 2001, the amount incurred by the Group to Southern Airlines Advertising Company for advertising services was RMB9,940,000.

(iii) Southern Airlines Group Finance Company Limited ("SA Finance") which is 42% owned by the SA Group, 30% owned by the Company, 28% owned in aggregate by six subsidiaries of the Company.

The Company has entered into a financial agreement dated 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. The agreement has been extended up 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 Commercial and Industrial 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 amounting to RMB1,341,126,000, which earned interest at the rate of 1.98%-3.50% per annum.

(iv) Shenzhen Air Catering Company Limited, which is 20% owned by the SA Group, and 80% 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 agreement has been extended by the parties to 23 May, 2002.

For the year ended 31 December, 2001, the amount paid by the Group to Shenzhen Air Catering Company Limited for the provision of in-flight meals was approximately RMB22,707,000.

(v) Guangzhou Aircraft Maintenance Engineering Company Limited ("GAMECO"), which is 50% owned by the Company and 50% owned by two independent third parties

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 labour costs at US$30.0 per hour during 2001.

For the year ended 31 December, 2001, the amount incurred by the Company for such repair and maintenance services was RMB534,828,000.

(vi) China Southern West Australian Flying College Pty Ltd (the "Australian Pilot College"), which is 65% owned by the Company and 35% owned by the SA Group.

The SA Group 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 the SA Group (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 Demerger Agreement, the Company has assumed all the interests, rights and obligations of the SA Group under the Training Agreement.

For the year ended 31 December, 2001, the amount paid by the Group to the Australian Pilot College for training services was RMB50,602,000.

(vii) Southern Airlines (Group) Economic Development Company, which is 61% owned by the SA Group and 39% owned by an independent third party.

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, 2001, 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 RMB86,386,000.

(viii) 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 inflight 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, 2001, the amount paid by the Group to Nanland for the provision of in-flight meals was RMB84,237,000.

(ix) Ticket sales arrangements

The Group has entered into ticket agency agreements for the sale of the Group's air tickets with several subsidiaries of the SA Group (the "Agents"). The Agents charge commission on the basis of the rates stipulated by the CAAC and 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, 2001, the aggregate amount of ticket sales of the Group conducted through the Agents was RMB201,551,000.

(C) Trademark Licence Agreement

The Company and the SA Group have entered into a 10-year Trademark Licence Agreement dated 22 May, 1997 pursuant to which the SA Group 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 world-wide basis in connection with the Company's airline and airline-related businesses. Unless the SA Group gives written notice of termination three months before the expiration of the agreement, the agreement will be automatically extended for another 10-year term.

(D) Leases

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

(i) The Company and the SA Group 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).

(ii) The Company and the SA Group 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).

(iii) The Company and the SA Group have entered into an indemnification agreement dated 22 May, 1997 in which the SA Group 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.

(E) Comprehensive Services and Employee Benefits

The Company and the SA Group have entered into a comprehensive services agreement (the "Services Agreement") dated 22 May, 1997. The SA Group shall receive certain fees for providing or causing to be provided to the Group and its employees certain services in relation to employee housing and welfare benefits for a term extending from 22 May, 1997 to 31 December, 2006.

With respect to employee housing services, the Services Agreement provides that the SA Group 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 the SA Group, the Company shall pay the SA Group RMB85 million per year, payable quarterly in arrears, for a term of ten years from 1995 to 2004.

In September 2000, the PRC Government issued a notice outlining its reformed policies over the provision of staff housing benefits by PRC enterprises. The notice provides that one-off lump sum cash allowances shall be paid to employees who were eligible for quarters as at 31 December, 1998 but are not allocated with to date. The notice further provides that in future, monthly cash allowances shall be paid in replacement of the allocation of staff quarters to new employees and those employees who were not eligible for quarters as at 31 December, 1998. Detailed timetable and procedures for implementing these policies are to be determined by the provincial or municipal governments based on their respective circumstances.

As of the date of this Annual Report, the Group has not yet formulated its one-off lump sum cash allowance policies. The Group anticipates that a revision of its existing Services Agreement with the SA Group may be necessary in order to accommodate with the new housing benefit regulations to be effective in the relevant provinces or municipals. However, based on its preliminary evaluation, the Group does not anticipate that the revision of the Services Agreement with the SA Group will have a significant adverse impact on the Group's results or financial position in the foreseeable future.

In addition, pursuant to the Services Agreement, the SA Group shall provide pension fund services to the Group, and provide medical benefits and certain related services to the Group's staff. As regards pension benefits, the Company has agreed to pay the SA Group:

1. an amount equivalent to 14% to 17% of the annual aggregate wages of the employees of the Group in the previous year as its contribution under several retirement pension schemes organised by the PRC Government, which the SA Group has undertaken to submit to the Social Insurance Bureau of the respective provinces in which the Company operates. The schemes will pay pension benefits to retired employees of the Group. The contribution percentages are fixed by the PRC Government and jointly approved by the relevant labour and finance administrative agencies of the PRC Government. No fee or charge shall be payable by the Company to the SA Group;

2. an amount equivalent to 4.5% of the annual aggregate wages of the employees of the Group in the previous year as its contribution under the supplemental pension scheme organised by the SA Group. The scheme will pay pension benefits to retired employees of the Group. In addition, the Company shall pay a management fee to the SA Group for administering the supplemental pension scheme; and

3. fixed annual fees for providing post-retirement medical and other welfare benefits to the current and future retirees of the Group from the effective date of the Services Agreement to 31 December, 2006.

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 (E) 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 (A) on normal commercial terms (by reference to transactions of a similar nature made by similar entities within the PRC) or (B) (where there is no available comparison) on terms that are fair and reasonable so far as the shareholders of the Company are concerned; and

(c) the transactions have been performed either (A) in accordance with the terms of the agreement governing each such transaction or (B) (where there is no such agreement) on terms no less favourable than terms available from third parties.

Donations

During the year, the Group made donations for charitable purposes amounting to RMB1.4 million (2000: RMB2.2 million).

Designated Deposits and Overdue Time Deposits

As at 31 December, 2001, 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 2001.

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
12 April, 2002