



NOTES TO THE FINANCIAL STATEMENTS

(Prepared under International Financial Reporting Standards)

(Expressed in Renminbi)

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 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.



NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

(Prepared under International Financial Reporting Standards)

(Expressed in Renminbi)

2 PRINCIPAL ACCOUNTING POLICIES (cont'd)

(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.



NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

(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.



NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

(Prepared under International Financial Reporting Standards)

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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.



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.



NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

(Prepared under International Financial Reporting Standards)

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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.



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)

(Prepared under International Financial Reporting Standards)

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

	2003 RMB'000	2002 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.



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% 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).



NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

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4 (LOSS)/PROFIT BEFORE TAXATION AND MINORITY INTERESTS

	2003 RMB'000	2002 RMB'000
(Loss)/profit before taxation and minority interests is arrived at after charging:		
<i>Operating expenses</i>		
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
<i>Interest expense</i>		
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%).



NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

(Prepared under International Financial Reporting Standards)

(Expressed in Renminbi)

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 RMB'000	2002 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

(a) Directors' and supervisors' emoluments

	2003 RMB'000	2002 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.

**NOTES TO THE FINANCIAL STATEMENTS (Cont'd)***(Prepared under International Financial Reporting Standards)**(Expressed in Renminbi)***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 Number	2002 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 RMB'000	2002 RMB'000
Salaries, allowances and benefits in kind	1,701	1,496
Retirement benefits	25	24
	1,726	1,520

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 Number	2002 Number
Directors and supervisors	–	1
Employees	5	4
	5	5
Nil to HK\$1,000,000 (RMB1,066,000 equivalent)	5	5



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 RMB'000	2002 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 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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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 RMB'000	2002 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.

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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10 FIXED ASSETS

	Buildings	Aircraft		Other flight equipment, including rotatable spares	Machinery, equipment and vehicles	Total
	RMB'000	Owned	Held under finance leases	RMB'000	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	1,782,400	36,196,638
Exchange adjustments	16,572	-	-	-	36,851	53,423
Reclassification on exercise of purchase options	-	997,403	(997,403)	-	-	-
Additions	11,382	2,818,475	-	558,594	137,307	3,525,758
Transferred from construction in progress	133,839	-	-	-	12,255	146,094
Disposals	(34,273)	(104,235)	-	-	(38,540)	(177,048)
At 31 December, 2003	3,287,593	17,222,360	10,462,575	6,842,064	1,930,273	39,744,865
Representing:						
Cost	2,932,399	10,993,419	6,123,034	4,667,887	1,446,235	26,162,974
Valuation - 1996	355,194	6,228,941	4,339,541	2,174,177	484,038	13,581,891
	3,287,593	17,222,360	10,462,575	6,842,064	1,930,273	39,744,865
Accumulated depreciation:						
At 1 January, 2003	476,867	2,145,849	2,499,495	3,177,253	976,345	9,275,809
Exchange adjustments	2,892	-	-	-	30,129	33,021
Reclassification on exercise of purchase options	-	389,958	(389,958)	-	-	-
Charge for the year	128,776	710,509	495,869	467,202	195,526	1,997,882
Written back on disposal	(14,740)	(54,555)	-	-	(28,459)	(97,754)
At 31 December, 2003	593,795	3,191,761	2,605,406	3,644,455	1,173,541	11,208,958
Net book value:						
At 31 December, 2003	2,693,798	14,030,599	7,857,169	3,197,609	756,732	28,535,907
At 31 December, 2002	2,683,206	11,364,868	8,960,483	3,106,217	806,055	26,920,829



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10 FIXED ASSETS (cont'd)

	Buildings RMB'000	Aircraft		Other flight equipment, including rotable spares RMB'000	Machinery, equipment and vehicles RMB'000	Total RMB'000
		Owned RMB'000	Held under finance leases RMB'000			
(b) The Company						
Cost or valuation:						
At 1 January, 2003	1,036,612	9,053,359	11,459,978	3,941,880	895,562	26,387,391
Reclassification on exercise of purchase options	-	997,403	(997,403)	-	-	-
Additions	2,228	2,818,475	-	455,763	87,555	3,364,021
Additions through transfer of fixed assets upon dissolution of subsidiary	514,197	-	-	998,215	217,272	1,729,684
Transferred from construction in progress	91,018	-	-	-	8,228	99,246
Disposals	(347)	-	-	-	(20,178)	(20,525)
At 31 December, 2003	1,643,708	12,869,237	10,462,575	5,395,858	1,188,439	31,559,817
Representing:						
Cost	1,449,476	8,255,920	6,123,034	3,570,949	924,558	20,323,937
Valuation - 1996	194,232	4,613,317	4,339,541	1,824,909	263,881	11,235,880
	1,643,708	12,869,237	10,462,575	5,395,858	1,188,439	31,559,817
Accumulated depreciation:						
At 1 January, 2003	176,841	1,327,363	2,499,495	2,387,634	465,150	6,856,483
Reclassification on exercise of purchase options	-	389,958	(389,958)	-	-	-
Charge for the year	72,980	514,000	495,869	373,896	116,207	1,572,952
Additions through transfer of fixed assets upon dissolution of subsidiary	73,772	-	-	311,097	153,358	538,227
Written back on disposal	(23)	-	-	-	(18,073)	(18,096)
At 31 December, 2003	323,570	2,231,321	2,605,406	3,072,627	716,642	8,949,566
Net book value:						
At 31 December, 2003	1,320,138	10,637,916	7,857,169	2,323,231	471,797	22,610,251
At 31 December, 2002	859,771	7,725,996	8,960,483	1,554,246	430,412	19,530,908



NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

(Prepared under International Financial Reporting Standards)

(Expressed in Renminbi)

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 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.

**NOTES TO THE FINANCIAL STATEMENTS (Cont'd)***(Prepared under International Financial Reporting Standards)**(Expressed in Renminbi)***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 RMB'000	2002 RMB'000	2003 RMB'000	2002 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
	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.



NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

(Prepared under International Financial Reporting Standards)

(Expressed in Renminbi)

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 RMB'000	2002 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 RMB'000	2002 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

**NOTES TO THE FINANCIAL STATEMENTS (Cont'd)***(Prepared under International Financial Reporting Standards)**(Expressed in Renminbi)***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 RMB'000	2002 RMB'000	2003 RMB'000	2002 RMB'000
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 RMB'000	2002 RMB'000	2003 RMB'000	2002 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.



NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

(Prepared under International Financial Reporting Standards)

(Expressed in Renminbi)

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 RMB'000	2002 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 RMB'000	2002 RMB'000	2003 RMB'000	2002 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

**NOTES TO THE FINANCIAL STATEMENTS (Cont'd)***(Prepared under International Financial Reporting Standards)**(Expressed in Renminbi)***16 DEFERRED TAXATION**

Movements in net deferred tax liabilities are as follows:

	The Group		The Company	
	2003 RMB'000	2002 RMB'000	2003 RMB'000	2002 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)

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

	The Group		The Company	
	2003 RMB'000	2002 RMB'000	2003 RMB'000	2002 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)



NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

(Prepared under International Financial Reporting Standards)

(Expressed in Renminbi)

17 INVENTORIES

	The Group		The Company	
	2003 RMB'000	2002 RMB'000	2003 RMB'000	2002 RMB'000
Expendable spare parts and maintenance materials	486,290	489,554	182,742	106,376
Other supplies	57,487	56,146	30,477	11,758
	543,777	545,700	213,219	118,134

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

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 RMB'000	2002 RMB'000	2003 RMB'000	2002 RMB'000
Within 1 month	589,080	576,789	445,980	394,744
More than 1 month but less than 3 months	235,828	88,133	228,530	62,536
More than 3 months but less than 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.

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

	The Group		The Company	
	2003 RMB'000	2002 RMB'000	2003 RMB'000	2002 RMB'000
Bank loans due:				
Within one year	7,096,846	5,240,726	5,958,968	3,479,322
In the second year	646,492	839,036	401,466	522,482
In the third to fifth year, inclusive	1,223,710	3,730,849	826,417	3,143,413
After the fifth year	2,648,533	1,262,549	2,442,616	962,477
	11,615,581	11,073,160	9,629,467	8,107,694
Other loans due:				
In the second year	3,000	3,000	-	-
	11,618,581	11,076,160	9,629,467	8,107,694
Portion classified as current liabilities	(7,096,846)	(5,240,726)	(5,958,968)	(3,479,322)
	4,521,735	5,835,434	3,670,499	4,628,372

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.



NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

(Prepared under International Financial Reporting Standards)

(Expressed in Renminbi)

21 BANK AND OTHER LOANS (cont'd)

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

	The Group		The Company	
	2003 RMB'000	2002 RMB'000	2003 RMB'000	2002 RMB'000
Export-Import Bank 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
CSAHC	359,300	3,340,118	228,800	2,280,118
Guangzhou Baiyun International Airport Company Limited	63,000	–	–	–
Shenzhen Yingshun Investment Development Company Limited	21,000	–	–	–
SA Finance	10,052	561,531	–	550,000
	3,017,938	7,262,594	1,727,191	4,876,793

**NOTES TO THE FINANCIAL STATEMENTS (Cont'd)***(Prepared under International Financial Reporting Standards)**(Expressed in Renminbi)***21 BANK AND OTHER LOANS (cont'd)**

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

	Interest rate and final maturity	The Group		The Company	
		2003 RMB'000	2002 RMB'000	2003 RMB'000	2002 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	893,838	-	850,000
	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	2,310,268	-	2,231,768
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	3,426,038	1,546,492	2,111,768
	Floating interest rates ranging from 1.48% to 1.50% per annum as at 31 December, 2003, with maturities through 2013	2,505,134	-	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	20,090	-	-
		5,209,775	6,653,234	4,051,626	5,193,536
Less: Loans due within one year classified as current liabilities		(688,040)	(817,800)	(381,127)	(565,164)
		4,521,735	5,835,434	3,670,499	4,628,372



NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

(Prepared under International Financial Reporting Standards)

(Expressed in Renminbi)

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:

	2003			2002		
	Payments RMB'000	Interest RMB'000	Obligations RMB'000	Payments RMB'000	Interest RMB'000	Obligations RMB'000
The Group and the Company						
Balance due:						
Within one year	1,648,141	350,286	1,297,855	2,006,392	439,694	1,566,698
In the second year	1,356,614	290,163	1,066,451	1,624,381	351,237	1,273,144
In the third to fifth year, inclusive	4,348,235	439,418	3,908,817	4,153,235	647,988	3,505,247
After the fifth year	608,124	40,308	567,816	1,960,607	107,247	1,853,360
	7,961,114	1,120,175	6,840,939	9,744,615	1,546,166	8,198,449
Less: Balance due within one year classified as current liabilities			(1,297,855)			(1,566,698)
			5,543,084			6,631,751

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

**NOTES TO THE FINANCIAL STATEMENTS (Cont'd)***(Prepared under International Financial Reporting Standards)**(Expressed in Renminbi)***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 RMB'000	2002 RMB'000	2003 RMB'000	2002 RMB'000
Due within 1 month or on demand	279,165	164,442	206,620	88,645
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	119,054
	928,093	532,480	745,888	296,989

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.



NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

(Prepared under International Financial Reporting Standards)

(Expressed in Renminbi)

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 RMB'000	2002 RMB'000	2003 RMB'000	2002 RMB'000
Balance at 1 January,	193,887	187,125	63,389	48,154
Additional amount provided	68,620	49,051	67,603	33,460
Amount utilised	(62,326)	(42,289)	–	(18,225)
Balance at 31 December,	200,181	193,887	130,992	63,389
Less: Current portion included in accrued expenses	10,717	52,000	–	–
	189,464	141,887	130,992	63,389

25 SHARE CAPITAL

	2003 RMB'000	2002 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.

**NOTES TO THE FINANCIAL STATEMENTS (Cont'd)***(Prepared under International Financial Reporting Standards)**(Expressed in Renminbi)***26 RESERVES**

Movements on reserves during the year comprise:

	Notes	The Group		The Company	
		2003 RMB'000	2002 RMB'000	2003 RMB'000	2002 RMB'000
Share premium					
Balance at 1 January,		3,683,956	3,813,659	3,683,956	3,813,659
Land use rights adjustment	(f)	-	(129,703)	-	(129,703)
Share premium from issuance of shares, net of related issuance costs		1,640,767	-	1,640,767	-
Balance at 31 December,		5,324,723	3,683,956	5,324,723	3,683,956
Statutory surplus reserve	(a)				
Balance at 1 January,		337,195	391,867	337,195	121,943
Adjustments from adoption of new PRC accounting regulations	(c)	-	(106,007)	-	163,917
Transfer from profit and loss account		23,856	51,335	1,449	51,335
Balance at 31 December,		361,051	337,195	338,644	337,195
Statutory public welfare fund	(b)				
Balance at 1 January,		171,574	225,440	171,574	114,558
Adjustments from adoption of new PRC accounting regulations	(c)	-	(79,533)	-	31,349
Transfer from profit and loss account		1,113	25,667	724	25,667
Balance at 31 December,		172,687	171,574	172,298	171,574
Discretionary surplus reserve	(d)				
Balance at 1 January,		76,603	69,867	76,603	-
Adjustments from adoption of new PRC accounting regulations	(c)	-	-	-	69,867
Transfer from profit and loss account		-	6,736	-	6,736
Balance at 31 December,		76,603	76,603	76,603	76,603
Retained earnings/(Accumulated losses)					
Balance at 1 January,		1,969,701	1,346,652	445,636	467,716
Adjustments from adoption of new PRC accounting regulations	(c)	-	185,540	-	(265,133)
Land use rights adjustment	(f)	-	12,970	-	12,970
(Loss)/profit for the year		(358,267)	575,761	(580,959)	381,305
Appropriations to reserves		(24,969)	(83,738)	(2,173)	(83,738)
Dividends paid		-	(67,484)	-	(67,484)
Balance at 31 December,		1,586,465	1,969,701	(137,496)	445,636
Total		7,521,529	6,239,029	5,774,772	4,714,964



NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

(Prepared under International Financial Reporting Standards)

(Expressed in Renminbi)

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.
- (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).



NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

(Prepared under International Financial Reporting Standards)

(Expressed in Renminbi)

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 longer presented as related party transactions of the Group.



NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

(Prepared under International Financial Reporting Standards)

(Expressed in Renminbi)

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 RMB'000	2002 RMB'000
Expenses			
<i>Paid to CSAHC and other related parties</i>			
Handling charges	(a)	27,051	36,306
Wet lease rentals	(b)	35,751	26,164
Advertising expenses	(c)	–	3,275
Sundry aviation supplies	(d)	42,849	101,350
Commission expense	(e)	4,896	16,725
Air catering expense	(f)	28,199	29,058
Repairing charges	(g)	693,303	592,311
Housing benefits	(h)	85,000	85,000
Lease charges for land and buildings	(i)	15,224	15,224
Flight simulation service charges	(j)	101,355	–
<i>Paid to CAAC and its affiliates</i>			
Jet fuel supplies		–	2,373,956
Aircraft insurance		–	256,238
Guarantee fees		–	1,025
Ticket reservation service charges		–	107,234
Passenger departure and cargo handling charges		–	62,111
Aircraft and traffic servicing charges		–	1,667,706
Commission expense		–	464,721
Income			
<i>Received from CSAHC and other related parties</i>			
Rental income	(j)	34,175	–
Wet lease rentals	(k)	–	27,599
Interest income	(l)	3,100	10,530
<i>Received from CAAC and its affiliates</i>			
Ground services income		–	39,735
Commission income		–	81,931
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)	–	946,866
Acquisition of subsidiaries	(p)	–	107,846



NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

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

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.

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).



NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

(Prepared under International Financial Reporting Standards)

(Expressed in Renminbi)

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 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.

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



NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

(Prepared under International Financial Reporting Standards)

(Expressed in Renminbi)

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 RMB'000	2002 RMB'000	2003 RMB'000	2002 RMB'000
Commitments in respect of aircraft and related equipment (Note)				
– 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	232,570	43,887	29,628	42,968
– authorised but not contracted for	708,099	500,545	229,302	245,440
	940,669	544,432	258,930	288,408
	13,627,686	9,547,848	10,070,158	9,291,824



NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

(Prepared under International Financial Reporting Standards)
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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 RMB'000	2002 RMB'000	2003 RMB'000	2002 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 RMB'000	2002 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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(Expressed in Renminbi)

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 RMB'000	2002 RMB'000	2003 RMB'000	2002 RMB'000
Payments due				
Within one year	1,482,888	1,280,060	1,193,892	1,044,720
In the second to fifth year, inclusive	4,248,095	4,358,474	3,578,618	3,772,227
After the fifth year	2,388,874	2,898,104	2,278,463	2,893,237
	8,119,857	8,536,638	7,050,973	7,710,184

(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.



NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

(Prepared under International Financial Reporting Standards)

(Expressed in Renminbi)

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 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.



NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

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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, 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.

**NOTES TO THE FINANCIAL STATEMENTS (Cont'd)***(Prepared under International Financial Reporting Standards)**(Expressed in Renminbi)***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		2002	
	Carrying amount RMB'000	Fair value RMB'000	Carrying amount RMB'000	Fair value RMB'000
The Group				
Cash and cash equivalents	2,080,174	2,080,174	3,771,043	3,771,043
Trade receivables	833,604	833,604	671,776	671,776
Other receivables	296,047	296,047	372,586	372,586
Bank and other loans, current portion	7,096,846	7,164,216	5,240,726	5,326,511
Amounts due to related companies	929,003	929,003	525,090	525,090
Other liabilities	1,019,811	1,019,811	646,989	646,989
Accounts payable	928,093	928,093	532,480	532,480
Bills payable	438,135	438,135	1,299,680	1,299,680
Sales in advance of carriage	466,087	466,087	390,531	390,531
Accrued expenses	2,527,794	2,527,794	2,341,454	2,341,454
Bank and other loans, non-current portion	4,521,735	4,743,128	5,835,434	6,111,052



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		2002	
	Carrying amount RMB'000	Fair value RMB'000	Carrying amount RMB'000	Fair value RMB'000
The Company				
Cash and cash equivalents	1,404,874	1,404,874	2,960,337	2,960,337
Trade receivables	683,206	683,206	464,930	464,930
Other receivables	222,438	222,438	239,601	239,601
Bank and other loans, current portion	5,958,968	6,010,222	3,479,322	3,546,409
Amounts due to related companies	870,682	870,682	358,077	358,077
Other liabilities	854,057	854,057	411,218	411,218
Accounts payable	745,888	745,888	296,989	296,989
Bills payable	438,135	438,135	1,299,680	1,299,680
Sales in advance of carriage	405,851	405,851	340,457	340,457
Accrued expenses	1,628,072	1,628,072	1,049,806	1,049,806
Bank and other loans, non-current portion	3,670,499	3,827,220	4,628,372	4,811,961

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)***(Prepared under International Financial Reporting Standards)**(Expressed in Renminbi)***31 FAIR VALUE OF FINANCIAL INSTRUMENTS AND CONCENTRATION OF RISK (cont'd)**

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 RMB'000	Hong Kong regional RMB'000	*International RMB'000	Total RMB'000
2003				
Traffic revenue	13,086,939	807,677	3,070,184	16,964,800
Other revenue	436,122	-	69,201	505,323
	13,523,061	807,677	3,139,385	17,470,123
Operating profit/(loss)	440,158	(29,210)	44,781	455,729
2002				
Traffic revenue	13,197,589	1,118,695	3,165,608	17,481,892
Other revenue	485,046	-	51,682	536,728
	13,682,635	1,118,695	3,217,290	18,018,620
Operating profit	1,614,975	193,440	217,662	2,026,077

* 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.



NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

(Prepared under International Financial Reporting Standards)

(Expressed in Renminbi)

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 RMB'000	2002 RMB'000
(Loss)/profit before taxation and minority interests	(511,610)	1,139,099
Depreciation and amortisation of fixed assets	1,997,882	1,839,293
Other amortisation	40,089	9,816
Amortisation of deferred credits	(1,541)	(7,217)
Share of associated companies' results	(47,798)	(36,988)
Share of jointly controlled entities' results	39,495	3,352
Loss/(gain) on sale of fixed assets	22,217	(170,740)
Interest income	(13,061)	(52,618)
Interest expense	823,725	959,193
Unrealised exchange loss, net	177,356	174,978
Decrease/(increase) in inventories	1,923	(76,472)
Increase in trade receivables	(161,828)	(110,749)
Decrease/(increase) in other receivables	76,539	(166,004)
(Increase)/decrease in prepaid expenses and other assets	(6,045)	123,924
Increase/(decrease) in amounts due to related companies	403,913	(193,175)
Increase/(decrease) in accounts payable	395,613	(61,843)
(Decrease)/increase in bills payable	(861,545)	1,299,680
Increase in sales in advance of carriage	75,556	19,985
Increase in accrued expenses	203,439	86,215
Increase/(decrease) in other liabilities	372,822	(33,032)
Increase in provision for major overhauls	47,577	16,226
Cash inflows from operations	3,074,718	4,762,923

(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)).

**NOTES TO THE FINANCIAL STATEMENTS (Cont'd)***(Prepared under International Financial Reporting Standards)**(Expressed in Renminbi)***33 RECONCILIATION AND SUPPLEMENTARY STATEMENT OF CASH FLOW INFORMATION**

(cont'd)

(c) Effect of acquisition of subsidiaries

	2003 RMB'000	2002 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.



NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

(Prepared under International Financial Reporting Standards)

(Expressed in Renminbi)

36 SUBSIDIARIES

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

Name of company	Place and date of establishment/ operation	Attributable equity interest		Issued/ registered capital [#]	Principal activities
		Direct %	Indirect %		
China Southern Airlines (Group) Zhuhai Helicopter Company Limited (a)	PRC 31 August, 1993	100	–	100,000,000	Helicopter transportation
Guangxi Airlines Company Limited (a)	PRC 28 April, 1994	60	–	170,900,000	Airline
Southern Airlines Group Shantou Airlines Company Limited (a)	PRC 20 July, 1993	60	–	280,000,000	Airline
Zhuhai Airlines Company Limited (a)	PRC 8 May, 1995	60	–	250,000,000	Airline
Xiamen Airlines Company Limited (a)	PRC 11 August, 1984	60	–	588,434,000	Airline
Guizhou Airlines Company Limited (a)	PRC 12 November, 1991	60	–	80,000,000	Airline
Guangzhou Nanland Air Catering Company Limited (b)	PRC 21 November, 1989	51	–	55,980,000	Air catering
China Southern West Australian Flying College Pty Ltd	Australia 26 January, 1971	65	–	A\$100,000	Pilot training services
Guangzhou Baiyun International Logistic Company Ltd	PRC 23 July, 2002	61	–	20,000,000	Logistics operations
Guangzhou Aviation Hotel	PRC 8 January, 1997	90	–	63,290,000	Hotel operation



NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

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36 SUBSIDIARIES (cont'd)

Name of company	Place and date of establishment/ operation	Attributable equity interest		Issued/ registered capital [#]	Principal activities
		Direct %	Indirect %		
Southern Airlines Advertising Company Ltd	PRC 3 March, 1994	90	–	2,000,000	Aviation advertising
South China International Aviation & Travel Services Company	PRC 11 May, 1992	90	–	2,100,000	Travel services
CZ Flamingo Limited	Cayman Islands 8 December, 1993	100	–	US\$1,000	Aircraft leasing
CZ Skylark Limited	Cayman Islands 17 November, 1993	100	–	US\$1,000	Aircraft leasing
CZ Kapok Limited	Cayman Islands 26 October, 1993	100	–	US\$1,000	Aircraft leasing
CSA-I Limited	Cayman Islands 1 September, 1993	100	–	US\$1,000	Aircraft leasing
CZ93B Limited	Cayman Islands 11 May, 1993	100	–	US\$1,000	Aircraft leasing
CZ97A Limited	Cayman Islands 2 January, 1997	100	–	US\$1,000	Aircraft leasing
Zhong Yuan 99A Limited	Cayman Islands 15 February, 1999	100	–	US\$1,000	Aircraft leasing
CXA92A Limited	Cayman Islands 3 August, 1992	–	60	US\$1,000	Aircraft leasing
CXA93A Limited	Cayman Islands 1 July, 1993	–	60	US\$1,000	Aircraft leasing
CXA95B Limited	Cayman Islands 7 July, 1995	–	60	US\$1,000	Aircraft leasing



NOTES TO THE FINANCIAL STATEMENTS (Cont'd)

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(Expressed in Renminbi)

36 SUBSIDIARIES (cont'd)

Name of company	Place and date of establishment/ operation	Attributable equity interest		Issued/ registered capital [#]	Principal activities
		Direct %	Indirect %		
CXA95C Limited	Cayman Islands 16 October, 1995	–	60	US\$1,000	Aircraft leasing
CXA98A Limited	Cayman Islands 20 March, 1998	–	60	US\$1,000	Aircraft leasing
Xiamen Aviation Property Development Company (a)	PRC 22 June, 1993	–	60	5,000,000	Property development
Xiamen Aviation Advertising Company Limited (a)	PRC 17 December, 1992	–	60	620,218	Aviation advertising
Xiamen Aviation Supplies Limited (a)	PRC 30 July, 1997	–	60	8,560,000	Aviation supplies
Xiamen Aviation Development Company Limited (a)	PRC 18 February, 1998	–	54	5,000,000	Hotel management
Bai Lu Finance Limited	Hong Kong 22 February, 1996	–	54	HK\$10,000,000	Investment holding
Xiamen Air Holidays Limited	Hong Kong 28 April, 1994	–	54	HK\$3,000,000	Travel servicing
Xiamen Macau Holidays Limited	Macau 11 May, 1995	–	27.5	MOP 1,000,000	Travel servicing
Shantou Hua Kang Air Catering Company Ltd (a)	PRC 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

**NOTES TO THE FINANCIAL STATEMENTS (Cont'd)***(Prepared under International Financial Reporting Standards)**(Expressed in Renminbi)***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 [#]	Principal activities
		Direct %	Indirect %		
Guangzhou Aircraft Maintenance Engineering Company Limited* (Note)	PRC 28 October, 1989	50	–	US\$27,500,000	Provision of aircraft repair and maintenance services
Southern Airlines Group Finance Company Limited	PRC 28 June, 1995	32	15.42	424,330,000	Provision of financial services
Hainan Phoenix Information System Limited	PRC 12 March, 1994	45	–	US\$16,360,000	Provision of ticket reservation system services
Hong Kong Business Aviation Centre Company Limited	Hong Kong 7 January, 1998	20	–	HKD1,000,000	Provision of private flight logistic services
Sichuan Airlines Corporation Limited	PRC 28 August, 2002	39	–	350,000,000	Airline
MTU Maintenance Zhuhai Co. Ltd.*	PRC 6 April, 2001	50	–	US\$63,100,000	Provision of engine repair and maintenance services
China Postal Airlines Limited*	PRC 25 November, 1996	49	–	306,000,000	Airline



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 [#]	Principal activities
		Direct	Indirect		
		%	%		
Zhuhai Xiang Yi Aviation Technology Company Limited*	PRC 10 July, 2002	51	–	US\$29,800,000	Provision of flight simulation services
CSN-ETC e-commerce Limited*	PRC 10 February, 2003	51	–	5,880,000	Provision of internet services

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.