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 subsidiaries (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 new 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 ("H Shares") and American Depositary Shares ("ADS") (each ADS representing 50 H Shares) have been 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 ("A Shares") which are listed on the Shanghai Stock Exchange.

Pursuant to a sale and purchase agreement dated 12 November, 2004 between the Company, CSAHC, China Northern Airlines Company ("CNA") and Xinjiang Airlines Company ("XJA") which was approved by the Company's shareholders in an extraordinary general meeting held on 31 December, 2004, the Company acquired the airline operations and certain related assets of CNA and XJA with effect from 31 December, 2004 (the "CNA/XJA Acquisitions"). The consideration payable for the CNA/XJA Acquisitions amounting to RMB15,522 million was determined based on the fair value of the acquired assets. Such consideration was partly satisfied by assumption of debts and liabilities of CNA and XJA totalling RMB13,563 million outstanding as at 31 December, 2004 and the remaining balance of RMB1,959 million will be satisfied in cash.

As the above acquisitions were completed on 31 December, 2004, they have no impact on the Company's consolidated income statement for the year ended 31 December, 2004.

Further details of the CNA/XJA Acquisitions are set out in Note 34(b) to the financial statements.

2 PRINCIPAL ACCOUNTING POLICIES

(a) Statement of compliance

These financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") promulgated by the International Accounting Standards Board. IFRS includes International Accounting Standards ("IAS") and related interpretations. These financial statements also comply with the disclosure requirements of the Hong Kong Companies Ordinance and the applicable disclosure provisions of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited.

(b) Basis of preparation

The financial statements are prepared on the historical cost basis as modified by the revaluation of certain property, plant and equipment.

The preparation of financial statements in conformity with IFRS requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, income and expenses. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgements about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

Notes to the Financial Statements (Cont'd)

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

2 PRINCIPAL ACCOUNTING POLICIES (cont'd)

(b) Basis of preparation (cont'd)

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods.

The accounting policies set out below have been applied consistently by the Group and are consistent with those used in the previous year.

(c) Basis of consolidation

(i) Subsidiaries

A subsidiary is an entity controlled by the Company. Control exists when the Company has the power, directly or indirectly, to govern the financial and operating policies of an entity so as to obtain benefits from its activities. In assessing control, potential voting rights that presently are exercisable or convertible are taken into account. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases.

Intra-group balances and transactions, and any unrealised profits arising from intra-group transactions, are eliminated in full in preparing the consolidated financial statements. Unrealised losses resulting from intra-group transactions are eliminated in the same way as unrealised profits, but only to the extent that there is no evidence of impairment.

In the Company's balance sheet, an investment in a subsidiary is stated at cost less any impairment losses (see Note 2(l)).

(ii) Associates and jointly controlled entities

An associate is an entity in which the Group has significant influence, but not control, over the financial and operating policies. The consolidated financial statements include the Group's share of the total recognised gains and losses of associates on an equity accounted basis, from the date that significant influence commences until the date that significant influence ceases. When the Group's share of losses exceeds its interest in an associate, the Group's carrying amount is reduced to nil and recognition of further losses is discontinued except to the extent that the Group has incurred legal or constructive obligations or made payments on behalf of an associate.

A jointly controlled entity is an entity over whose activities the Group has joint control, established by contractual agreement. The consolidated financial statements include the Group's share of the total recognised gains and losses of jointly controlled entities on an equity accounted basis, from the date that joint control commences until the date that joint control ceases. When the Group's share of losses exceeds its interest in a jointly controlled entity, the Group's carrying amount is reduced to nil and recognition of further losses is discontinued except to the extent that the Group has incurred legal or constructive obligations or made payments on behalf of a jointly controlled entity.

2 PRINCIPAL ACCOUNTING POLICIES (cont'd)

(c) Basis of consolidation (cont'd)

(ii) Associates and jointly controlled entities (cont'd)

Unrealised profits arising from transactions with associates and jointly controlled entities are eliminated to the extent of the Group's interest in the entity. Unrealised losses are eliminated in the same way as unrealised profits, but only to the extent that there is no evidence of impairment.

In the Company's balance sheet, its investments in associates and jointly controlled entities are stated at cost less any impairment losses (see Note 2(l)).

(d) Property, plant and equipment

(i) Owned assets

An item of property, plant and equipment is initially recorded at cost less accumulated depreciation (see (iv) below) and impairment losses (see Note 2(l)). The cost of an asset comprises its purchase price and any directly attributable costs of bringing the asset to working condition and location for its intended use. Subsequent to the revaluation (see Note 10), which was based on depreciated replacement costs, property, plant and equipment are carried at revalued amount, being the fair value at the date of the revaluation less any subsequent accumulated depreciation and impairment losses. 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.

Gains or losses arising from the retirement or disposal of an item of property, plant and equipment are determined as the difference between the estimated net disposal proceeds and the carrying amount of the asset and are recognised in the income statement on the date of retirement or disposal. Any related revaluation surplus is transferred from the revaluation reserve to retained profits.

(ii) Leased assets

Leases in terms of which the Group assumes substantially all the risks and rewards of ownership are classified as finance leases.

Flight equipment acquired by way of finance lease 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, less accumulated depreciation (see (iv) below) and impairment losses (see Note 2(l)) and the corresponding liabilities, net of finance charges, are recorded as obligations under finance leases. Subsequent to the revaluation (see Note 10), which was based on depreciated replacement costs, leased assets are carried at revalued amount, being the fair value at the date of the revaluation less any subsequent accumulated depreciation and impairment losses. 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.

The finance charge is allocated to each period during the lease term so as to produce a constant periodic rate of interest on the remaining balance of the liability. Contingent rentals are written off as an expense of the period in which they are incurred.

Notes to the Financial Statements (Cont'd)
(Prepared under International Financial Reporting Standards)
(Expressed in Renminbi)

2 PRINCIPAL ACCOUNTING POLICIES (cont'd)

(d) Property, plant and equipment (cont'd)

(ii) Leased assets (cont'd)

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

Payments made under operating leases are recognised in the income statement on a straight-line basis over the term of the lease. Lease incentives received are recognised in the income statement as an integral part of the total lease expense.

(iii) Subsequent costs

The Group recognises in the carrying amount of an item of property, plant and equipment the cost of replacing part of such an item when that cost is incurred if it is probable that the future economic benefits embodied with the item will flow to the Group and the cost of the item can be measured reliably. All other costs are recognised in the income statement as an expense as incurred.

(iv) Depreciation

Depreciation is calculated to write off the cost or revalued amount of items of property, plant and equipment over their estimated useful lives on a straight-line basis, after taking into account its estimated residual value, as follows:

	Depreciable life	Residual value
Buildings	15 to 40 years	Nil
Owned and leased aircraft	8 to 15 years	28.75%
Other flight equipment		
– Jet engines	8 to 15 years	3%
– Others, including rotable spares	8 to 15 years	Nil
Machinery and equipment	5 to 10 years	3%
Vehicles	6 years	3%

Depreciation for leased assets is provided at rates which write off the cost of the assets in equal annual amounts over the term of the relevant lease or, where it is likely the Group will obtain ownership of the asset, the life of the asset, as set out above.

Notes to the Financial Statements (Cont'd)

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

2 PRINCIPAL ACCOUNTING POLICIES (cont'd)

(e) 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 property, plant and equipment 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.

(f) 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.

(g) 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.

(h) Other investments

Financial instruments held for trading are classified as current assets and are stated at fair value, with any resultant gain or loss recognised in the income statement.

Where the Group has the positive intent and ability to hold bonds to maturity, they are stated at amortised cost less impairment losses (see Note 2(l)).

Other financial instruments are stated at cost less impairment losses (see Note 2(l)). Other financial instruments 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.

(i) 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 are 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)
(Expressed in Renminbi)

2 PRINCIPAL ACCOUNTING POLICIES (cont'd)

(j) Trade and other receivables

Trade and other receivables are stated at cost less provision for doubtful accounts. Provision for doubtful accounts is established based on evaluation of the recoverability of these accounts at the balance sheet date.

(k) 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.

(l) Impairment loss

The carrying amounts of the Group's assets, other than inventories (see Note 2(i)), trade and other receivables (see Note 2(j)) and deferred tax assets (see Note 2(q)) 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 income statement.

The Group assesses 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.

(m) Interest-bearing borrowings

Interest-bearing borrowings are recognised initially at fair value, 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 income statement over the period of the borrowings on an effective interest basis.

(n) 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.

2 PRINCIPAL ACCOUNTING POLICIES (cont'd)

(o) Defeasance of long-term liabilities

Where long-term liabilities have been defeased by the placement of security deposits, those liabilities and deposits (and income and charge arising therefrom) are netted off in order to reflect the overall commercial effect of the arrangements. Such netting off has been effected where a right is held by the Group to insist on net settlement of the liability and deposit including in all situations of default and where that right is assured beyond doubt.

(p) 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.

(q) 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.

(r) Revenue recognition

(i) Passenger, cargo and mail revenues are recognised when the transportation is provided. Ticket sales for transportation not yet provided are included in current liabilities as sales in advance of carriage. Revenues from airline-related business are recognised when services are rendered. Revenue is stated net of sales tax. In addition, prior to 1 May, 2003, revenue was stated net of the contributions to the Civil Aviation Administration of China ("CAAC") Infrastructure Development Fund.

(ii) Interest income is recognised on a time proportion basis according to the outstanding principal and the applicable interest rate.

(iii) Dividend income is recognised when the Group's right to receive the dividend is established.

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

Notes to the Financial Statements (Cont'd)

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

2 PRINCIPAL ACCOUNTING POLICIES (cont'd)

(s) 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.

(t) 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 income statement 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 overhauls required to be performed on the related aircraft prior to their return to the lessors.

(u) Borrowing costs

Borrowing costs are expensed in the income statement 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.

The capitalisation of borrowing costs as part of the cost of a qualifying asset commences when expenditures for the asset are being incurred, borrowing costs are being incurred and activities that are necessary to prepare the asset for its intended use are in progress. Capitalisation of borrowing costs ceases when substantially all the activities necessary to prepare the qualifying asset for its intended use are complete.

(v) Retirement benefits

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

2 PRINCIPAL ACCOUNTING POLICIES (cont'd)

(x) Translation of foreign currencies

Transactions in foreign currencies are translated into Renminbi at the applicable rates of exchange quoted by the People's Bank of China ("PBOC rates") prevailing on the transaction dates. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are translated into Renminbi at the PBOC rates at the balance sheet date. Non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are translated into Renminbi at the PBOC rates prevailing on the transaction dates.

(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 other entities.

(z) Segmental reporting

A segment is a distinguishable component of the Group that is engaged either in providing products or services (business segment), or in providing products or services within a particular economic environment (geographical segment), which is subject to risks and rewards that are different from those of other segments.

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. In addition, turnover for the four-month period ended 30 April, 2003 was stated net of contributions to the CAAC Infrastructure Development Fund. An analysis of turnover is as follows:

	2004 RMB million	2003 RMB million
Traffic revenue		
Passenger	21,100	15,010
Cargo and mail	2,244	1,955
	23,344	16,965
Other operating revenue		
Commission income	203	140
General aviation income	55	40
Ground services income	146	99
Air catering income	53	31
Net income from lease arrangements (Note)	–	69
Rental income	45	40
Aircraft lease income	11	–
Other	117	86
	630	505
	23,974	17,470

Note: As result of a lease arrangement in 2003, the Company received net cash benefits of RMB69 million which were recognised as income in 2003. Further details of the arrangement are set out in note 10(g) to the financial statements.

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% (2003: 3%) of traffic revenue in respect of domestic flights and outbound international/Hong Kong regional flights, except for the period from 1 May, 2003 to 31 December, 2003 when passenger revenue was exempted from sales tax.
Other operating revenue	3% (2003: 3%) of commission income, general aviation income and ground services income, and 3% to 5% (2003: 3% to 5%) of other operating revenue.

3 TURNOVER (cont'd)

Sales tax incurred during the year ended 31 December, 2004, netted off against revenue, amounted to RMB716 million (2003: RMB206 million).

In addition, the Group is required to pay contributions to the CAAC Infrastructure Development Fund. Prior to 1 May, 2003, contributions to CAAC Infrastructure Development Fund were payable at 5% and 2% respectively of the domestic and international/Hong Kong regional traffic revenue. For the period from 1 May, 2003 to 31 March, 2004, the Group was exempted from paying any contributions. Effective from 1 April, 2004, contributions to the CAAC Infrastructure Development Fund are payable based on the traffic capacity deployed by the Group on its routes. The contributions now form part of the flight operations expenses and amounted to RMB466 million for the year ended 31 December, 2004. The contributions for the year ended 31 December, 2003 amounted to RMB251 million and were netted off against traffic revenue.

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, 2004, the fuel surcharge revenue of the Group totalled approximately RMB348 million (2003: RMB740 million).

Notes to the Financial Statements (Cont'd)

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

4 PROFIT/(LOSS) BEFORE TAXATION AND MINORITY INTERESTS

Profit/(loss) before taxation and minority interests is arrived at after charging:

	2004 RMB million	2003 RMB million
Operating expenses		
Jet fuel	6,050	3,867
Aircraft maintenance	3,132	2,377
Routes	5,626	4,363
Depreciation		
– owned assets	1,891	1,502
– assets held under finance leases	472	496
Amortisation of deferred expenditure	50	40
Operating lease charges		
– aircraft and flight equipment	1,665	1,536
– land and buildings	109	136
Staff costs		
– salaries, wages and welfare	2,260	1,496
– contributions to retirement schemes	168	150
Office and administration	718	471
Auditors' remuneration	11	8
Other	913	572
	23,065	17,014
Interest expense		
Interest on bank and other loans wholly repayable within five years	221	288
Interest on other loans	156	176
Finance charges on obligations under finance leases	348	443
Less: borrowing costs capitalised (Note)	(34)	(83)
Net interest expense	691	824
and after crediting:		
Net realised and unrealised gain on equity securities held for trading	15	–
Dividend income from unlisted investments	14	17

Note: The borrowing costs have been capitalised at rates ranging from 1.51% to 3.48% per annum (2003: 1.62% to 5.46% per annum).

The loss attributable to shareholders for the year ended 31 December, 2004 includes a loss of RMB 169 million (2003: RMB581 million) which has been dealt with in the financial statements of the Company.

5 LOSS ON DISPOSAL OF PROPERTY, PLANT AND EQUIPMENT

Loss on disposal of property, plant and equipment represents:

	2004 RMB million	2003 RMB million
Aircraft (Note)	–	20
Flight equipment and other	1	2
	1	22

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

6 EMOLUMENTS OF DIRECTORS, SUPERVISORS AND SENIOR MANAGEMENT

(a) Directors' and supervisors' emoluments

	2004 RMB'000	2003 RMB'000
Fees	255	203
Salaries, allowances and benefits in kind	3,498	1,244
Retirement benefits	116	98
Bonuses	868	943
	4,737	2,488

Included in the above were fees of RMB255,000 (2003: RMB203,000) paid to independent non-executive directors during the year.

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

	2004 Number	2003 Number
Nil to HK$1,000,000 (RMB1,066,000 equivalent)	18	18

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)

(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:

	2004 RMB'000	2003 RMB'000
Salaries, allowances and benefits in kind	2,045	1,701
Retirement benefits	29	25
	2,074	1,726

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:

	2004 Number	2003 Number
Directors and supervisors	–	–
Employees	5	5
	5	5
Nil to HK$1,000,000 (RMB1,066,000 equivalent)	5	5

7 INCOME TAX IN THE CONSOLIDATED INCOME STATEMENT

(a) Income tax in the consolidated income statement represents:

	2004 RMB million	2003 RMB million
PRC income tax	176	47
Share of associates' taxation	2	3
Share of jointly controlled entities' taxation	11	7
	189	57
Deferred tax (Note 17)		
– current year	(111)	11
– adjustment for change in enacted tax rate	–	(392)
Income tax expense/(credit)	78	(324)

7 INCOME TAX IN THE CONSOLIDATED INCOME STATEMENT (cont'd)

(a) Income tax in the consolidated income statement represents: (cont'd)

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 from 33% to 15% beginning from that date.

As a result of the reduction in income tax rate, the Company's net deferred tax liability balance at 1 January, 2003 of RMB507 million was reduced by RMB392 million. Accordingly, a net deferred tax credit of RMB392 million was recognised in the income statement 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 the PRC government, or has sustained tax losses in these overseas jurisdictions. Accordingly, no provision for overseas tax has been made for both the current and prior years.

(b) Reconciliation between tax expense and accounting profit at applicable tax rates:

	2004 RMB million	2003 RMB million
Profit/(loss) before taxation and minority interests	233	(511)
Expected PRC income tax expense/(credit) at 15% (2003: 15%)	35	(77)
Adjustments:		
Effect of change in income tax rate	–	(392)
Non-deductible expenses	40	80
Other, net	3	65
Income tax expense/(credit)	78	(324)

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.

The PRC withholding tax payable by the Group for the year ended 31 December, 2004 of RMB23 million (2003: RMB8 million) in respect of the leases executed on or after 1 September, 1999 has been included as part of the operating lease charges for the year.

Notes to the Financial Statements (Cont'd)
(Prepared under International Financial Reporting Standards)
(Expressed in Renminbi)

8 DIVIDENDS

No interim dividend was paid during both the current and prior years.

The board of directors of the Company does not recommend the payment of a final dividend in respect of the year ended 31 December, 2004. No final dividend was paid in respect of the year ended 31 December, 2003.

9 BASIC LOSS PER SHARE

The calculation of basic loss per share is based on the consolidated loss attributable to shareholders of RMB48 million (2003: RMB358 million) and the weighted average number of shares in issue during the year of 4,374 million (2003: 3,832 million).

The amount of diluted loss per share is not presented as there were no dilutive potential ordinary shares in existence for both the current and prior years.

Notes to the Financial Statements (Cont'd)

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

10 PROPERTY, PLANT AND EQUIPMENT

(a) The Group

	Buildings	Aircraft: Owned	Aircraft: Held under finance leases	Other flight equipment, including rotable spares	Machinery, equipment and vehicles	Total
	RMB million	RMB million	RMB million	RMB million	RMB million	RMB million
Cost or valuation:						
At 1 January, 2004	3,288	17,222	10,463	6,842	1,930	39,745
Exchange adjustments	5	–	–	–	12	17
Reclassification on exercise of purchase options	–	550	(550)	–	–	–
Additions	336	4,156	–	525	5	5,022
Transferred from construction in progress	2,472	–	–	–	235	2,707
Through the CNA/XJA Acquisitions	915	5,206	4,616	1,753	490	12,980
Disposals	(28)	–	–	(76)	(73)	(177)
At 31 December, 2004	**6,988**	**27,134**	**14,529**	**9,044**	**2,599**	**60,294**
Representing:						
Cost	6,633	20,905	10,189	6,870	2,115	46,712
Valuation – 1996	355	6,229	4,340	2,174	484	13,582
	6,988	27,134	14,529	9,044	2,599	60,294
Accumulated depreciation:						
At 1 January, 2004	594	3,192	2,605	3,644	1,174	11,209
Exchange adjustments	1	–	–	–	9	10
Reclassification on exercise of purchase options	–	183	(183)	–	–	–
Charge for the year	179	956	472	544	212	2,363
Written back on disposal	(17)	–	–	(51)	(61)	(129)
At 31 December, 2004	**757**	**4,331**	**2,894**	**4,137**	**1,334**	**13,453**
Net book value:						
At 31 December, 2004	**6,231**	**22,803**	**11,635**	**4,907**	**1,265**	**46,841**
At 31 December, 2003	2,694	14,030	7,858	3,198	756	28,536

Notes to the Financial Statements (Cont'd)

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

10 PROPERTY, PLANT AND EQUIPMENT (cont'd)

(b) The Company

	Buildings	Aircraft Owned	Aircraft Held under finance leases	Other flight equipment, including rotable spares	Machinery, equipment and vehicles	Total
	RMB million	RMB million	RMB million	RMB million	RMB million	RMB million
Cost or valuation:						
At 1 January, 2004	1,644	12,868	10,463	5,396	1,189	31,560
Reclassification on exercise of purchase options	–	550	(550)	–	–	–
Additions through transfer of property, plant and equipment upon dissolution of a subsidiary	3	–	–	134	13	150
Additions	12	3,509	–	192	38	3,751
Transferred from construction in progress	1,663	–	–	–	235	1,898
Through the CNA/XJA Acquisitions	727	5,206	4,616	1,745	441	12,735
Disposals	(23)	–	–	–	(40)	(63)
At 31 December, 2004	**4,026**	**22,133**	**14,529**	**7,467**	**1,876**	**50,031**
Representing:						
Cost	3,832	17,520	10,189	5,642	1,612	38,795
Valuation – 1996	194	4,613	4,340	1,825	264	11,236
	4,026	22,133	14,529	7,467	1,876	50,031
Accumulated depreciation:						
At 1 January, 2004	324	2,231	2,605	3,073	717	8,950
Reclassification on exercise of purchase options	–	183	(183)	–	–	–
Additions through transfer of property, plant and equipment upon dissolution of a subsidiary	1	–	–	72	10	83
Charge for the year	110	744	472	346	117	1,789
Written back on disposal	(10)	–	–	–	(35)	(45)
At 31 December, 2004	**425**	**3,158**	**2,894**	**3,491**	**809**	**10,777**
Net book value:						
At 31 December, 2004	**3,601**	**18,975**	**11,635**	**3,976**	**1,067**	**39,254**
At 31 December, 2003	1,320	10,637	7,858	2,323	472	22,610

Notes to the Financial Statements (Cont'd)

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

10 PROPERTY, PLANT AND EQUIPMENT (cont'd)

(c) 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 periods 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 Company gives appropriate notice of termination. In this connection, rental payments totalling RMB18 million (2003: RMB15 million) were paid to CSAHC during 2004 in respect of these leases.

(d) In compliance with the PRC rules and regulations governing initial public offering of shares by PRC joint stock limited companies, the property, plant and equipment 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 property, plant and equipment 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 property, plant and equipment held by the Group as at 31 December, 2000, the carrying amounts of property, plant and equipment did not differ materially from their respective fair value.

The effect of the above revaluation was to increase future annual depreciation charges of the Group by approximately RMB33 million (2003: RMB33 million). Had the property, plant and equipment of the Group and the Company been stated at cost (i.e. the effect of the revaluation was excluded), the net book value of property, plant and equipment of the Group and the Company as at 31 December, 2004 would have been approximately RMB46,838 million and RMB39,684 million respectively (2003: RMB28,523 million and RMB22,794 million respectively), made up as follows:

	The Group		The Company	
	2004	2003	**2004**	2003
	RMB million	RMB million	**RMB million**	RMB million
Buildings	**6,797**	3,110	**4,178**	1,610
Aircraft				
– owned	**28,257**	18,345	**22,923**	13,658
– held under finance leases	**15,008**	10,942	**15,008**	10,942
Flight equipment and others	**12,516**	9,634	**9,726**	6,910
	62,578	42,031	**51,835**	33,120
Less: Accumulated depreciation	**15,740**	13,508	**12,151**	10,326
	46,838	28,523	**39,684**	22,794

Notes to the Financial Statements (Cont'd)
(Prepared under International Financial Reporting Standards)
(Expressed in Renminbi)

10 PROPERTY, PLANT AND EQUIPMENT (cont'd)

(e) As at 31 December, 2004, certain aircraft of the Group and the Company with an aggregate carrying value of approximately RMB23,562 million and RMB21,814 million respectively (2003: RMB14,576 million and RMB12,796 million respectively) were mortgaged under certain loan and lease agreements (see Notes 21 and 22).

(f) In 2003, 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 million (2003: RMB34 million) was received by the Company during the year in respect of the leases. As at 31 December, 2004, the cost and accumulated depreciation of the relevant property, plant and equipment totalled RMB787 million and RMB514 million respectively (2003: RMB787 million and RMB462 million respectively). Depreciation of the relevant property, plant and equipment recognised during the year totalled RMB55 million (2003: RMB55 million). As at 31 December 2004, the Company's rental receivable in respect of the leases due in 2005 amounted to RMB34 million (2003: RMB34 million).

(g) 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. 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. Provided that 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 property, plant and equipment. As at 31 December, 2004, the net present value of the lease commitments and the corresponding defeased deposits and debt securities amounted to RMB2,462 million (2003: RMB2,409 million). As a result of the Arrangements, the Company received net cash benefits which were recognised as income (Note 3).

(h) As at 31 December, 2004 and up to the date of approval of these financial statements, the Group is in the process of applying for the land use right certificates and property title certificates in respect of the properties located in the Guangzhou new airport, Guangzhou Baiyun International Airport, in which the Group has interests and for which such certificates have not been granted. As at 31 December, 2004, carrying value of such properties of the Group and the Company amounted to RMB2,477 million and RMB1,417 million respectively.

The directors of the Company are of the opinion that the use of and the conduct of operating activities at the properties referred to above are not affected by the fact that the Group has not yet obtained the relevant land use right certificates and property title certificates.

Notes to the Financial Statements (Cont'd)

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

11 CONSTRUCTION IN PROGRESS

	2004 RMB million	2003 RMB million
The Company		
Shenzhen cargo centre	22	–
Guangzhou new airport support area	65	–
Boeing 777 aircraft engines upgrade	18	12
Guangzhou new airport base	–	1,378
Hubei catering building	–	28
Zhengzhou ticket selling office	–	22
Material and engineering system	22	21
Henan office building	–	14
Other	105	57
	232	1,532
Subsidiaries		
Guangzhou new cargo centre	254	68
Fuzhou Chang Le airport facilities	20	14
Other	59	16
	333	98
	565	1,630

12 INTEREST IN SUBSIDIARIES

	The Company	
	2004 RMB million	2003 RMB million
Unlisted shares/capital contributions, at cost	1,232	978
Amounts due from subsidiaries	917	468
	2,149	1,446

In 2004, China Southern Airlines (Group) Zhuhai Helicopter Company Limited, a wholly owned subsidiary of the Company, was dissolved. Its operations and assets and liabilities were transferred to the Company. No material gains or losses were incurred by the Company on dissolution of the subsidiary.

A new subsidiary, Guangzhou Air Cargo Company Limited, was established in 2004.

Details of the Company's principal subsidiaries are set out in Note 37.

Notes to the Financial Statements (Cont'd)

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

13 INTEREST IN ASSOCIATES

	The Group		The Company	
	2004	2003	**2004**	2003
	RMB million	RMB million	**RMB million**	RMB million
Share of attributable net assets other than goodwill	**429**	422	**–**	–
Unlisted capital contributions, at cost	**–**	–	**357**	348
Impairment loss for investment in an associate	**–**	–	**(61)**	(61)
	429	422	**296**	287

Details of the Group's principal associates are set out in Note 38.

14 INTEREST IN JOINTLY CONTROLLED ENTITIES

	The Group		The Company	
	2004	2003	**2004**	2003
	RMB million	RMB million	**RMB million**	RMB million
Share of attributable net assets other than goodwill	**782**	731	**–**	–
Unlisted capital contributions, at cost	**–**	–	**636**	564
	782	731	**636**	564

Details of the Company's principal jointly controlled entities are set out in Note 38.

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

	2004	2003
	RMB million	RMB million
Non-current assets	**845**	606
Current assets	**794**	619
Non-current liabilities	**(389)**	(236)
Current liabilities	**(468)**	(258)
Net assets	**782**	731
Income	**762**	486
Expenses	**(767)**	(525)
Net loss	**(5)**	(39)

15 OTHER INVESTMENTS

	The Group		The Company	
	2004	2003	**2004**	2003
	RMB million	RMB million	**RMB million**	RMB million
Non-current investments				
Equity securities available for sale	272	204	167	107
Current Investments				
Equity securities held for trading	523	–	502	–
Debt securities held-to-maturity	160	–	–	–
	683	–	502	–

16 DEFERRED EXPENDITURE

	The Group		The Company	
	2004	2003	**2004**	2003
	RMB million	RMB million	**RMB million**	RMB million
Custom duties and other direct costs	**19**	26	**8**	18
Lump sum housing benefits (Note 29)	**197**	223	**197**	223
Deferred loss on aircraft sale and leaseback arrangements	**100**	–	**100**	–
	316	249	**305**	241

17 DEFERRED TAX

Movements in net deferred tax (liabilities)/assets are as follows:

	The Group		The Company	
	2004	2003	**2004**	2003
	RMB million	RMB million	**RMB million**	RMB million
Balance at 1 January,	**(398)**	(779)	**(90)**	(507)
Credited/(charged) to income statement (Note 7)				
– current year	**111**	(11)	**141**	25
– adjustment for change in income tax rate	**–**	392	**–**	392
Balance at 31 December,	**(287)**	(398)	**51**	(90)

Notes to the Financial Statements (Cont'd)

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

17 DEFERRED TAX (cont'd)

The net deferred tax (liabilities)/assets at 31 December, 2004 were made up of the following tax effects:

	The Group		The Company	
	2004 RMB million	2003 RMB million	2004 RMB million	2003 RMB million
Deferred tax assets:				
Tax losses	39	223	39	223
Repairs and maintenance accruals	129	88	125	93
Repair charges capitalised	254	261	195	199
Accrued expenses	146	19	146	19
Other	21	9	20	11
Total deferred tax assets	589	600	525	545
Deferred tax liabilities:				
Repairs and maintenance accruals	75	81	–	–
Depreciation of property, plant and equipment	752	848	459	591
Other	49	69	15	44
Total deferred tax liabilities	876	998	474	635
Net deferred tax (liabilities)/assets	(287)	(398)	51	(90)

18 INVENTORIES

	The Group		The Company	
	2004 RMB million	2003 RMB million	2004 RMB million	2003 RMB million
Expendable spare parts and maintenance materials	1,175	486	904	183
Other supplies	127	58	95	30
	1,302	544	999	213

No significant amount of inventories was carried at net realisable value at 31 December, 2003 and 2004.

19 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 provision for doubtful accounts, is set out below:

	The Group		The Company	
	2004 RMB million	2003 RMB million	**2004 RMB million**	2003 RMB million
Within 1 month	**998**	589	**863**	446
More than 1 month but less than 3 months	**163**	236	**133**	228
More than 3 months but less than 12 months	**42**	9	**39**	9
	1,203	834	**1,035**	683

As at 31 December, 2004, the Group and the Company had an amount due from a fellow subsidiary of RMB52 million (2003: RMB54 million) which was included in trade receivables.

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

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 associate 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, 2004 were simultaneously placed with several designated major PRC banks by SA Finance. As at 31 December, 2004, the Group's and the Company's deposits with SA Finance amounted to RMB406 million and RMB362 million respectively (2003: RMB366 million and RMB346 million respectively).

Notes to the Financial Statements (Cont'd)

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

21 BANK AND OTHER LOANS

	The Group		The Company	
	2004	2003	**2004**	2003
	RMB million	RMB million	**RMB million**	RMB million
Bank loans due:				
Within one year	**11,518**	7,097	**10,161**	5,959
In the second year	**1,626**	646	**1,476**	401
In the third to fifth year, inclusive	**6,422**	1,224	**5,283**	826
After the fifth year	**3,887**	2,649	**3,781**	2,443
	23,453	11,616	**20,701**	9,629
Other loans due:				
In the second year	**–**	3	**–**	–
	23,453	11,619	**20,701**	9,629
Portion classified as current liabilities	**(11,518)**	(7,097)	**(10,161)**	(5,959)
	11,935	4,522	**10,540**	3,670

As at 31 December, 2004, bank loans of the Group and the Company totalling RMB8,620 million and RMB7,783 million respectively (2003: RMB4,902 million and RMB3,823 million respectively) were secured by mortgages over certain of the Group's and the Company's aircraft with carrying amount of RMB11,927 million and RMB10,179 million respectively (2003: RMB6,718 million and RMB4,938 million respectively).

As at 31 December, 2004, loans to the Group and the Company from SA Finance amounted to RMB256 million and RMB76 million respectively (2003: RMB120 million and RMB 120 million respectively).

As at 31 December, 2004, certain bank loans were guaranteed by the following parties:

	The Group		The Company	
	2004	2003	**2004**	2003
	RMB million	RMB million	**RMB million**	RMB million
Industrial Commercial Bank of China	**149**	–	**149**	–
Export-Import Bank of the United States	**1,732**	2,208	**969**	1,236
Bank of China	**291**	357	**53**	262
CSAHC	**2,452**	359	**1,812**	229
Guangzhou Baiyun International Airport Company Limited	**–**	63	**–**	–
Shenzhen Yingshun Investment Development Company Limited	**–**	21	**–**	–
SA Finance	**9**	10	**–**	–
	4,633	3,018	**2,983**	1,727

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 rates and final maturity

	The Group		The Company	
	2004 RMB million	2003 RMB million	**2004 RMB million**	2003 RMB million
(i) Renminbi denominated loans				
Fixed interest rates ranging from 4.80% to 6.03% per annum as at 31 December, 2004, with maturities through 2009.	**1,628**	–	**135**	–
Non-interest bearing loan from a municipal government authority, repayable in 2005.	**3**	3	**–**	–
Floating interest rates ranging from 4.94% to 5.76% per annum as at 31 December, 2004, with maturities through 2014.	**1,217**	76	**1,217**	–
(ii) US dollars denominated loans				
Floating interest rates ranging from 3 months LIBOR+0.65% to 0.9% per annum as at 31 December, 2004, with maturities through 2011.	**1,426**	–	**1,426**	–
Floating interest rates ranging from 6 months LIBOR+0.3% to 1.2% per annum as at 31 December, 2004, with maturities through 2014.	**6,578**	2,505	**6,578**	2,505
Fixed interest rates ranging from 2.18% to 8.35% per annum as at 31 December, 2004, with maturities through 2011.	**2,676**	2,626	**2,326**	1,546
	13,528	5,210	**11,682**	4,051
Less: Loans due within one year classified as current liabilities	**(1,593)**	(688)	**(1,142)**	(381)
	11,935	4,522	**10,540**	3,670

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, 2004, bank and other loans of the Group and the Company included short-term bank loans totalling RMB9,925 million and RMB9,019 million respectively (2003: RMB6,409 million and RMB5,578 million respectively). On such date, the Group's and the Company's weighted average interest rate on short-term borrowings were 1.60% and 1.56% per annum respectively (2003: 1.76% and 1.65% per annum respectively).

As at 31 December, 2004, the Group had banking facilities with several PRC commercial banks for providing loan finance up to an approximate amount of RMB35,750 million (2003: RMB9,860 million). As at 31 December, 2004, an approximate amount of RMB11,525 million (2003: RMB4,412 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 2005 to 2013. As at 31 December, 2004, future payments under these finance leases, which were 67% and 33% respectively (2003: 74% and 26% respectively) denominated in United States dollars and Japanese yen, are as follows:

	The Group and the Company					
	2004			2003		
	Obligations RMB million	Payments RMB million	Interest RMB million	Obligations RMB million	Payments RMB million	Interest RMB million
Balance due:						
Within one year	**2,144**	**2,580**	**436**	1,298	1,648	350
In the second year	**2,863**	**3,213**	**350**	1,066	1,357	291
In the third to fifth year, inclusive	**6,044**	**6,540**	**496**	3,909	4,348	439
After the fifth year	**692**	**722**	**30**	568	608	40
	11,743	**13,055**	**1,312**	6,841	7,961	1,120
Less: Balance due within one year classified as current liabilities	**(2,144)**			(1,298)		
	9,599			5,543		

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 Company's 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.

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, 2004, certain of the Group's and the Company's aircraft with carrying amount of RMB11,635 million (2003: RMB7,858 million) were mortgaged to secure facilities with financial institutions granted to lessors totalling RMB11,743 million (2003: RMB6,841 million).

23 AMOUNTS DUE TO RELATED COMPANIES

Amounts due to related companies, which represent balances with CSAHC and its affiliates, and the Group's associates and jointly controlled entities, are unsecured, interest free and repayable within one year (Note 28).

24 TRADE PAYABLES

An ageing analysis of trade payables is set out below:

	The Group		The Company	
	2004 RMB million	2003 RMB million	2004 RMB million	2003 RMB million
Due within 1 month or on demand	599	279	505	207
Due after 1 month but within 3 months	430	278	370	231
Due after 3 months but within 6 months	525	371	445	308
	1,554	928	1,320	746

As at 31 December, 2004, the Group and the Company had an amount due to a fellow subsidiary of RMB838 million (2003: RMB693 million) which was included in trade payables.

All of the trade payables are expected to be settled within one year.

Notes to the Financial Statements (Cont'd)

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

25 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	
	2004	2003	**2004**	2003
	RMB million	RMB million	**RMB million**	RMB million
Balance at 1 January,	**200**	194	**131**	63
Provision for the year	**89**	68	**47**	68
Through the CNA/XJA Acquisitions	**70**	–	**70**	–
Amount utilised	**–**	(62)	**–**	–
Balance at 31 December,	**359**	200	**248**	131
Less: Current portion included in accrued expenses	**(75)**	(11)	**(62)**	–
	284	189	**186**	131

26 SHARE CAPITAL

	2004	2003
	RMB million	RMB million
Registered capital:		
2,200,000,000 domestic shares of RMB 1.00 each	**2,200**	2,200
1,174,178,000 H shares of RMB 1.00 each	**1,174**	1,174
1,000,000,000 A shares of RMB 1.00 each	**1,000**	1,000
	4,374	4,374
Issued and paid up capital:		
2,200,000,000 domestic shares of RMB 1.00 each	**2,200**	2,200
1,174,178,000 H shares of RMB 1.00 each	**1,174**	1,174
1,000,000,000 A shares of RMB 1.00 each	**1,000**	1,000
	4,374	4,374

In July 2003, the Company issued 1,000,000,000 A shares with a par value of RMB1.00 each at an 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 million, amounted to RMB1,641 million 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)

27 RESERVES

	Note	The Group 2004 RMB million	The Group 2003 RMB million	The Company 2004 RMB million	The Company 2003 RMB million
Share premium					
Balance at 1 January		**5,325**	3,684	**5,325**	3,684
Share premium from issuance of shares, net of related issuance costs		**–**	1,641	**–**	1,641
Balance at 31 December		**5,325**	5,325	**5,325**	5,325
Statutory surplus reserve	(a)				
Balance at 1 January		**361**	337	**339**	338
Transfer from income statement		**41**	24	**10**	1
Balance at 31 December		**402**	361	**349**	339
Statutory public welfare fund	(b)				
Balance at 1 January		**173**	172	**172**	171
Transfer from income statement		**20**	1	**5**	1
Balance at 31 December		**193**	173	**177**	172
Discretionary surplus reserve	(c)				
Balance at 1 January and 31 December		**77**	77	**77**	77
Retained earnings					
Balance at 1 January		**1,586**	1,969	**(138)**	446
Loss for the year		**(48)**	(358)	**(169)**	(581)
Appropriations to reserves		**(61)**	(25)	**(15)**	(3)
Balance at 31 December		**1,477**	1,586	**(322)**	(138)
Total		**7,474**	7,522	**5,606**	5,775

Notes to the Financial Statements (Cont'd)
(Prepared under International Financial Reporting Standards)
(Expressed in Renminbi)

27 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% and 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 fund must be made before distribution of a dividend to shareholders.

(c) The usage of this reserve is similar to that of statutory surplus reserve.

(d) 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 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, 2004 the Company did not have any distributable reserves (2003: Nil).

Notes to the Financial Statements (Cont'd)

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

28 RELATED PARTY TRANSACTIONS

The Group obtained various operational and financial services provided by CSAHC and its affiliates, and the Group's associates and jointly controlled entities during the normal course of its business.

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 associates and jointly controlled entities during the year:

	Note	2004 RMB million	2003 RMB million
Expenses			
Paid to CSAHC and its affiliates			
Handling charges	(a)	33	27
Wet lease rentals	(b)	–	36
Sundry aviation supplies	(c)	66	43
Commission expense	(d)	2	5
Air catering expense	(e)	50	28
Housing benefits	(f)	85	85
Lease charges for land and buildings	(g)	18	15
Paid to associates and jointly controlled entities			
Repairing charges	(h)	1,159	693
Flight simulation service charges	(i)	100	101
Interest expense	(j)	3	–
Income			
Received from associates and jointly controlled entities			
Interest income	(k)	4	3
Rental income	(l)	34	34
Others			
Short term advances from CSAHC	(m)	–	166
Refund of medical benefit payments	(n)	–	58
CNA/XJA Acquisitions	(o)	15,522	–

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 in 2003 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 from October 2002. The wet lease agreement was terminated in April 2003.

Notes to the Financial Statements (Cont'd)

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

28 RELATED PARTY TRANSACTIONS (cont'd)

Notes: (cont'd)

(c) 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.

(d) 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.

(e) 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.

(f) 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 29).

(g) Charges were paid to CSAHC under certain lease agreements in respect of certain land and buildings in the PRC (Note 10(c)).

(h) 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.

(i) Flight simulation service charges represent fees incurred by the Group in connection with flight simulation services provided by Zhuhai Xiang Yi Aviation Technology Company Limited ("Zhuhai Xiang Yi"), a jointly controlled entity of the Company.

(j) Interest expense represents interest paid to loans from SA Finance. The applicable interest rate in determined in accordance with borrowing rate published by the PRC (Note 21).

(k) 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 PRC (Note 20).

(l) Rental income represents rental received under certain operating lease agreements where the Company leases certain flight training facilities and buildings to Zhuhai Xiang Yi (Note 10(f)).

(m) During 2003, CSAHC made short term advances to the Group. These advances were unsecured, interest free and fully repaid in 2004.

(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 agreement.

(o) As disclosed in Note 1 to the financial statements, on 31 December, 2004 the Company acquired the airline operations and certain related assets of CNA and XJA at a total consideration of RMB15,522 million, which was partly satisfied by assumption of debts and liabilities of CNA and XJA totalling RMB13,563 million outstanding as at that date. The remaining consideration payable of RMB1,959 million will be satisfied in cash.

28 RELATED PARTY TRANSACTIONS (cont'd)

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.

29 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 20% (2003: 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 income statement as and when incurred.

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 million to CSAHC for a ten-year period effective 1 January, 1995.

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. 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 income statement. As at 31 December, 2004, the Group already made payments totalling RMB191 million (2003: RMB130 million) under the scheme and recorded its remaining contractual liabilities totalling RMB69 million (2003: RMB130 million) as accrued expenses on its balance sheet. Housing allowances are payable when applications are received from eligible employees.

Notes to the Financial Statements (Cont'd)

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

30 COMMITMENTS

(a) Capital commitments

As at 31 December, 2004, the Group and the Company had capital commitments as follows:

	The Group		The Company	
	2004	2003	**2004**	2003
	RMB million	RMB million	**RMB million**	RMB million
Commitments in respect of aircraft and related equipment (Note)				
– authorised and contracted for	**11,776**	10,615	**10,121**	7,739
– authorised but not contracted for	**13,571**	–	**13,571**	–
	25,347	10,615	**23,692**	7,739
Commitments in respect of investments in the Guangzhou new airport				
– authorised and contracted for	**110**	617	**110**	617
– authorised but not contracted for	**714**	1,455	**714**	1,455
	824	2,072	**824**	2,072
Other commitments				
– authorised and contracted for	**132**	233	**117**	30
– authorised but not contracted for	**568**	708	**200**	229
	700	941	**317**	259
	26,871	13,628	**24,833**	10,070

30 COMMITMENTS (cont'd)

(a) Capital commitments (cont'd)

Note:

As at 31 December, 2004, the Group had on order five Boeing 737-700 aircraft, six Airbus 319-100 aircraft, fifteen Airbus 320-200 aircraft, two Airbus 321-200 aircraft, four Airbus 330-200 aircraft, one Embraer ERJ-145 aircraft and certain flight equipment, scheduled for deliveries in 2005 to 2007. Deposits of RMB4,640 million have been made towards the purchase of these aircraft and related equipment. As at 31 December, 2004, 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	
	2004	2003	**2004**	2003
	RMB million	RMB million	**RMB million**	RMB million
Year ended/ending 31 December				
2004	**–**	4,585	**–**	3,249
2005	**8,748**	6,030	**7,093**	4,490
2006	**2,996**	–	**2,996**	–
2007	**32**	–	**32**	–
	11,776	10,615	**10,121**	7,739

As at 31 December, 2004, the Group's and the Company's attributable share of the capital commitments of jointly controlled entities was as follows:

	2004	2003
	RMB million	RMB million
Authorised and contracted for	**–**	24
Authorised but not contracted for	**156**	284
	156	308

Notes to the Financial Statements (Cont'd)

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

30 COMMITMENTS (cont'd)

(b) Operating lease commitments

As at 31 December, 2004, commitments under non-cancellable aircraft and flight equipment operating leases were as follows:

	The Group		The Company	
	2004	2003	**2004**	2003
	RMB million	RMB million	**RMB million**	RMB million
Payments due				
Within one year	**1,761**	1,483	**1,488**	1,194
In the second to fifth year, inclusive	**9,207**	4,248	**8,602**	3,579
After the fifth year	**1,782**	2,389	**1,761**	2,278
	12,750	8,120	**11,851**	7,051

(c) Investing commitments

At 31 December, 2004, the Group and the Company committed to make capital contributions in respect of:

	2004	2003
	RMB million	RMB million
Subsidiaries	**181**	–
Jointly controlled entities	**83**	446
	264	446

31 CONTINGENT LIABILITIES

(a) Pursuant to the Reorganisation of CSAHC effected in 1995 (Note 1), the Company assumed the airline and airline-related businesses together with the relevant assets and liabilities from CSAHC. 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.

31 CONTINGENT LIABILITIES (cont'd)

(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.

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 their uses 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 involved in a civil litigation (Hong Kong High Court Action No. 515 of 2001) ("Litigation") which commenced in 2003. According to the writ of summons for the Litigation, New Link Consultants Limited, the plaintiff claimed unspecified damages against the Group (as one of the defendants to the Litigation) for breach of the agreement 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 should have 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. Based on the opinion given by the Company's legal advisors, the directors of the Company consider that the Company has a valid defence against the claim and that a provision for such claim and/or the associated legal costs is not required.

32 FINANCIAL INSTRUMENTS

Financial assets of the Group include cash and cash equivalents, trade receivables, other receivables and short-term investments. Financial liabilities of the Group include bank and other loans, amounts due to related companies, trade payables, bills payable, other liabilities and taxes payable.

Liquidity risk

As at 31 December, 2004, the Group's net current liabilities amounted to RMB18,855 million (2003: RMB10,792 million). For the year ended 31 December, 2004, the Group recorded a net cash inflow from operating activities of RMB3,596 million (2003: RMB2,129 million), a net cash outflow from investing activities and financing activities of RMB2,593 million (2003: RMB3,819 million) and an increase in cash and cash equivalents of RMB1,003 million (2003: decrease of RMB1,690 million).

Notes to the Financial Statements (Cont'd)

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

32 FINANCIAL INSTRUMENTS (cont'd)

Liquidity risk (cont'd)

In 2005 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. The Group has obtained firm commitments from its principal bankers to renew its short-term bank loans outstanding at 31 December, 2004 when they fall due during 2005. In relation 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 RMB24,225 million during 2005 and thereafter. The directors of the Company believe that such financing will be available to the Group.

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, 2005. 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 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.

32 FINANCIAL INSTRUMENTS (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, 2004, the balance due from BSP agents amounted to RMB411 million (2003: RMB446 million).

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, 2003 and 2004 are set out below:

	2004		2003	
	Carrying amount RMB million	Fair value RMB million	Carrying amount RMB million	Fair value RMB million
The Group				
Cash and cash equivalents	3,083	3,083	2,080	2,080
Trade receivables	1,203	1,203	834	834
Other receivables	616	616	296	296
Short-term investments	683	683	–	–
Bank and other loans	23,453	23,665	11,619	11,907
Amounts due to related companies	2,330	2,330	929	929
Trade payables	1,554	1,554	928	928
Bills payable	136	136	438	438
Other liabilities	2,974	2,974	1,020	1,020
Taxes payable	39	39	90	90

Notes to the Financial Statements (Cont'd)

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

32 FINANCIAL INSTRUMENTS (cont'd)

Fair value (cont'd)

	2004		2003	
	Carrying amount RMB million	Fair value RMB million	Carrying amount RMB million	Fair value RMB million
The Company				
Cash and cash equivalents	2,302	2,302	1,405	1,405
Trade receivables	1,035	1,035	683	683
Other receivables	391	391	222	222
Short-term investments	502	502	–	–
Bank and other loans	20,701	20,862	9,629	9,837
Amounts due to related companies	2,278	2,278	871	871
Trade payables	1,320	1,320	746	746
Bills payable	136	136	438	438
Other liabilities	2,467	2,467	854	854
Taxes payable	–	–	48	48

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, short-term investments, amounts due to related companies, trade payables, bills payable, other liabilities and taxes payable*

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.

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.

Notes to the Financial Statements (Cont'd)

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

33 SEGMENTAL INFORMATION

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.

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

	Domestic RMB million	**Hong Kong regional** RMB million	***International** RMB million	**Total** RMB million
2004				
Traffic revenue	**17,742**	**1,180**	**4,422**	**23,344**
Other operating revenue	**630**	**–**	**–**	**630**
Turnover	**18,372**	**1,180**	**4,422**	**23,974**
Operating profit	**650**	**67**	**192**	**909**
2003				
Traffic revenue	13,087	808	3,070	16,965
Other operating revenue	436	–	69	505
Turnover	13,523	808	3,139	17,470
Operating profit/(loss)	440	(29)	45	456

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

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)

34 RECONCILIATION AND SUPPLEMENTARY STATEMENT OF CASH FLOW INFORMATION

(a) The reconciliation of profit/(loss) before taxation and minority interests to cash inflows from operations is as follows:

	2004 RMB million	2003 RMB million
Profit/(loss) before taxation and minority interests	233	(511)
Depreciation and amortisation of property, plant and equipment	2,363	1,998
Other amortisation	50	40
Amortisation of deferred credits	(4)	(2)
Share of associates' results	(12)	(48)
Share of jointly controlled entities' results	5	39
Loss on disposal of property, plant and equipment	1	22
Interest income	(22)	(13)
Interest expense	725	824
Net realised and unrealised gain on equity securities held for trading	(15)	–
Unrealised exchange loss, net	42	177
(Increase)/decrease in inventories	(29)	2
Increase in trade receivables	(218)	(162)
(Increase)/decrease in other receivables	(166)	77
Increase in prepaid expenses and other assets	(31)	(6)
Increase in deferred expenditure	(2)	–
(Decrease)/increase in amounts due to related companies	(586)	404
Increase in trade payables	344	396
Decrease in bills payable	(374)	(862)
Increase in sales in advance of carriage	408	76
Increase in accrued expenses	507	203
Increase in other liabilities	1,223	373
Increase in provision for major overhauls	113	48
Cash inflows from operations	4,555	3,075

Notes to the Financial Statements (Cont'd)

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

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

(b) Effect of the CNA/XJA Acquisitions

	2004 RMB million
Assets acquired:	
Property, plant and equipment	12,980
Cash and cash equivalents	398
Trade receivables	314
Inventories	729
Other	1,101
	15,522
Liabilities assumed:	
Bank and other loans	4,587
Obligations under finance leases	6,125
Trade payables	343
Accrued expenses	1,475
Other	1,033
	13,563
Net identifiable assets and liabilities	1,959
Cash consideration payable and not yet settled	1,959
Net cash inflow from acquisitions – cash and cash equivalents acquired	398

35 ULTIMATE HOLDING COMPANY

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

36 SUBSEQUENT EVENTS

In January 2005, the Company, as a lessee, entered into an agreement with an independent lessor for operating leases of nine Boeing 737-800 aircraft for a term of seven years with total future lease payments totalling approximately RMB1,721 million, scheduled for deliveries in 2005 and 2006.

In January 2005, China Aviation Supplies Import and Export Corporation, as a sole importing agent, entered into, on behalf of several PRC airlines including the Group, a general purchase agreement with the Boeing Company for the import of Boeing B7E7 aircraft. The Company, being one of the ultimate users for thirteen of the Boeing B7E7 aircraft, endorsed the general purchase agreement. The Company is currently in negotiation with the Boeing Company regarding the purchase agreements on such aircraft.

Notes to the Financial Statements (Cont'd)

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

36 SUBSEQUENT EVENTS (cont'd)

In March 2005, the Company, as a lessee, entered into another agreement with an independent lessor for operating leases of a total of twenty-five aircraft comprising five Boeing 737-700 aircraft, five Boeing 737-800 aircraft, five Airbus 320-200 aircraft and ten Airbus 321-200 aircraft with scheduled deliveries in 2006 and 2007. The term of the lease ranges from ten to twelve years with total future lease payments totalling approximately RMB8,243 million.

In April 2005, the Company entered into a purchase agreement with Airbus SNC for the purchase of five Airbus A380 aircraft, scheduled for deliveries in 2007 to 2010.

37 SUBSIDIARIES

The particulars of the Company's principal subsidiaries at 31 December, 2004 are as follows:

Name of company	Place and date of establishment/ operation	Attributable equity interest Direct %	Attributable equity interest Indirect %	Issued/ registered capital#	Principal activities
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	–	700,000,000	Airline
Guizhou Airlines Company Limited (a)	PRC 12 November, 1991	60	–	80,000,000	Airline
Guangzhou Air Cargo Company Limited (a)	PRC 31 March, 2004	70	–	238,000,000	Cargo services
Guangzhou Baiyun International Logistic Company Ltd (a)	PRC 23 July, 2002	61	–	20,000,000	Logistics operations
Guangzhou Nanland Air Catering Company Limited (b)	PRC 21 November, 1989	51	–	55,980,000	Air catering
China Northern Airlines Aircraft Maintenance Co., Ltd (a)	PRC 8 November, 1997	75	–	US$3,800,000	Aircraft repair and maintenance services

Notes to the Financial Statements (Cont'd)

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

37 SUBSIDIARIES (cont'd)

Name of company	Place and date of establishment/ operation	Attributable equity interest Direct %	Attributable equity interest Indirect %	Issued/ registered capital#	Principal activities
Xinjiang Aviation Ground Service Company Ltd (a)	PRC 27 May, 2002	60	–	15,000,000	Airport ground services
China Southern West Australian Flying College Pty Limited	Australia 26 January, 1971	65	–	A$100,000	Pilot training services
Xinjiang Civil Aviation Property Management Limited (a)	PRC 12 December, 2002	51.8	–	251,332,832	Utility service
Guangzhou Aviation Hotel (a)	PRC 8 January, 1997	90	–	63,290,000	Hotel operation
South China International Aviation & Travel Services Company (a)	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

Notes to the Financial Statements (Cont'd)

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

37 SUBSIDIARIES (cont'd)

Name of company	Place and date of establishment/ operation	Attributable equity interest Direct %	Indirect %	Issued/ registered capital#	Principal activities
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
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 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
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)

38 ASSOCIATES AND JOINTLY CONTROLLED ENTITIES

The particulars of the Group's principal associates and jointly controlled entities as at 31 December, 2004 are as follows:

Name of company	Place and date of establishment/ operation	Attributable equity interest Direct %	Attributable equity interest Indirect %	Issued/ registered capital#	Principal activities
Guangzhou Aircraft Maintenance Engineering Company Limited*	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	–	HK$1,000,000	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
Zhuhai Xiang Yi Aviation Technology Company Limited*	PRC 10 July, 2002	51	–	US$29,800,000	Provision of flight simulation training services
CSN-ETC e-commerce Limited*	PRC 7 October, 2002	51	–	5,880,000	Provision of internet services
Beijing Ground Service Company Limited*	PRC 1 April, 2004	50	–	18,000,000	Airport ground service support
Southern Airlines Advertising Company Limited	PRC 3 March, 1994	45	–	5,000,000	Aviation advertising

Expressed in RMB, unless otherwise stated

* These are jointly controlled entities