

Notes to the Financial Statements

(Prepared under PRC Accounting Rules and Regulations)
(Expressed in Renminbi)

1 BACKGROUND OF THE COMPANY

China Southern Airlines Company Limited (the "Company") and its subsidiary companies (collectively the "Group") are principally engaged in the provision of domestic, Hong Kong and Macau and international passenger, cargo and mail airline services.

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

Pursuant to an approval document Zheng Wei Fa 【1997】 No. 33 from the China Securities Regulatory Commission, the Company listed its 1,174,178,000 H Shares on both the Stock Exchange of Hong Kong Limited and the New York Stock Exchange in July 1997. Pursuant to an approval document 【2003】 No. 70 from the China Securities Regulatory Commission, the Company issued and listed its 1,000,000,000 A Shares with a par value of RMB1.00 each on the Shanghai Stock Exchange in July 2003.

On 13 March 2003, the Company obtained an approval certificate Wai Jing Mao Zi Yi Han 【2003】 No. 273 from the Ministry of Foreign Trade & Economic Cooperation to change to a permanent joint stock limited company with foreign investments and obtained the business license dated 17 October 2003 (Qi Gu Guo Fu Zi No. 000995) issued by the State Administration of Industry and Commerce of the PRC.

2 BASIS OF PREPARATION OF THE FINANCIAL STATEMENTS

The financial statements have been prepared on the basis that the Group will continue to operate through the next accounting period until at least 31 December 2007 as a going concern.

At 31 December 2006, the Group's net current liabilities was RMB31,734,000,000.

In 2007 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 2006 when they fall due during 2007. Up to the date of approval of these financial statements, the Group was granted banking facilities by several PRC commercial banks for providing loan finance up to approximately RMB59,978,000,000 in 2007 and years afterwards. The directors of the Company believe that sufficient 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 2007. 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. And thus the financial statements have been prepared as a going concern.

Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)
(Expressed in Renminbi)

3 PRINCIPAL ACCOUNTING POLICIES

The principal accounting policies adopted by the Group in the preparation of the financial statements are in conformity with the Accounting Standards for Business Enterprises and the "Accounting Regulations for Business Enterprises" issued by the Ministry of Finance of the PRC ("MOF"), "Accounting Method for Civil Aviation Enterprises" and other relevant regulations which are as follows:

(a) Accounting year

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

(b) Basis of Consolidation

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

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

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

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

(c) Basis of preparation and measurement basis

The financial statements have been prepared on an accrual basis. Unless otherwise stated, the measurement basis used is historical cost.

(d) Reporting currency

The Group's reporting currency is the Renminbi.

Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)
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3 PRINCIPAL ACCOUNTING POLICIES (cont'd)

(e) Translation of foreign currencies

Foreign currency transactions during the year are translated into Renminbi at the exchange rates quoted by the People's Bank of China ruling at the transaction dates. Monetary assets and liabilities denominated in foreign currencies are translated into Renminbi at the exchange rates quoted by the People's Bank of China ruling at the balance sheet date. Exchange gains and losses on foreign currency translation, except for the exchange gains and losses directly relating to the construction of fixed assets (see note 3(j)), are dealt with in the income statement.

(f) Cash equivalents

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

(g) Provision for bad and doubtful debts

The provision for bad debt losses is estimated by management based on individual accounts receivable which show signs of uncollectibility and an ageing analysis. Provision for other receivables is determined based on their specific nature and management's estimate of their collectibility.

(h) Inventories

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

Inventories are recorded using the perpetual inventory method.

Consumables are amortised in full when issued for use.

(i) Investments

(i) Short-term investments

Short-term investments are carried at the lower of cost and market value. The cost of a short-term investment is the total price paid on acquisition of the investment. However, it does not include cash dividends which have been declared but which are unpaid or unpaid interest on debentures which was due at the time of acquisition.

Provision for diminution in value is made on an item-by-item basis for any shortfall of the market value over the cost of material short-term investments. Provision for diminution in value is also made for any shortfall of the market value over the cost of other short-term investments on an aggregate basis by each category of the investments.

With the exception of cash dividends which have been declared but which are unpaid at the time of acquisition and interest on debentures which is due but not yet paid at the time of acquisition, cash dividends and interest are set off against the carrying amount of the short-term investments when received by the Company. Upon the disposal of short-term investments, the difference between the carrying amount of the short-term investments and the proceeds received is recognised as profit or loss for the current period.

Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)
(Expressed in Renminbi)

3 PRINCIPAL ACCOUNTING POLICIES (cont'd)

(i) Investments (cont'd)

(ii) Long-term equity investments

Where the Company has the power to control, jointly control or exercise significant influence over an investee enterprise, the investment is accounted for under the equity method of accounting whereby the investment is initially recorded at cost and adjusted thereafter for any post acquisition change in the Company's share of the investors' equity in the investee enterprise.

Equity investment difference, which is the difference between the initial investment cost and the Company's share of investors' equity in the investee enterprise, is accounted for as follows:

- Any excess of the initial investment cost over the Company's share of the investors' equity in the investee enterprise is amortised on a straight-line basis. The amortisation period is determined according to the investment period as stipulated in the relevant agreement, or 10 years if the investment period is not specified in the agreement. The unamortised balance is included in long-term equity investments at the year end.
- If the investment was acquired before the MOF's issuance of the "Questions and Answers on Implementing Accounting Regulations for Business Enterprises and related accounting standards (II)" (Cai Kuai [2003] No. 10), any shortfall of the initial investment cost over the Company's share of the investors' equity in the investee enterprise is amortised on a straight-line basis over the investment period as stipulated in the relevant agreement, or 10 years if the investment period is not specified in the agreement. The unamortised balance is included in long-term equity investments at the year end. Such shortfalls are recognised in the "Capital surplus – reserve for equity investment" if the investment was acquired after the issuance of Cai Kuai [2003] No. 10.

Where the Group does not control, jointly control or exercise significant influence over an investee enterprise, the investment is accounted for under the cost method, stating it at the initial investment cost. Investment income is recognised once the investee enterprise declares a cash dividend or distributes profits.

Upon the disposal of long-term equity investments, the difference between the proceeds received and the carrying amount of the investments is recognised as profit or loss.

The Group makes provision for impairment losses on long-term equity investments (see note 3(n)).

(j) Fixed assets and construction in progress

Fixed assets are assets with comparatively high unit values held by the Group for use in the supply of services and administrative purposes. They are expected to be used for more than one year.

Fixed assets are stated in the balance sheet at cost or revalued amount less accumulated depreciation and impairment losses (see note 3(n)). Construction in progress is stated in the balance sheet at cost less impairment losses (see note 3(n)). The revalued amount refers to the amount adjusted to value of fixed assets based on the valuation amounts in accordance with the relevant rules and regulations.

All direct and indirect costs that are related to the construction of fixed assets and incurred before the assets are ready for their intended uses are capitalised as construction in progress. Those costs include borrowing costs (including foreign exchange differences arising from the loan principal and the related interest) on specific borrowings for the construction of the fixed assets during the construction period.

Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)
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3 PRINCIPAL ACCOUNTING POLICIES (cont'd)

(j) Fixed assets and construction in progress (cont'd)

Construction in progress is transferred to fixed assets when it is ready for its intended use. No depreciation is provided against construction in progress.

Pursuant to an approval document Cai Kuai Han 【2004】 No. 39 "Reply from MOF relating to Agreement on Selection of China Southern Airlines as Pilot Site for Fixed Assets Management of High Value Rotables" issued by the MOF, the Group accounts for high value rotables as fixed assets.

Fixed assets of the Group are depreciated using the straight-line method over their estimated useful lives. The respective annual depreciation rates for fixed assets are as follows:

	Annual depreciation rate
Owned and finance leased aircraft	4.75%-6.33%
Other flight equipment:	
– Jet engines	4.75%-6.33%
– Others, including high value rotables	6.47%-12.50%
Buildings	3.23%-4.85%
Machinery and equipment	9.70%-19.40%
Motor vehicles	16.17%

Land use rights are stated in the balance sheet at cost or revalued amount less accumulated amortisation and impairment losses (see note 3(n)), and are amortised on a straight-line basis over the period of land use rights.

(k) Leased assets

A lease can be classified as a finance lease or an operating lease. A finance lease is a lease that transfers substantially all the risks and rewards incidental to ownership of a leased asset to the lessee, whether or not the legal title to the asset is eventually transferred. An operating lease is a lease other than a finance lease.

(i) Assets acquired under finance leases

The Group's flight equipment acquired by way of finance leases are stated under fixed assets at an amount equal to the lower of their original carrying amount in the books of the legal owner (the lessor) and the present value of the minimum lease payments at the inception of the lease. Depreciation of leased assets is calculated using the straight-line method. Subsequent to the revaluation (see note 13), 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.

If there is no reasonable certainty that the Group will obtain ownership of the leased assets at the end of the lease term, the leased assets are depreciated over the shorter of the lease term or their estimated useful lives. If there is reasonable certainty that the Group will obtain ownership of the leased assets at the end of the lease term, the leased assets are depreciated over their estimated useful lives.

At the inception of the lease, the minimum lease payments are recorded as payables under finance leases. The difference between the value of the leased assets and the minimum lease payments is recognised as unrecognised finance charges under finance leases. At the year end, payables under finance leases are netted against the unrecognised finance charges under finance leases and included in long-term payables or long-term liabilities due within one year in the balance sheet.

Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)
(Expressed in Renminbi)

3 PRINCIPAL ACCOUNTING POLICIES (cont'd)

(k) Leased assets (cont'd)

(i) Assets acquired under finance leases (cont'd)

Unrecognised finance charges under finance leases are amortised using an effective interest rate method over the lease term.

The Group makes provision for impairment losses on assets acquired under finance leases (see note 3(n)).

(ii) Assets held for use in operating leases

Where the Group leases out assets under operating leases, the assets are included in the balance sheet according to their nature and are depreciated in accordance with the Group's depreciation policies, as set out in note 3(j). Impairment losses are provided for in accordance with the accounting policy set out in note 3(n). Revenue derived from operating leases is recognised in the income statement using the straight-line method over the lease term.

(iii) Operating lease charges

Rental payments under operating leases are charged as expenses on a straight-line basis over the lease term. Contingent rental payments are recognised as expenses in the accounting period in which they are incurred.

(l) Intangible assets

Intangible assets are stated in the balance sheet at cost or revalued amount less accumulated amortisation and impairment losses (see note 3(n)). The cost or revalued amount of the intangible assets is amortised on a straight-line basis over the contracted beneficial period or the effective period stipulated by law, whichever is shorter. Where the useful life is not stipulated by the contract or law, the amortisation is over a period of 10 years.

(m) Long-term deferred expenses

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

(n) Provision for impairment

The carrying amounts of assets (including long-term equity investments, fixed assets, construction in progress, lease and equipment deposits, intangible assets and other assets) are assessed regularly to determine whether their recoverable amounts have declined below their carrying amounts. Assets are tested for impairment whenever events or changes in conditions 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 amount by which the carrying amount is reduced is the impairment loss.

The recoverable amount is the greater of the net selling price and the present value of the estimated future cash flows arising from the continuous use of the asset and from the disposal of the asset at the end of its useful life.

Provision for impairment is calculated on an item by item basis and recognised as an expense in the income statement. However, when a deficit between the initial investment cost and the Group's share of the investors' equity of the investee enterprise has been credited to the capital reserve, any impairment losses for long-term equity investment are firstly set off against the difference initially recognised in the capital reserve relating to the investment and any excess impairment losses are then recognised in the income statement.

Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)
(Expressed in Renminbi)

3 PRINCIPAL ACCOUNTING POLICIES (cont'd)

(n) Provision for impairment (cont'd)

If there is an indication that there has been a change in the factors used to determine the provision for impairment and as a result the estimated recoverable amount is greater than the carrying amount of the asset, the impairment loss recognised in prior years is reversed. Reversals of impairment losses are recognised in the income statement. An impairment loss is reversed only to the extent of the asset's carrying amount that would have been determined had no impairment loss been recognised in prior years. In respect of the reversal of an impairment loss for a long-term equity investment, the reversal starts with the impairment losses that had previously been recognised in the income statement and then the impairment losses that had been charged to the capital reserve.

(o) Income tax

Income tax is recognised using the tax effect accounting method. Income tax for the year comprises current tax paid and payable and movements in deferred tax assets and liabilities.

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

Deferred tax is provided using the liability method for the differences between the accounting profits and the taxable profits arising from the timing differences in recognising income, expenses or losses between the accounting and tax regulations. When the tax rate changes or a new type of tax is levied, adjustments are made to the amounts originally recognised for the timing differences under the liability method. The current tax rates are used in arriving at the reversal amounts when the timing differences are reversed.

Deferred tax assets arising from tax losses, which are expected to be utilised against future taxable profits, are set off against the deferred tax liabilities (only for the same taxpayer within the same jurisdiction). When it is not probable that the tax benefits of deferred tax assets will be realised, the deferred tax assets are reduced to the extent that the related tax benefits are expected to be realised.

(p) Provisions and contingent liabilities

Provisions are recognised when the Group has a present obligation as a result of a past event, it is probable that an outflow of economic benefits will be required to settle the obligations and a reliable estimate can be made.

Where it is not probable that the settlement of the above obligation will cause an outflow of economic benefits, or the amount of the outflow cannot be estimated reliably, the obligation is disclosed as a contingent liability.

(q) Revenue recognition

When it is probable that the economic benefits will flow to the Group and the revenue and costs can be measured reliably, revenue is recognised in the income statement according to the following methods:

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

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3 PRINCIPAL ACCOUNTING POLICIES (cont'd)

(r) 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 in the balance sheet as prepaid expense.

(s) Borrowing costs

Borrowing costs incurred on specific borrowings for the construction of fixed assets are capitalised into the cost of the fixed assets during the construction period until the fixed assets are ready for their intended uses.

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

(t) Repair and maintenance expenses

Routine repair and maintenance expenses (including major overhaul expenses) are recognised in the income statement when incurred. In respect of aircraft held under operating leases, a provision is made over the lease term for the estimated cost of overhauls that are required to be performed on the related aircraft prior to their return to the lessors.

(u) Dividends appropriation

Cash dividends appropriated to shareholders are recognised in the income and profit appropriation statement upon approval. Cash dividends approved after the balance sheet date, but before the date on which the financial statements are authorised for issue, are disclosed in the balance sheet as a separate component under shareholders' equity.

(v) Retirement benefits

Pursuant to the relevant laws and regulations in the PRC, the Group has joined certain defined contribution retirement schemes for the employees arranged by the governmental organisations. The Group makes contributions to the retirement schemes at the applicable rates based on the employees' salaries. The contributions are charged to the income statement on an accrual basis.

(w) Frequent flyer award programmes

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

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

(x) Related parties

If the Group has the power, directly or indirectly, to control, jointly control or exercise significant influence over another party, or vice versa, or where the Group and one or more parties are subject to common control from another party, they are considered to be related parties. Related parties may be individuals or enterprises.

Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)
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4 TAXATION

(a) Major taxes applicable to the rendering of services by the Group are as follows:

Type of taxes	Tax rate	Basis of tax
Business tax	3% or 5%	Traffic revenue, ground services income and commission income. All inbound international and Hong Kong and Macau regional flights are exempted from business tax
City construction tax	7%	Business tax
Education surcharge	3%	Business tax

Pursuant to Article 5 of 【1985】 Cai Sui Zi No. 069 “Ministry of Finance’s Rules on Certain Questions on City Construction Tax Provisional Regulations” and Article 2 of 【1994】 No. 23 “State Council Supplementary Notice on Exemption of Education Surcharge”, the Company, after having becoming a foreign investment enterprise as described in Note 1, is exempted from city construction tax and education surcharge since 1 October 2003.

(b) Income tax

The income tax rate applicable to the Company is 18%. The income tax rates applicable to its branches are in the range of 15% to 33%.

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

Except for the following subsidiaries and jointly controlled entities which are entitled to a preferential income tax rate, other subsidiaries and jointly controlled entities are subject to an income tax rate of 33% according to the PRC related tax laws and regulations.

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4 TAXATION (cont'd)

(b) Income tax (cont'd)

Certain subsidiaries and jointly controlled entities of the Company have been granted with preferential tax treatments as set out below:

Name of subsidiaries	Preferential tax rate	Reasons for granting concession
Zhuhai Airlines Company Limited	15%	Operates in a special economic zone and accordingly enjoys a reduced income tax rate pursuant to documents Cai Shui Zi (86) No. 122 and Cai Shui Zi (87) No. 115.
Southern Airlines (Group) Shantou Airlines Company Limited	15%	Ditto
Xiamen Airlines Company Limited	15%	Ditto
Zhuhai Xiang Yi Aviation Technology Company Limited	15%	Ditto
Guangzhou Nanland Air Catering Company Limited	27%	Pursuant to "Rules and Regulations for Implementation of Income Tax for Foreign Investment Enterprises and Foreign Enterprises of the PRC", the applicable state income tax rate is 24% and local income tax rate is 3%.
CSN – ETC E-commerce Limited	7.5%	Pursuant to the preferential treatment as stipulated in the "PRC Corporate Income Tax Provisional Regulations" and Sui Tian Guo Shui Jiu Jian 【2007】 No.14.
Name of jointly controlled entities		
Guangzhou Aircraft Maintenance Engineering Company Limited	15%	Pursuant to Sui Guo Shui Zhi Fa 【2001】 No. 77 issued by Guangzhou Municipal State Tax Bureau, the applicable income tax rate is 15% since 2000.
MTU Maintenance Zhuhai Company Limited	15%	Pursuant to "Rules and Regulations for Implementation of Income Tax for Foreign Investment Enterprises and Foreign Enterprises of the PRC", the applicable income tax rate is 15%.

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	The Group		The Company	
	2006 RMB million	2005 RMB million	2006 RMB million	2005 RMB million
Income tax payable	129	31	77	–
Business tax payable	350	335	200	156
City construction tax payable	1	16	1	4
Value added tax payable	9	2	–	1
Others	44	18	19	19
Total	533	402	297	180

5 CASH AT BANK AND ON HAND

	The Group				The Company			
	2006		2005		2006		2005	
	Original currency million	RMB million	Original currency million	RMB million	Original currency million	RMB million	Original currency million	RMB Million
Cash on hand								
Renminbi		4		3		3		2
US Dollars	–	5	–	5	–	5	–	5
Other currencies	–	9	–	6	–	8	–	6
		18		14		16		13
Cash at bank								
Renminbi		1,465		1,927		880		1,064
US Dollars	17	129	27	215	11	86	23	184
HK Dollars	2	2	22	23	2	2	8	8
Japanese Yen	1,006	66	1,161	80	990	65	1,093	75
Singapore Dollars	1	6	2	10	1	6	2	8
Thai Bahts	9	2	53	10	9	2	40	8
Malaysian Ringgit	8	17	14	30	8	17	8	18
Euro	2	21	3	29	2	21	3	29
Korean Won	2,289	19	5,224	42	1,807	15	4,483	36
Vietnam Dong	16,000	8	36,736	18	16,000	8	36,736	18
Australian Dollars	7	43	23	135	6	36	8	45
Other currencies	–	21	–	17	–	21	–	16
		1,799		2,536		1,159		1,509
Deposits in SA Finance								
Renminbi		631		557		597		480
Other monetary funds								
Renminbi time deposit		–		23		–		–
Others		14		–		14		–
Total		2,462		3,130		1,786		2,002

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5 CASH AT BANK AND ON HAND (cont'd)

Deposits in SA Finance represent deposits with China Southern Airlines Group Finance Company Limited ("SA Finance"), a PRC authorised financial institution controlled by CSAHC and an associate of the Group (Note 47).

As at 31 December 2006, no fixed deposit was pledged to secure the Group's bank loans. (2005: a fixed deposit of RMB23 million was pledged to secure a bank loan of RMB17 million) (see Note (19)).

As at 31 December 2006, the Group's overseas bank deposits amounted to RMB185 million (2005: RMB384 million). These overseas bank deposits are not subject to any significant risk of uncollectibility.

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

	2006	2005
US Dollar	7.8087	8.0694
HK Dollar	1.0047	1.0407
Japanese Yen	0.06563	0.06857
Singapore Dollar	5.0926	4.8543
Thai Bahts	0.2203	0.1967
Malaysian Ringgit	2.177	2.177
Euro	10.2665	9.5535
Korean Won	0.0083	0.007967
Vietnam Dong	0.0005	0.0005
Australian Dollar	6.1599	5.9066

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

6 DIVIDENDS RECEIVABLE

	The Group		The Company	
	2006	2005	2006	2005
	RMB million	RMB million	RMB million	RMB million
Guangzhou Aircraft Maintenance Engineering Company Limited	–	–	33	37
Southern Airlines (Group) Shantou Airlines Company Limited	–	–	–	13
Travelsky Technology Limited	–	4	–	–
Total	–	4	33	50

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7 ACCOUNTS RECEIVABLE

	The Group		The Company	
	2006	2005	2006	2005
	RMB million	RMB million	RMB million	RMB million
Accounts receivable	1,825	1,750	1,240	1,193
Less: Provision for bad and doubtful debts	59	52	36	38
Total	1,766	1,698	1,204	1,155

The ageing analysis of accounts receivable is as follows:

The Group

	2006				2005			
	Amount	% of total accounts receivable	Bad debt provision	Rate of bad debt provision	Amount	% of total accounts receivable	Bad debt provision	Rate of bad debt provision
	RMB million	%	RMB million	%	RMB million	%	RMB million	%
Within 1 year	1,791	98.2%	27	1.5%	1,710	97.7%	17	1.0%
After 1 year but within 2 years	15	0.8%	13	86.7%	9	0.5%	7	77.8%
After 2 years but within 3 years	6	0.3%	6	100.0%	7	0.4%	5	71.4%
After 3 years	13	0.7%	13	100.0%	24	1.4%	23	95.8%
Total	1,825	100.0%	59	3.2%	1,750	100.0%	52	3.0%

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7 ACCOUNTS RECEIVABLE (cont'd)

The Company

	2006				2005			
	Amount RMB million	% of total accounts receivable %	Bad debt provision RMB million	Rate of bad debt provision %	Amount RMB million	% of total accounts receivable %	Bad debt provision RMB million	Rate of bad debt provision %
Within 1 year	1,214	97.9%	10	0.8%	1,164	97.6%	9	0.8%
After 1 year but within 2 years	10	0.8%	10	100.0%	7	0.6%	7	100.0%
After 2 years but within 3 years	6	0.5%	6	100.0%	5	0.4%	5	100.0%
After 3 years	10	0.8%	10	100.0%	17	1.4%	17	100.0%
Total	1,240	100.0%	36	2.9%	1,193	100.0%	38	3.2%

Provision for bad and doubtful debts is analysed as follows:

	The Group		The Company	
	2006 RMB million	2005 RMB million	2006 RMB million	2005 RMB million
At 1 January	52	95	38	82
Add: Charge for the year	19	7	4	1
Less: Reversal during the year	11	2	6	–
Write-off during the year	1	48	–	45
At 31 December	59	52	36	38

Except for the balances disclosed in Note 47, there was no other amount due from shareholders who hold 5% or more voting right of the Company included in the balance of accounts receivable.

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

At 31 December 2006, the Group and the Company did not have any individually significant accounts receivable balances that were aged over three years.

At 31 December 2006, total amounts of the Group's and the Company's accounts receivable from the top five parties were as follows:

	The Group		The Company	
	2006	2005	2006	2005
Amounts (RMB million)	965	909	762	693
% of total accounts receivable	52.9%	51.9%	61.5%	58.1%

Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)
(Expressed in Renminbi)

8 OTHER RECEIVABLES

	The Group		The Company	
	2006	2005	2006	2005
	RMB million	RMB million	RMB million	RMB million
Due from subsidiaries	–	–	667	704
Due from other related companies	34	15	65	30
Others	920	989	731	870
	954	1,004	1,463	1,604
Less: Provision for bad and doubtful debts	14	10	10	10
Total	940	994	1,453	1,594

Provision for bad and doubtful debts is analysed as follows:

	The Group		The Company	
	2006	2005	2006	2005
	RMB million	RMB million	RMB million	RMB million
At 1 January	10	74	10	74
Add: Charge for the year	4	–	–	–
Less: Write-off during the year	–	64	–	64
At 31 December	14	10	10	10

Ageing analysis of other receivables is as follows:

The Group

	2006				2005			
	Amount	% of total other receivables	Bad debt provision	Rate of bad debt provision	Amount	% of total other receivables	Bad debt provision	Rate of bad debt provision
	RMB million	%	RMB million	%	RMB million	%	RMB million	%
Within 1 year	392	41.1%	–	0.0%	729	72.6%	–	0.0%
After 1 year but within 2 years	393	41.2%	–	0.0%	92	9.2%	–	0.0%
After 2 years but within 3 years	83	8.7%	–	0.0%	39	3.8%	–	0.0%
After 3 years	86	9.0%	14	16.3%	144	14.4%	10	6.9%
Total	954	100.0%	14	1.5%	1,004	100.0%	10	1.0%

Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)
(Expressed in Renminbi)

8 OTHER RECEIVABLES (cont'd)

The Company

	2006				2005			
	Amount RMB million	% of total other receivables %	Bad debt provision RMB million	Rate of bad debt provision %	Amount RMB million	% of total other receivables %	Bad debt provision RMB million	Rate of bad debt provision %
Within 1 year	949	64.9%	–	0.0%	1,080	67.3%	–	0.0%
After 1 year but within 2 years	349	23.8%	–	0.0%	336	20.9%	–	0.0%
After 2 years but within 3 years	80	5.5%	–	0.0%	63	3.9%	–	0.0%
After 3 years	85	5.8%	10	11.8%	125	7.9%	10	8.0%
Total	1,463	100.0%	10	0.7%	1,604	100.0%	10	0.6%

Except for the balances disclosed in Note 47, there was no other amount due from shareholders who hold 5% or more voting right of the Company included in the balance of other receivables.

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

Other receivables of the Group and the Company at 31 December 2005 included an amount due from Zhongyuan Airlines Company Limited ("Zhongyuan Airlines") of RMB98 million, which had been fully settled by transfer of certain properties of Zhongyuan Airlines to the Company during the year.

At 31 December 2006, the Group and the Company did not have any individually significant other receivables that were aged over three years. The balances aged over 3 years mainly included deposits for operations and property leases.

At 31 December 2006, total amounts of the Group's and the Company's other receivables from the top five parties were as follows:

	The Group		The Company	
	2006	2005	2006	2005
Amounts (RMB million)	454	548	1,008	1,057
% of total other receivables	47.6%	54.6%	68.9%	65.9%

Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)
(Expressed in Renminbi)**9 PAYMENTS IN ADVANCE**

All payments in advance are aged within one year.

Except for the balances disclosed in Note 47, there was no other amount due from shareholders who hold 5% or more voting right of the Company included in the balance of payments in advance.

10 INVENTORIES

	The Group		The Company	
	2006	2005	2006	2005
	RMB million	RMB million	RMB million	RMB million
Expendable spare parts	1,797	1,590	1,394	1,200
Consumables	32	73	26	67
Aviation in-flight supplies	23	27	21	25
Others	27	45	1	13
Subtotal	1,879	1,735	1,442	1,305
Less: Provision for diminution in value of inventories	421	259	353	209
Total	1,458	1,476	1,089	1,096

Provision for diminution in value of inventories is analysed as follows:

	The Group		The Company	
	2006	2005	2006	2005
	RMB million	RMB million	RMB million	RMB million
At 1 January	259	46	209	–
Provision made during the year	162	213	144	209
At 31 December	421	259	353	209

All the above inventories are obtained through purchases.

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

	2006	2005
	RMB million	RMB million
The Group	697	721
The Company	611	596

Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)
(Expressed in Renminbi)

11 DEFERRED EXPENSES

	Notes	The Group		The Company	
		2006 RMB million	2005 RMB million	2006 RMB million	2005 RMB million
Operating lease rental	(a)	256	191	202	148
Consumables	(b)	57	101	3	–
Insurance premiums	(c)	43	40	40	36
Aviation training fee	(d)	84	–	90	104
Others		7	18	3	13
Total		447	350	338	301

Notes:

- (a) Pursuant to aircraft operating lease agreements, the Group is required to prepay one to six months' rentals to lessors. The operating lease rentals are recognised as expenses on a straight-line basis over the lease term. The balance at the year end represents the unamortised balance of the prepaid rentals.
- (b) A jointly controlled entity of the Group is principally engaged in the provision of engine repairs and maintenance services. Consumables consumed prior to the completion of the related engine repairs and maintenance are recorded as deferred expenses and charged to income statement upon the completion of the related engine repairs and maintenance services.
- (c) The Group prepays the insurance premiums to an insurance company. The prepaid insurance premiums are then amortised over the relevant period. The balance at the year end represents the unamortised balance of the prepaid insurance premiums.
- (d) The principal activity of a subsidiary of the Group is to provide aviation training services. The prepaid aviation training fees by the Company to this subsidiary and other third party aviation training services providers are initially recorded as deferred expenses and then charged to the income statement upon the provision of the related training services.

Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)
(Expressed in Renminbi)**12 LONG-TERM EQUITY INVESTMENTS****The Group**

	Investments in associates RMB million	Other investments in securities RMB million	Other equity investments RMB million	Total RMB million
At 1 January 2006	232	115	204	551
Add: Additions during the year	31	–	4	35
Adjustment under the equity accounting method	54	–	10	64
Less: Disposals during the year	–	2	1	3
Dividends received	29	–	–	29
At 31 December 2006	288	113	217	618

The Company

	Investments in subsidiaries RMB million	Investments in associates RMB million	Investments in jointly controlled entities RMB million	Other investments in securities RMB million	Other equity investments RMB million	Total RMB million
At 1 January 2006	3,413	232	615	69	108	4,437
Add: Additions during the year	12	31	–	–	–	43
Adjustment under the equity accounting method	(36)	42	85	–	10	101
Amortisation of equity investment difference	2	–	–	–	–	2
Less: Dividends received	3	29	50	–	–	82
At 31 December 2006	3,388	276	650	69	118	4,501

At 31 December 2006, no provision for impairment losses of individually significant long-term equity investments was made by the Group and the Company.

Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)
(Expressed in Renminbi)

12 LONG-TERM EQUITY INVESTMENTS (cont'd)

Assets of the Group were revalued in 1996 in connection with the Group's overseas listing. As a result, a net revaluation deficit amounting to RMB30,284,000 was reported on the Company's subsidiaries. The Company made a corresponding adjustment amounting to RMB20,498,000 to investments in subsidiaries which was recorded as equity investment difference. The difference is amortised on a straight-line basis over 10 years, which represent the estimated remaining useful lives of the revalued assets of the subsidiaries. The equity investment difference is analysed as follows:

	Equity investment difference
	RMB million
Original net amount:	20
Accumulated amortisation:	
At 1 January 2006	18
Amortisation for the year	2
At 31 December 2006	20
Unamortised balance:	
At 31 December 2006	-
At 31 December 2005	2

Details of the Group's principal associates and jointly controlled entities and the Company's principal subsidiaries are set out in Note 51.

(a) The Group

(i) Associates

As at 31 December 2006, the Group's investments in associates, which are accounted for under equity accounting method, are analysed as follows:

	SA Finance	Sichuan Airlines	Others	Total
	RMB million	(Note 1) RMB million	RMB million	RMB million
Attributable equity interest:				
Direct	21.09%	39.00%		
Indirect	12.89%	-		
Initial investment cost (At 1 January 2006)	246	137	22	405
At 1 January 2006	-	210	22	232
Add: Additions during the year	-	-	31	31
Adjustment under equity accounting method	33	8	13	54
Less: Dividends received	-	29	-	29
At 31 December 2006	33	189	66	288

Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)
(Expressed in Renminbi)**12 LONG-TERM EQUITY INVESTMENTS** (cont'd)**(a) The Group** (cont'd)*(i) Associates* (cont'd)

Note 1: The principal accounting policies of Sichuan Airlines Corporation Limited ("Sichuan Airlines") are different from the Group's principal accounting policies. The differences in accounting policies are mainly relating to maintenance expenses and finance charges on obligations under finance leases. Maintenance expenses of rotables are expensed as and when incurred in the Group's financial statements whereas such expenses were capitalised and amortised over 6 years in Sichuan Airlines' financial statements in the years prior to 2006. Starting from 1 January 2006, maintenance expenses of rotables are expensed as and when incurred in Sichuan Airlines' financial statements. Finance charges on obligations under finance leases are charged to the income statement using effective interest method in the Group's financial statements whereas such charges are amortised on a straight-line basis over the lease period in Sichuan Airlines' financial statements.

(ii) Other investment in securities

At 31 December 2006, the Group's other investments in securities, which are accounted for under cost accounting method are analysed as follows:

Name of investees	Type of security	No. of shares	Market price at year end RMB million	Percentage of equity interest held	Initial investment cost RMB million	2006 RMB million	2005 RMB million
The Company:							
CITIC Ocean Helicopter Co., Ltd	Domestic shares	23,044,066	96	4.49%	69	69	69
Subsidiaries:							
Travelsky Technology Limited	Domestic shares	21,924,500	–	2.5%	33	33	33
Bank of Communications	Domestic shares	7,480,000	–	0.016%	11	11	11
Others						–	2
Sub-total of subsidiaries						44	46
Group total						113	115

Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)
(Expressed in Renminbi)

12 LONG-TERM EQUITY INVESTMENTS (cont'd)

(b) The Company

(i) Subsidiaries

At 31 December 2006, the Company's investments in subsidiaries, which are accounted for under the equity accounting method, are analysed as follows:

	Xiamen Airlines Company Limited RMB million	Southern Airlines (Group) Shantou Airlines Company Limited RMB million	Guangxi Airlines Company Limited RMB million	Zhuhai Airlines Company Limited RMB million	Guizhou Airlines Company Limited RMB million	Other subsidiaries RMB million	Total RMB million
Attributable equity interest:							
Direct	60%	60%	100%	60%	60%		
Period of operations	–	16 years	–	20 years	–		
Initial investment cost (AT 1 January 2006)	420	168	187	150	48	809	1,782
At 1 January 2006	2,226	133	111	95	70	778	3,413
Add: Additions during the year	–	–	12	–	–	–	12
Adjustment under equity accounting method	31	10	(100)	40	(21)	4	(36)
Amortisation of equity investment difference	4	–	(2)	3	–	(3)	2
Less: Dividends received	–	3	–	–	–	–	3
At 31 December 2006	2,261	140	21	138	49	779	3,388

Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)
(Expressed in Renminbi)**12 LONG-TERM EQUITY INVESTMENTS** (cont'd)**(b) The Company** (cont'd)*(ii) Associates*

At 31 December 2006, the Company's investments in associates, which are accounted for under the equity accounting method, are analysed as follows:

	SA Finance RMB million	Sichuan Airlines (Note 1) RMB million	Others RMB million	Total RMB million
Attributable equity interest:				
Direct	21.09%	39.00%		
Initial investment cost (At 1 January 2006)	127	137	22	286
At 1 January 2006	–	210	22	232
Add: Additions during the year	–	–	31	31
Adjustment under equity accounting method	21	8	13	42
Less: Dividends received	–	29	–	29
At 31 December 2006	21	189	66	276

Note 1: The principal accounting policies of Sichuan Airlines are different from the Company's principal accounting policies. The differences in accounting policies are mainly relating to maintenance expenses and finance charges on obligations under finance leases. Maintenance expenses of rotables are expensed as and when incurred in the Company's financial statements whereas such expenses were capitalised and amortised over 6 years in Sichuan Airlines' financial statements in the years prior to 2006. Starting from 1 January 2006, maintenance expenses of rotables are expensed as and when incurred in Sichuan Airlines' financial statements. Finance charges on obligations under finance leases are charged to the income statement using effective interest method in the Company's financial statements whereas such charges are amortised on a straight-line basis over the lease period in Sichuan Airlines' financial statements.

Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)
(Expressed in Renminbi)

12 LONG-TERM EQUITY INVESTMENTS (cont'd)

(b) The Company (cont'd)

(iii) Jointly controlled entities

At 31 December 2006, the Company's investments in jointly controlled entities, which are accounted for under the equity accounting method, are analysed as follows:

	China Postal Airlines Limited RMB million	Guangzhou Aircraft Maintenance Engineering Company Limited RMB million	MTU Maintenance Zhuhai Co. Ltd. RMB million	Beijing Southern Airlines Ground Services Company RMB million	Total RMB million
Attributable equity interest:					
Direct	49%	50%	50%	50%	
Period of operations	15 years	40 years	30 years	16 years	
Initial investment cost (At 1 January 2006)	150	87	261	9	507
At 1 January 2006	84	382	148	1	615
Add: Adjustment under equity accounting method	(4)	50	40	(1)	85
Less: Dividend received	–	50	–	–	50
At 31 December 2006	80	382	188	–	650

Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)
(Expressed in Renminbi)**12 LONG-TERM EQUITY INVESTMENTS** (cont'd)**(c) Other equity investments of the Group and the Company**

At 31 December 2006, the Group's and the Company's other equity investments, which are accounted for under cost accounting method, are analysed as follows:

Name of investees	Investment period (years)	Initial investment cost RMB million	Percentage of equity interest held	2006 RMB million	2005 RMB million
The Company:					
Haikou Meilan Airport International Co., Ltd.	–	100	6.73%	100	100
Others				18	8
The Company total:				118	108
Subsidiaries:					
Xiamen Aviation Industrial Company Limited	–	20	10.0%	20	20
CAAC Express Ltd.	–	8	4.29%	8	8
Shantou Hua Kang Aviation Catering Co. Ltd. (Note)	–	15	100.0%	15	11
Pacific Ocean Insurance Company Ltd.	–	13	0.23%	13	13
Others				43	44
Subsidiaries total:				99	96
The Group total:				217	204

Note: Shantou Hua Kang Aviation Catering Co. Ltd. does not have significant impact on the Group's operating results. Accordingly, it is accounted for under cost method.

Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)
(Expressed in Renminbi)

12 LONG-TERM EQUITY INVESTMENTS (cont'd)

(d) Ratio of the total carrying amounts of the Group's and the Company's long-term investments to net asset

At 31 December 2006, the ratio of the total carrying amounts of the Group's and the Company's long-term equity investments to net assets are as follows:

	The Group		The Company	
	2006	2005	2006	2005
	RMB million	RMB million	RMB million	RMB million
Carrying amount of long-term equity investments	618	551	4,501	4,437
Net assets	10,074	9,951	10,074	9,951
Ratio of carrying amounts to net assets	6.1%	5.5%	44.7%	44.6%

The Group and the Company do not have significant restrictions on the realisation of investments and the remittance of investment returns.

Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)
(Expressed in Renminbi)

13 FIXED ASSETS

The Group

	Land use rights and buildings RMB million	Aircraft		Other flight equipment including rotables RMB million	Machinery equipment and motor vehicles RMB million	Total RMB million
		Owned RMB million	Held under finance leases RMB million			
Cost or valuation:						
At 1 January 2006	7,811	28,961	22,551	10,495	3,294	73,112
Additions	–	1,303	4,159	802	357	6,621
Reclassification on exercise of purchase option	–	3,273	(3,273)	–	–	–
Through the acquisition of airline assets (Note 47(c)(12))	34	39	–	41	17	131
Transfer from construction in progress	516	–	96	12	49	673
Disposals (Note a)	(780)	(477)	–	(518)	(139)	(1,914)
Reclassification	(172)	–	–	–	172	–
At 31 December 2006	7,409	33,099	23,533	10,832	3,750	78,623
Accumulated depreciation:						
At 1 January 2006	968	5,876	3,958	5,198	1,864	17,864
Charge for the year	270	1,847	1,058	967	484	4,626
Reclassification on exercise of purchase option	–	1,034	(1,034)	–	–	–
Written back on disposal	(56)	(407)	–	(414)	(123)	(1,000)
Reclassification	(41)	–	–	–	41	–
At 31 December 2006	1,141	8,350	3,982	5,751	2,266	21,490
Net book value:						
At 31 December 2006	6,268	24,749	19,551	5,081	1,484	57,133
At 31 December 2005	6,843	23,085	18,593	5,297	1,430	55,248

Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)
(Expressed in Renminbi)

13 FIXED ASSETS (cont'd)

The Company

	Land use rights and buildings RMB million	Aircraft		Other flight equipment including rotables RMB million	Machinery, equipment and motor vehicles RMB million	Total RMB million
		Owned RMB million	Held under finance leases RMB million			
Cost or valuation:						
At 1 January 2006	4,064	22,261	22,551	8,322	1,967	59,165
Additions	–	–	4,159	659	237	5,055
Reclassification on exercise of purchase option	–	3,273	(3,273)	–	–	–
Transfer from a subsidiary (Note b) Through the acquisition of airline assets (Note 47(c)(12))	147	–	–	177	63	387
Transfer from construction in progress	34	39	–	41	17	131
Disposals (Note a)	394	–	96	12	45	547
Reclassification	(685)	(477)	–	(365)	(95)	(1,622)
	(172)	–	–	–	172	–
At 31 December 2006	3,782	25,096	23,533	8,846	2,406	63,663
Accumulated depreciation:						
At 1 January 2006	502	4,413	3,958	4,176	1,133	14,182
Charge for the year	145	1,495	1,058	678	339	3,715
Reclassification on exercise of purchase option	–	1,034	(1,034)	–	–	–
Transfer from a subsidiary (Note b)	42	–	–	98	49	189
Written back on disposal	(39)	(407)	–	(201)	(85)	(732)
Reclassification	(41)	–	–	–	41	–
At 31 December 2006	609	6,535	3,982	4,751	1,477	17,354
Net book value:						
At 31 December 2006	3,173	18,561	19,551	4,095	929	46,309
At 31 December 2005	3,562	17,848	18,593	4,146	834	44,983

Note a: As agreed with certain companies having operations at Guangzhou Baiyun International Airport, certain public facilities located in the airport were reallocated among the companies. As a result, property, plant and equipment of the Group and the Company at Guangzhou Baiyun International Airport with a carrying amount of RMB539 million and RMB459 million respectively were transferred to them during the year.

Note b: During the year, certain assets and liabilities of Guangxi Airlines Company Limited ("Guangxi Airlines") were transferred to the Company in 2006.

As at 31 December 2006, no provision for the impairment losses of fixed assets was made by the Group and the Company.

Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)
(Expressed in Renminbi)**13 FIXED ASSETS** (cont'd)

As at 31 December 2006, the original cost of the fixed assets that have been fully depreciated but are still in use was RMB2,214 million and RMB1,770 million for the Group and the Company respectively (2005: RMB1,846 million and RMB1,353 million respectively).

The respective periods of land use rights range from 30 to 70 years. As at 31 December 2006, the remaining useful lives ranged from 14 years to 62 years.

As at 31 December 2006, certain aircraft, other flight equipment, buildings and machinery equipment of the Group and the Company were mortgaged under certain loan and finance lease agreements (see Note 19, Notes 27 and Note 28). The net book value of these fixed assets is analysed as follows:

	The Group		The Company	
	2006	2005	2006	2005
	RMB million	RMB million	RMB million	RMB million
Aircraft				
Mortgaged under bank loans	10,345	11,735	6,031	7,833
Mortgaged under finance leases	19,551	18,593	19,551	18,593
Sub-total	29,896	30,328	25,582	26,426
Other flight equipment				
Mortgaged under bank loans	–	238	–	–
Buildings and machinery				
Mortgaged under bank loans	476	–	–	–
Total	30,372	30,566	25,582	26,426

Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)
(Expressed in Renminbi)

13 FIXED ASSETS (cont'd)

The Company entered into two separate arrangements (the "Arrangements") with certain independent third parties during each of 2002 and 2003. Under each of the Arrangements, the Company sold an aircraft and then immediately leased back the aircraft for an agreed period. 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 2006, the net present value of the lease commitments and the corresponding defeased deposits and debt securities amounted to RMB2,272 million (2005: RMB2,376 million). As a result of the Arrangements, the Company received net cash benefits which were recognised as income in the relevant period.

As at 31 December 2006 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 Guangzhou Baiyun International Airport, in which the Group has interests and for which such certificates have not been granted. As at 31 December 2006, carrying value of such properties of the Group and the Company amounted to RMB1,586 million and RMB852 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 PRC Accounting Rules and Regulations)
(Expressed in Renminbi)

14 CONSTRUCTION IN PROGRESS

As at 31 December 2006, the construction in progress of the Group and the Company are analysed by major projects are as follows:

Project	Budget RMB million	At	Additions RMB million	Transfer to fixed assets RMB million	Transfer to intangible assets RMB million	At 31	% of progress	Source of fund
		1 January 2006 RMB million				December 2006 RMB million		
The Company								
Buyer furniture equipment and capitalised interest of pre-delivered aircraft	170	73	71	(96)	-	48	85	80% bank loan
Zhengzhou ticket selling office	49	22	-	-	-	22	45	Self-financing
Material and engineering system	39	32	1	-	-	33	84	Self-financing
Guangzhou Baiyun Airport supporting area	89	66	21	-	-	87	98	Self-financing
B777 engine upgrading project	91	2	56	(12)	-	46	64	Self-financing
Shenzhen cargo centre	65	53	12	(65)	-	-	100	Self-financing
Shenzhen office building	159	9	38	-	-	47	29	Self-financing
Beijing air terminal	162	95	67	(78)	(84)	-	100	Self-financing
Jilin Long Jia Airport	154	109	45	(154)	-	-	100	Self-financing
Dalian Warehouse	30	30	-	(30)	-	-	100	Self-financing
Alteration A300 into freighter	339	-	18	-	-	18	5	Self-financing
Shanghai Pudong base	148	1	19	-	-	20	14	Self-financing
Others	1,080	67	217	(112)	-	172	26	Self-financing
The Company total	2,575	559	565	(547)	(84)	493		
Subsidiaries								
Guangzhou Baiyun Airport cargo centre	630	2	99	(83)	-	18	97	92% bank loan
Fuzhou Chang Le airport facilities	181	37	6	(33)	-	10	95	Self-financing
Others	654	124	52	(7)	(59)	110	27	Self-financing
Subsidiaries total	1,465	163	157	(123)	(59)	138		
Jointly controlled entities	18	4	1	(3)	-	2	22	Self-financing
Group total	4,058	726	723	(673)	(143)	633		

As at 31 December 2006, no provision for the impairment losses of construction in progress was made by the Group and the Company.

Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)
(Expressed in Renminbi)

14 CONSTRUCTION IN PROGRESS (cont'd)

Borrowing costs capitalised in construction in progress of the Group and the Company were as follows:

	The Group		The Company	
	2006	2005	2006	2005
	RMB million	RMB million	RMB million	RMB million
Capitalisation rate	5.29%-5.61%	4.14%-5.27%	5.61%	4.14%-5.17%
Borrowing costs capitalised	85	98	26	84

15 LEASE AND EQUIPMENT DEPOSITS

	The Group				The Company			
	2006		2005		2006		2005	
	Original currency million	RMB million	Original currency million	RMB million	Original currency million	RMB million	Original currency million	RMB million
Advance payments for purchase of aircraft (USD)	1,087	8,692	788	6,355	967	7,751	676	5,455
Rental deposits for aircraft under operating leases (USD)	98	766	113	911	84	659	103	835
		9,458		7,266		8,410		6,290

Pursuant to aircraft purchase agreements, the Group and the Company are generally required to pay aircraft manufacturers the purchase price of aircraft in instalment prior to delivery.

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

Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)
(Expressed in Renminbi)

16 INTANGIBLE ASSETS

	The Group	The Company
	RMB million	RMB million
Cost or valuation:		
At 1 January 2006	678	426
Additions	36	31
Through the acquisition of CSAHC Hainan's assets (Note 47(12))	35	35
Transfer from construction in progress	143	84
Disposals	27	11
At 31 December 2006	865	565
Accumulated amortisation:		
At 1 January 2006	98	71
Charge for the year	45	30
Disposals	1	-
At 31 December 2006	142	101
Carrying value:		
At 31 December 2006	723	464
At 31 December 2005	580	355

The intangible assets of the Group and the Company comprise mainly land use rights and software which were all obtained through purchases from third parties.

As at 31 December 2006, remaining useful lives of the above land use rights and software ranged from 22 years to 56 years and 2 years to 10 years respectively.

As at 31 December 2006 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 in respect of certain land use rights, in which the Group has interests and for which such certificates have not been granted. As at 31 December 2006, carrying value of such land use rights of the Group and the Company amounted to RMB4,679,000. The directors of the Company are of the opinion that the use of land and the conduct of operating activities referred to above are not affected by the fact that the Group has not yet obtained the relevant land use right certificates.

Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)
(Expressed in Renminbi)

17 LONG-TERM DEFERRED EXPENSES

	The Group RMB million	The Company RMB million
Cost:		
At 1 January 2006	186	131
Additions	35	7
At 31 December 2006	221	138
Accumulated amortisation:		
At 1 January 2006	150	115
Charge for the year	47	19
At 31 December 2006	197	134
Carrying value:		
At 31 December 2006	24	4
At 31 December 2005	36	16

Long-term deferred expenses comprises mainly custom duties and other direct costs incurred in relation to introducing, modifying and certifying certain operating lease aircraft of the Group and the Company. The balance is amortised on a straight-line basis over the respective lease periods of the aircraft.

At 31 December 2006, the remaining unamortised period ranged from 2 to 4 years.

18 LONG-TERM RECEIVABLES

At 31 December 2006, long-term receivables represent staff housing loans provided to staff. Pursuant to relevant agreement, the loans are interest-free and repayable within 5 years.

Long-term receivables as at 31 December 2005 represented insurance premiums deposited with a PRC insurance company. Pursuant to the relevant insurance agreement, the insurance premiums will be fully refunded to the Group upon the expiry of the agreement in 2007, therefore the balance was recorded in other receivable at end of 2006.

Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)
(Expressed in Renminbi)

19 SHORT-TERM LOANS

Details of short term loans are analysed as follows:

Note	The Group				The Company			
	2006		2005		2006		2005	
	Original currency million	RMB million	Original currency million	RMB million	Original currency million	RMB million	Original currency million	RMB million
Unsecured loans								
US Dollars	2,288	17,866	1,511	12,193	2,220	17,334	1,435	11,579
Hong Kong Dollars	1,640	1,648	1,821	1,895	1,640	1,648	1,640	1,707
Renminbi		437		25		-		-
Sub-total		19,951		14,113		18,982		13,286
Guaranteed loans (a)								
US Dollars	6	48	6	48		-		-
Renminbi		90		300		-		-
Sub-total		138		348		-		-
Secured loans (b)								
Renminbi		-		17		-		-
Sub-total		-		17		-		-
Pledged and guaranteed loans (c)								
US Dollars	4	27	-	-	-	-	-	-
Renminbi		20		-		-		-
Sub-total		47		-		-		-
Total		20,136		14,478		18,982		13,286

Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)
(Expressed in Renminbi)

19 SHORT-TERM LOANS (cont'd)

(a) The loans of the Group were guaranteed by the following parties:

	The Group	
	2006	2005
	RMB million	RMB million
CSAHC	127	348
Bank of China	10	–
Industrial Bank Co., Ltd.	48	–
	185	348

(b) At 31 December 2005, the loan was secured by a fixed deposit of the Group.

(c) The pledged and guaranteed loans are pledged by the Group's certain assets (Note 13) and guaranteed by CSAHC.

At 31 December 2006, the Group's and the Company's weighted average interest rates on short-term borrowings were at 5.77% and 5.78% per annum respectively (2005: both were 4.83% per annum).

At 31 December 2006, the Group and the Company had no overdue short-term loans (2005: Nil).

There was no short-term loan payable to shareholders who hold 5% or more of the voting rights of the Company.

20 BILLS PAYABLE

The Group and the Company

	2006		2005	
	RMB million	%	RMB million	%
Commercial acceptance bills	–	–	896	100%

At 31 December 2005, all of the bills payables were expected to be settled within one year. There were no bills payable to shareholders who hold 5% or more of the voting rights of the Company.

21 ACCOUNTS PAYABLE

Except as disclosed in Note 47, there was no balance of accounts payable to shareholders who hold 5% or more of the voting rights of the Company.

At 31 December 2006, the Group and the Company did not have any individually significant accounts payable that were aged over three years.

22 SALES IN ADVANCE OF CARRIAGE

Sales in advance of carriage represent the proceeds from sales of air tickets in advance of carriage received by the Group and the Company. At 31 December 2006, the Group and the Company did not have any individually significant sales in advance of carriage balances that were aged over three years.

Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)
(Expressed in Renminbi)

23 OTHER CREDITORS

	The Group		The Company	
	2006	2005	2006	2005
	RMB million	RMB million	RMB million	RMB million
Airport construction surcharge	404	542	335	482
CAAC Infrastructure (Note 1)				
Development Fund	190	178	130	125
Education surcharges	7	11	2	5
Staff lump sum housing allowances (Note 2)	90	92	90	92
Others	2	5	1	3
	693	828	558	707

Note 1: CAAC Infrastructure development fund is analysed as follows:

	The Group		The Company	
	2006	2005	2006	2005
	RMB million	RMB million	RMB million	RMB million
At 1 January	178	162	125	108
Add: Charge for the year	1,095	978	855	740
Less: Payment during the year	1,083	962	850	723
At 31 December	190	178	130	125

Note 2: Pursuant to Cai Kuai Zi [2001] No. 5 issued by the MOF, staff lump sum housing allowances payable to employees who joined the Company before 1998 but not yet allocated with staff housing were recorded as other creditors. These expenses were charged against retained earnings at the beginning of 2001.

Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)
(Expressed in Renminbi)

24 OTHER PAYABLES

	The Group		The Company	
	2006	2005	2006	2005
	RMB million	RMB million	RMB million	RMB million
Amount due to subsidiaries	–	–	293	51
Amount due to other related companies	172	20	168	181
Others	2,317	2,883	1,672	2,097
	2,489	2,903	2,133	2,329

Except as disclosed in Note 47, there was no payable to shareholders who hold 5% or more of the voting rights of the Company in the balance of other payables.

At 31 December 2006, the Group and the Company did not have any individually significant other payables that were aged over three years.

25 ACCRUED EXPENSES

	Note	The Group		The Company		
		2006	2005	2006	2005	
		RMB million	RMB million	RMB million	RMB million	
Custom duties and value added tax		–	12	–	12	Accrued but not paid
Landing and take-off fees	(a)	1,119	1,096	865	890	Accrued but not paid
Jet fuel costs	(a)	1,020	686	757	493	Accrued but not paid
Aircraft and engine repair charges	(a)	1,085	806	1,266	960	Accrued but not paid
Air catering expenses	(a)	153	132	153	131	Accrued but not paid
Interest expense	(b)	449	339	407	312	Accrued but not paid
Provision for major overhauls						
– current portion (Note 29)		255	151	96	123	Accrued but not paid
Seat reservation charges		66	190	–	105	Accrued but not paid
Operating lease rentals		–	86	–	86	Accrued but not paid
Property management						
and repair expenses		–	37	–	37	Accrued but not paid
Others		147	221	102	162	Accrued but not paid
Total		4,294	3,756	3,646	3,311	

Notes:

(a) Landing and take-off fees, jet fuel costs, aircraft and engine repair expenses and air catering expenses

The transaction volume and amounts involved for landing and take-off fees, jet fuel costs, aircraft and engine repair expenses and air catering expenses are significant and their settlements generally take one to three months. Accordingly, such expenses were accrued at the year end to match with the revenues.

(b) Interest expenses

Accrual for interest expense was mainly for finance lease obligations and loans in respect of aircraft purchases. The Group is generally required to repay the principal and interest amounts every three or six months. Interest expense was accrued at the year end.

Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)
(Expressed in Renminbi)

26 LONG-TERM LIABILITIES DUE WITHIN ONE YEAR

	The Group				The Company			
	2006		2005		2006		2005	
	Original currency million	RMB million	Original currency million	RMB million	Original currency million	RMB million	Original currency million	RMB million
Long-term loans due within one year (Note 27)								
Guaranteed (RMB)		52		2		–		–
Unsecured (HKD)	4	4	–	–	–	–	–	–
Unsecured (USD)	358	2,796	107	865	353	2,757	103	835
Mortgaged and guaranteed (USD)	77	602	72	582	49	386	55	440
Mortgaged and guaranteed (RMB)		–		1		–		–
Mortgaged (USD)	68	530	57	458	12	92	13	103
Sub-total		3,984		1,908		3,235		1,378
Obligations under finance leases due within one year (Note 28)								
Mortgaged and guaranteed								
– US Dollars	293	2,286	304	2,453	293	2,286	304	2,453
– Japanese Yen	11,641	764	12,825	879	11,641	764	12,825	879
Sub-total		3,050		3,332		3,050		3,332
Total		7,034		5,240		6,285		4,710

Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)
(Expressed in Renminbi)

27 LONG-TERM LOANS

The Group

Interest rate (at 31 December 2006)	2006		2005	
	Original currency million	RMB million	Original currency million	RMB million
Renminbi denominated loans:				
Non-interest bearing loan from a municipal government authority		3		3
Floating interest rates ranging from 5.10% to 5.51% per annum, with maturities through 2010		325		890
United States Dollars denominated loans:				
Fixed interest rates ranging from 4.43% to 7.48% per annum, with maturities through 2015	239	1,863	299	2,414
Floating interest rates ranging from 3-month LIBOR+0.65% to 0.99% per annum, with maturities through 2010	267	2,087	496	4,000
Floating interest rates ranging from 6-month LIBOR+0.30% to 1.20% per annum, with maturities through 2016	1,289	10,068	957	7,722
Hong Kong Dollars denominated loans:				
Floating interest rates, with maturities in 2006	–	–	9	9
Non-interest bearing loan from a minority shareholder, with maturities through 2011	19	19	–	–
		14,365		15,038
Less: long-term loans due within one year (Note 26)		3,984		1,908
		10,381		13,130

Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)
(Expressed in Renminbi)**27 LONG-TERM LOANS** (cont'd)**The Company**

Interest rate (at 31 December 2006)	2006		2005	
	Original currency million	RMB million	Original currency million	RMB million
Renminbi denominated loans: (Note 1)		–		550
United States Dollars denominated loans:				
Fixed interest rates ranging from 4.43% to 7.47% per annum, with maturities through 2015	184	1,440	227	1,835
Floating interest rates ranging from 3-month LIBOR+0.65% to 0.90% per annum, with maturities through 2009	221	1,727	241	1,946
Floating interest rates ranging from 6-month LIBOR+0.30% to 1.20% per annum, with maturities through 2013	953	7,439	931	7,511
		10,606		11,842
Less: long-term loans due within one year (Note 26)		3,235		1,378
		7,371		10,464

Note 1: The loans were fully repaid in 2006.

The borrowing terms of long-term loans of the Group and the Company are analysed as follows:

	Note	The Group		The Company	
		2006 RMB million	2005 RMB million	2006 RMB million	2005 RMB million
Unsecured loans		4,965	6,216	4,602	5,665
Guaranteed loans	(a)	377	386	216	223
Mortgaged loans	(b)	6,692	5,748	4,177	3,844
Mortgaged and guaranteed loans	(c)	2,331	2,688	1,611	2,110
		14,365	15,038	10,606	11,842

Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)
(Expressed in Renminbi)

27 LONG-TERM LOANS (cont'd)

(a) Above guaranteed loans were guaranteed by the following parties:

	The Group		The Company	
	2006	2005	2006	2005
	RMB million	RMB million	RMB million	RMB million
CSAHC	350	357	216	223
Shenzhen Yingshun Investment Development Company Limited	22	22	–	–
SA Finance	5	7	–	–
	377	386	216	223

(b) The mortgaged loans were secured by mortgages over certain of the Group's and the Company's aircraft (see Note 13).

(c) The mortgaged and guaranteed loans were secured by mortgages over certain of the Group's and the Company's aircraft, buildings and machinery (see Note 13), and were guaranteed by the following parties:

	The Group		The Company	
	2006	2005	2006	2005
	RMB million	RMB million	RMB million	RMB million
Export-Import Bank of the United States	828	1,171	404	593
Bank of China	74	155	74	155
Industrial and Commercial Bank of China	79	111	79	111
CSAHC	1,350	1,251	1,054	1,251
	2,331	2,688	1,611	2,110

The maturity analysis of the long-term loans of the Group and the Company is as follows:

	The Group		The Company	
	2006	2005	2006	2005
	RMB million	RMB million	RMB million	RMB million
Within 1 year	3,984	1,908	3,235	1,378
After 1 year but within 2 years	3,139	4,356	2,138	3,475
After 2 years but within 3 years	2,364	2,473	1,686	1,785
After 3 years	4,878	6,301	3,547	5,204
	14,365	15,038	10,606	11,842

There were no payables to shareholders who hold 5% or more of the voting rights of the Company in the balance of long-term loans.

Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)
(Expressed in Renminbi)**28 OBLIGATIONS UNDER FINANCE LEASES****The Group and the Company**

	2006	2005
	RMB million	RMB million
At 1 January	15,750	11,619
Add: Additions during the year	3,402	6,938
Less: Payments during the year	3,272	2,014
Effect due to fluctuations of foreign exchange rates	523	793
At 31 December	15,357	15,750
Less: Obligations under finance leases due within one year (Note 26)	3,050	3,332
	12,307	12,418

Certain lease financing arrangements comprised finance leases between the Company and certain of its subsidiaries, and corresponding borrowings between such subsidiaries and certain banks. The Company has guaranteed the subsidiaries' obligations under the bank borrowing arrangements and accordingly, the relevant leased assets and obligations are recorded in the Company's balance sheet as owned assets and bank loans respectively to reflect the substance of these transactions.

The Group and the Company have commitments under finance lease agreements in respect of aircraft and related equipment. These leases will expire during the years 2007 to 2017. As at 31 December 2006, the weighted average interest rates on obligations under finance leases were 5.47%, future minimum payments under these finance leases for the Group and the Company are as follows:

	2006	2005
	RMB million	RMB million
Within 1 year	3,050	3,332
After 1 year but within 2 years	2,800	2,889
After 2 years but within 3 years	1,634	2,607
After 3 years	7,873	6,922
	15,357	15,750

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

Securities, including charges over the assets concerned and relevant insurance policies, are provided to the lessors. As at 31 December 2006, certain of the Group's and the Company's aircraft were mortgaged to secure finance lease obligations as disclosed in Note 13.

Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)
(Expressed in Renminbi)

28 OBLIGATIONS UNDER FINANCE LEASES (cont'd)

Obligation under finance leases above were guaranteed by the following parties:

	2006 RMB million	2005 RMB million
Bank of China	5,088	7,186
Industrial and Commercial Bank of China	4,988	6,403
Agriculture Bank of China	1,378	1,548
Obligation under finance leases without guarantee	3,903	613
	15,357	15,750

At 31 December, currency analysis of long term payable for obligations under finance leases is as follows:

	2006		2005	
	Original currency million	RMB million	Original currency million	RMB million
US dollars	1,376	10,748	1,242	10,020
Japanese Yen	23,759	1,559	34,970	2,398
		12,307		12,418

Balance due within one year is disclosed in Note 26 to the financial statements. There was no amount due to shareholders who hold 5% or more of the voting rights of the Company included in the balance of obligations under finance leases.

29 PROVISION FOR MAJOR OVERHAULS

	The Group RMB million	The Company RMB million
At 1 January 2006	466	309
Including current portion	151	123
Add: Provision for the year	669	370
Transfer from a subsidiary (Note 1)	-	34
Less: Provision utilised during the year	75	61
At 31 December 2006	1,060	652
Less: Current portion included in accrued expenses (Note 25)	255	96
	805	556

Note 1: The assets and liabilities of Guangxi Airlines relating to aviation operation were transferred to the Company during the year.

Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)
(Expressed in Renminbi)**30 DEFERRED CREDITS****The Group**

	Gain on sales and leaseback transactions RMB million	Rebates on aircraft under operating leases RMB million	Rebates on aircraft under finance leases RMB million	Total RMB million
Cost:				
At 1 January 2006	270	116	439	825
Additions	–	–	357	357
31 December 2006	270	116	796	1,182
Accumulated amortisation:				
At 1 January 2006	110	32	28	170
Amortisation for the year	35	8	52	95
31 December 2006	145	40	80	265
Carrying value:				
At 31 December 2006	125	76	716	917
At 31 December 2005	160	84	411	655

The Company

	Gain on sales and leaseback transactions RMB million	Rebates on aircraft under operating leases RMB million	Rebates on aircraft under finance leases RMB million	Total RMB million
Cost:				
At 1 January 2006	259	116	439	814
Additions	–	–	357	357
31 December 2006	259	116	796	1,171
Accumulated amortisation:				
At 1 January 2006	109	32	28	169
Amortisation for the year	32	8	52	92
31 December 2006	141	40	80	261
Carrying value:				
At 31 December 2006	118	76	716	910
At 31 December 2005	150	84	411	645

Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)
(Expressed in Renminbi)

30 DEFERRED CREDITS (cont'd)

The gain on sales and leaseback transactions, being the surplus of the sale proceeds over the aircraft's net book value and related disposal costs, was recorded as deferred credit and amortised over the respective lease terms.

Pursuant to certain aircraft operating lease arrangements, the Company received cash rebates from the lessors. Such rebates were deferred and amortised over the terms of the respective leases.

Pursuant to certain aircraft finance lease arrangements, the Company received cash rebates from the lessors. Such rebates were deferred and amortised over the terms of the respective leases on a straight-line basis.

31 DEFERRED TAXATION

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

	The Group RMB million	The Company RMB million
At 1 January 2006	(255)	74
Add: Movements during the year (Note 45)	27	55
At 31 December 2006	(228)	129

The deferred tax assets/(liabilities) at 31 December 2006 were made up of the following tax effects:

	Notes	The Group		The Company	
		2006 RMB million	2005 RMB million	2006 RMB million	2005 RMB million
Deferred tax assets:					
Tax losses	(a)	–	159	–	159
Repairs and maintenance accruals	(b)	264	143	264	143
Rotable repair charges capitalised	(c)	203	275	203	220
Accrued expenses	(d)	130	32	130	32
Gains on sales and leaseback transactions	(e)	22	22	22	22
Others		25	20	8	6
Total deferred tax assets		644	651	627	582
Deferred tax liabilities:					
Repairs and maintenance accruals	(b)	30	54	–	–
Depreciation of fixed assets	(f)	830	832	498	508
Others		12	20	–	–
Total deferred tax liabilities		872	906	498	508
Net balance		(228)	(255)	129	74

Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)
(Expressed in Renminbi)**31 DEFERRED TAXATION** (cont'd)

	The Group		The Company	
	2006	2005	2006	2005
	RMB million	RMB million	RMB million	RMB million
Net deferred tax asset recognised on the balance sheet	142	85	129	74
Net deferred tax liability recognised on the balance sheet	(370)	(340)	–	–
	(228)	(255)	129	74

Notes:

(a) Tax losses

Pursuant to the relevant tax regulations, tax losses are available for carry forward to set off against future PRC assessable income for a maximum period of five years. The deferred tax is recognised based on the unutilised taxable losses and estimated future taxable profits.

(b) Repairs and maintenance accruals

Certain of the Group's and the Company's overhaul expenses were deductible on a cash payment basis for taxation purposes. According to the accounting policies adopted in these financial statements, overhaul expenses are expensed as and when incurred. The Group and the Company recognised the deferred tax for these timing differences.

(c) Rotables repair charges

Pursuant to the relevant tax regulations, rotables repair charges are initially capitalised and amortised over five years for taxation purposes. According to the accounting policies adopted in these financial statements, rotables repair charges are expensed when incurred. The Group and the Company recognised the deferred tax for these timing differences.

(d) Accrued expenses

Certain of the Group's and the Company's expenses are deductible on a cash payment basis for taxation purposes. In the preparation of these financial statements, these expenses are accounted for on an accrual basis. The Group and the Company recognised the deferred tax for these timing differences.

(e) Gains on sales and leaseback transactions

Pursuant to the relevant tax regulations, gains on sales and leaseback transactions are taxable in the period they arise. According to the accounting policies adopted in these financial statements, these gains are recorded as deferred credits and amortised over the terms of the leases. The Group and the Company recognised the deferred tax on these timing differences.

(f) Depreciation of fixed assets

Deferred tax was recognised for the timing difference arising from the difference between the aircraft depreciation rates for accounting purposes and the rates used for taxation purposes.

Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)
(Expressed in Renminbi)

32 SHARE CAPITAL

The Group and the Company

	2006 RMB million	2005 RMB million
Registered, issued and paid up capital:		
2,200,000,000 domestic state-owned shares of RMB1.00 each	2,200	2,200
1,174,178,000 H shares of RMB1.00 each	1,174	1,174
1,000,000,000 A shares of RMB1.00 each	1,000	1,000
	4,374	4,374

KPMG Huazhen verified the above capital contributions, and issued related capital verification reports on 31 December 1994, 10 September 1997 and 17 July 2003 respectively.

33 CAPITAL RESERVE

The Group and the Company

	2006 RMB million	2005 RMB million
Share premium		
At 1 January and 31 December	5,801	5,801
Government grants		
At 1 January	53	–
Additions	–	53
At 31 December	53	53
Others		
At 1 January	39	–
Additions	5	39
At 31 December	44	39
Total	5,898	5,893

Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)
(Expressed in Renminbi)

34 SURPLUS RESERVES

	Notes	The Group		The Company	
		2006 RMB million	2005 RMB million	2006 RMB million	2005 RMB million
Statutory surplus reserve					
At 1 January		410	402	349	349
Add: Profit appropriation	(b)	12	8	–	–
Transfer from statutory public welfare fund	(a)	198	–	177	–
At 31 December		620	410	526	349
Statutory public welfare fund					
At 1 January		198	193	177	177
Add: Profit appropriation		–	5	–	–
Less: Transfer to statutory Surplus reserve	(a)	198	–	177	–
At 31 December		–	198	–	177
Discretionary surplus reserve					
At 1 January		83	77	77	77
Add: Profit appropriation	(b)	29	6	–	–
At 31 December		112	83	77	77
Total		732	691	603	603

Notes:

- (a) According to the Article 167 of the revised PRC Company Law effective on 1 January 2006, appropriation to the statutory public welfare fund is no longer required. In accordance with "The Notice on the Accounting Treatment after the Implementation of Company Law", the balance of statutory public welfare fund for the Group and the Company amounting to RMB 198 million and RMB 177 million respectively at 31 December 2005 were transferred to statutory surplus reserve.
- (b) In accordance with the relevant regulations, appropriations to reserves were made by the profit making subsidiaries in 2006.

35 PROFIT APPROPRIATION

On 16 April 2007, the Board of Directors approved not to appropriate dividend to ordinary shareholders.

Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)
(Expressed in Renminbi)

36 SALES FROM PRINCIPAL ACTIVITIES

	The Group		The Company	
	2006	2005	2006	2005
	RMB million	RMB million	RMB million	RMB million
Passenger	42,764	35,363	33,304	27,523
Cargo and mail	3,955	3,376	3,265	2,845
Others	328	313	284	275
	47,047	39,052	36,853	30,643

Sales from principal activities represents revenue from airline business operations. The Group's segmental information is set out in Note 48.

The total amount of the Group's and the Company's sales from principal activities from the top five customers are as follows:

	The Group		The Company	
	2006	2005	2006	2005
Amounts (RMB million)	1,031	833	896	639
% of total sales from principal activities	2.2%	2.1%	2.4%	2.1%

37 COST OF SALES FROM PRINCIPAL ACTIVITIES

Cost of sales from principal activities represents cost for airline business operations. The Group's segmental information is set out in Note 48.

38 BUSINESS TAXES AND SURCHARGES

	The Group		The Company	
	2006	2005	2006	2005
	RMB million	RMB million	RMB million	RMB million
Business tax	1,290	1,092	991	849
City construction tax	21	25	1	8
Education surcharge	10	12	1	4
Total	1,321	1,129	993	861

Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)
(Expressed in Renminbi)**39 PROFIT FROM OTHER OPERATIONS**

	The Group		The Company	
	2006	2005	2006	2005
	RMB million	RMB million	RMB million	RMB million
Ground services income	185	195	171	184
Others	116	(25)	42	35
Total	301	170	213	219

40 FINANCIAL EXPENSES

	The Group		The Company	
	2006	2005	2006	2005
	RMB million	RMB million	RMB million	RMB million
Interest expense incurred	2,603	1,780	2,255	1,544
Less: Borrowing costs capitalised	85	98	26	84
Net interest expense	2,518	1,682	2,229	1,460
Interest income	(44)	(57)	(31)	(40)
Net exchange gains	(1,507)	(1,232)	(1,430)	(1,166)
Bank charges	55	46	47	40
Total	1,022	439	815	294

The net foreign exchange gain for the Group and the Company during the year were mainly related to the exchange gains on short term loans, long term loans and obligations under finance leases denominated in foreign currencies.

41 INVESTMENT INCOME/(LOSS)

	The Group		The Company	
	2006	2005	2006	2005
	RMB million	RMB million	RMB million	RMB million
Equity investment income/(loss)				
accounted for				
Under cost method	5	32	2	14
Under equity method	64	(234)	103	(218)
Others	7	–	7	–
Total	76	(202)	112	(204)

There were no major restrictions on the remittance of the Group's and the Company's investment returns.

Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)
(Expressed in Renminbi)

42 SUBSIDY INCOME

	Notes	The Group		The Company	
		2006 RMB million	2005 RMB million	2006 RMB million	2005 RMB million
Subsidy income for relocation					
to a new airport	(a)	5	30	5	30
VAT refund	(b)	18	27	–	–
Subsidy income for flight routes and aviation industry development	(c)	122	20	98	16
Total		145	77	103	46

Notes:

- (a) Pursuant to the notices issued by the Finance Bureau of Guangdong Province, the Company received a subsidy amounting to RMB5 million in 2006 for the relocation to a new airport.
- (b) Pursuant to the notice Cai Sui No. 【2000】 102 “Notice to Questions on VAT Relating to Repair Charges of Aircraft” issued by the MOF and the State Administration of Taxation, to support development of aircraft repair and maintenance industry, the part of VAT paid by the Group for providing aircraft maintenance service which exceeds the rate of 6% would be refunded. The Group received subsidy income of RMB18 million from Guangzhou State Tax in 2006.
- (c) The Group and the Company received subsidy income for flight routes and aviation industry development amounting to RMB122 million and RMB98 million respectively.

43 NON-OPERATING INCOME

	The Group		The Company	
	2006 RMB million	2005 RMB million	2006 RMB million	2005 RMB million
Gain on disposal of fixed assets (Note)	343	17	342	7
Expired sales in advance of carriage	305	104	305	97
Others	82	31	64	22
Total	730	152	711	126

Note: During the year, the Group sold certain aircraft and engines to independent third parties. The excess of the sale proceeds which approximated fair values of these assets on the respective date of disposal, over the carrying amounts of the assets and related disposal costs was recognised as a gain on disposal of fixed assets. The related gain amounted to RMB335 million.

Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)
(Expressed in Renminbi)**44 NON-OPERATING EXPENSES**

	The Group		The Company	
	2006	2005	2006	2005
	RMB million	RMB million	RMB million	RMB million
Loss on disposal of fixed assets	10	49	6	23
Donations	6	45	5	45
Others	16	18	12	13
Total	32	112	23	81

45 INCOME TAX

	The Group		The Company	
	2006	2005	2006	2005
	RMB million	RMB million	RMB million	RMB million
Corporate income tax for the year	163	23	92	(31)
Deferred taxation (Note 31)	(27)	(27)	(55)	(19)
	136	(4)	37	(50)

46 RETIREMENT 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 in accordance with relevant rules and regulation. The Group is required to contribute to these schemes at the rates ranging from 10% to 23% (2005: 9% to 20%) 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.

In addition, the Group established a supplementary defined contribution retirement scheme for the benefit of employees in accordance with relevant PRC rules and regulations. In this connection, the Group is required to make defined contributions not exceeding one-twelfth of the total salaries of the preceding year.

The Group has no other significant obligation for the payment of pension benefits beyond the contributions described above.

For the purpose of optimising personnel structure, the Group introduced an early retirement plan for certain redundant employees in 2006.

Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)
(Expressed in Renminbi)

47 RELATED PARTIES AND RELATED PARTY TRANSACTIONS

(a) Related party with controlling relationship

	Registered place	Principal activities	Relation with the Company	Nature of ownership	Legal representative
The parent company:					
China Southern Air Holding Company	PRC	Management of its subsidiaries and affiliated companies operations and the sale of products of the Group	The ultimate holding company	State owned	Liu Shao Yong
Principal subsidiaries under the control of the Company:					
Guangxi Airlines Company Limited	PRC	Airline	Subsidiary	Limited liability company	Yang Guang Hua
Southern Airlines (Group) Shantou Airlines Company Limited	PRC	Airline	Subsidiary	Limited liability company	Zhang Zi Fang
Zhuhai Airlines Company Limited	PRC	Airline	Subsidiary	Limited liability company	Ren Ji Dong
Xiamen Airlines Company Limited	PRC	Airline	Subsidiary	Limited liability company	Yang Guang Hua
Guizhou Airlines Company Limited	PRC	Airline	Subsidiary	Limited liability company	Xu Jie Bo
Guangzhou Nanland Air Catering Company Limited	PRC	Air catering	Subsidiary	Sino-foreign equity joint venture company	Ren Ji Dong
Guangzhou Baiyun International Logistic Company Limited	PRC	Logistics operations	Subsidiary	Limited liability company	He Zong Kai
Zhuhai Xiang Yi Aviation Technology Company Limited	PRC	Provision of flight simulation training services	Subsidiary	Sino-foreign equity joint venture company	Liu Xian
Xinjiang Civil Aviation Property Management Limited	PRC	Property management	Subsidiary	Limited liability company	Zhang Gui Long
Guangzhou Air Cargo Company Limited	PRC	Cargo services	Subsidiary	Limited liability company	Li Kun
China Southern West Australian Flying College Pty Limited	Australia	Pilot training services	Subsidiary	Limited liability company	Gao Guang

Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)
(Expressed in Renminbi)**47 RELATED PARTIES AND RELATED PARTY TRANSACTIONS** (cont'd)**(a) Related party with controlling relationship** (cont'd)*Registered capital of related parties with controlling relationships and its changes*

	Currency	At the opening and closing of 2006
The parent company:		
China Southern Air Holding Company	RMB	2,198,980,000
Principal subsidiaries under the control of the Company:		
Guangxi Airlines Company Limited	RMB	170,900,000
Southern Airlines (Group) Shantou Airlines Company Limited	RMB	280,000,000
Zhuhai Airlines Company Limited	RMB	250,000,000
Xiamen Airlines Company Limited	RMB	700,000,000
Guizhou Airlines Company Limited	RMB	80,000,000
Guangzhou Nanland Air Catering Company Limited	RMB	120,000,000
Guangzhou Baiyun international Logistic Company Limited	RMB	50,000,000
Zhuhai Xiang Yi Aviation Technology Company Limited	USD	43,620,849
Xinjiang Civil Aviation Property Management Limited	RMB	251,322,832
Guangzhou Air Cargo Company Limited	RMB	238,000,000
China Southern West Australian Flying College Pty Limited	AUD	100,000

Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)
(Expressed in Renminbi)

47 RELATED PARTIES AND RELATED PARTY TRANSACTIONS (cont'd)

(a) Related party with controlling relationship (cont'd)

Equity interests held by related parties with controlling relationships and their changes

	Currency	At 1 January 2006		Increase		At 31 December 2006	
		Amount	%	Amount	%	Amount	%
The movements of the equity interest of CSAHC in the Company:							
China Southern Air Holding Company	RMB	2,200,000,000	50.3%	–	–	2,200,000,000	50.3%
Movements of the equity interest of the Company in its subsidiaries:							
Guangxi Airlines Company Limited	RMB	162,355,000	95.0%	8,545,000	5.0%	170,900,000	100.0%
Southern Airlines (Group) Shantou Airlines Company Limited	RMB	168,000,000	60.0%	–	–	168,000,000	60.0%
Zhuhai Airlines Company Limited	RMB	150,000,000	60.0%	–	–	150,000,000	60.0%
Xiamen Airlines Company Limited	RMB	420,000,000	60.0%	–	–	420,000,000	60.0%
Guizhou Airlines Company Limited	RMB	48,000,000	60.0%	–	–	48,000,000	60.0%
Guangzhou Nanland Air Catering Company Limited	RMB	90,000,000	75.0%	–	–	90,000,000	75.0%
Guangzhou Baiyun International Logistic Company Limited	RMB	127,673,000	61.0%	–	–	127,673,000	61.0%
Zhuhai Xiang Yi Aviations Technology Company Limited	USD	22,246,633	51.0%	–	–	22,246,633	51.0%
Xinjiang Civil Aviation Property Management Limited	RMB	130,276,998	51.8%	–	–	130,276,998	51.8%
Guangzhou Air Cargo Company Limited	RMB	166,600,000	70.0%	–	–	166,600,000	70.0%
China Southern West Australian Flying College Pty Limited	AUD	65,000	65.0%	–	–	65,000	65.0%

Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)
(Expressed in Renminbi)

47 RELATED PARTIES AND RELATED PARTY TRANSACTIONS (cont'd)

(b) Relationship between the Company and related parties without controlling relationships

(i) *Subject to common control from CSAHC, i.e. subsidiaries of CSAHC:*

Southern Airlines (Group) Import and Export Trading Company
Southern Airlines (Group) Economic Development Company
Nanlung Travel and Express (H.K.) Ltd.
Southern Airlines (Group) Passengers and Cargo Agent Company
Southern Airlines Group Finance Company Limited
Southern Airlines (Group) Air Catering Co., Ltd.
CSAHC Hainan Co., Ltd.
Southern Airlines (Group) Property Management Co., Ltd

(ii) *Company that is under the significant influence of CSAHC:*

Shenzhen Air Catering Company Limited

(iii) *Jointly controlled entities of the Group:*

Guangzhou Aircraft Maintenance Engineering Company Limited
MTU Maintenance Zhuhai Co., Ltd
Beijing Southern Airlines Ground Services Co., Ltd

Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)
(Expressed in Renminbi)

47 RELATED PARTIES AND RELATED PARTY TRANSACTIONS (cont'd)

(c) The transactions between the Group and the related parties carried out during the year were as follows:

	Notes	2006 RMB million	2005 RMB million
Expenses			
Handling charges	(1)	29	32
Air catering supplies	(2)	194	173
Commission expense	(3)	43	26
Sundry aviation supplies	(4)	86	88
Lease charges for aircraft	(5)	3	10
Lease charges for land and buildings	(6)	99	90
Property management fee and repair charges	(7)	27	28
Ground service expenses	(8)	21	16
Repairing charges	(9)	592	559
Interest expense	(10)	16	37
Income			
Interest income	(11)	6	3
Others			
Acquisition of airline assets	(12)	5	–
Sales of properties	(13)	23	–

Notes:

- (1) Handling charges represent fees payable to Southern Airlines (Group) Import and Export Trading Company in connection with the procurement of aircraft and flight equipment on the Group's behalf. Handling charges are calculated based on a fixed percentage of the procurement value by reference to market rates. The fees are usually paid by the end of the following month.
- (2) Air catering supplies represent fees payable to Shenzhen Air Catering Company Limited and Southern Airlines (Group) Air Catering Co., Ltd for providing in-flight meals to the Group. Prices are determined by reference to market prices. The payable amount is usually settled by the end of the following month.
- (3) Sales commission expenses represent commission payable to Nanlung Travel and Express (H.K.) Ltd. and Southern Airlines (Group) Passengers and Cargo Agent Company in connection with passenger tickets and cargo turnover sold by these sales agents on the Group's behalf. The commission rates are based on the rates stipulated by the CAAC. The sales commission expense payable is offset directly against the sales proceeds receivable from these sales agents.
- (4) Sundry aviation supplies represent purchases of sundry aviation supplies from Southern Airlines (Group) Economic Development Company. Prices are determined by reference to market prices. The payable amount is generally settled by the end of the following month.
- (5) Lease charges for aircraft represent the rental expenses for lease of an MD82 aircraft from CSAHC Hainan. The lease was terminated on 30 April 2006.
- (6) Lease charges for land and buildings represent rentals payable to CSAHC by the Group under certain lease agreements in respect of certain land and buildings of CSAHC. The rentals are determined based on market rents.

Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)
(Expressed in Renminbi)

47 RELATED PARTIES AND RELATED PARTY TRANSACTIONS (cont'd)

(c) The transactions between the Group and the related parties carried out during the year were as follows:
(cont'd)

Notes: (cont'd)

- (7) Property management fee and repair charge represent expenses payable to Southern Airlines (Group) Property Management Co., Ltd, a subsidiary of CSAHC, which provides property management services to the Group.
- (8) Ground service expenses represent the expenses for the ground services provided by Beijing Southern Airlines Ground Services Co., Ltd. The charge rates are in accordance with relevant regulations issued by the CAAC. During the year, ground services fee amounting to RMB21 million were eliminated in applying the proportional consolidation method.
- (9) Repair charges represent fees payable to Guangzhou Aircraft Maintenance Engineering Company Limited and MTU Maintenance Zhuhai Co. Ltd. in connection with aircraft repairs and maintenance services rendered to the Group. Fees are charged based on market prices. During the year, repair fees amounting to RMB592 million were eliminated in applying the proportional consolidation method.
- (10) Interest expense represents the interest paid for the loans from SA Finance. The applicable interest is determined in accordance with the interest rate as published by the People's Bank of China. Loans from SA Finance at the year end are set out in Note 47 (d).
- (11) Interest income represents the interest received from deposits placed with SA Finance by the Group (Note 5). The applicable interest rate is determined in accordance with the deposit rate published by the People's Bank of China. Interest income is received quarterly. Deposits with SA Finance at the year end are set out in Note 47 (d).
- (12) On 30 April 2006, the Company acquired certain assets of CSAHC Hainan at a consideration of RMB5,150,000.
- (13) On 28 December 2006, the Group disposed of certain properties to CSAHC at a consideration of RMB23,347,170 with reference to the valuation amount of the assets.

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

Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)
(Expressed in Renminbi)

47 RELATED PARTIES AND RELATED PARTY TRANSACTIONS (cont'd)

(d) The balances, deposits and loans with related parties are summarised as follows:

	Relationship	2006 RMB million	2005 RMB million
Cash deposits			
SA Finance	Other related company	631	557
Accounts receivable			
Nanlung Travel and Express (H.K.) Ltd	Other related company	–	42
Southern Airlines (Group) Passengers and Cargo Agent Company	Other related company	4	–
Other receivables			
Southern Airlines (Group) Import and Export Trading Company Ltd	Other related company	–	3
Guangzhou Aircraft Maintenance Engineering Company Limited	Jointly controlled entity	28	8
MTU Maintenance Zhuhai Co., Ltd	Jointly controlled entity	4	4
SA Finance	Other related company	2	–
Payments in advance			
Beijing Southern Airlines Ground Services Co., Ltd.	Jointly controlled entity	9	–
Accounts payables			
Southern Airlines (Group) Import and Export Trading Company Ltd	Other related company	2	850
Guangzhou Aircraft Maintenance Engineering Company Limited	Jointly controlled entity	31	25
Nanlung Travel and Express (H.K.) Ltd	Other related company	9	–
Other payables			
SA Finance	Other related company	–	5
CSAHC	Jointly controlled entity	145	12
Guangzhou Aircraft Maintenance Engineering Company Limited	Jointly controlled entity	2	3
Southern Airlines (Group) Property Management Co., Ltd	Other related company	25	–
Accrued expenses			
Southern Airlines (Group) Property Management Co., Ltd	Other related company	–	28
Guangzhou Aircraft Maintenance Engineering Company Limited	Jointly controlled entity	156	119
MTU Maintenance Zhuhai Co. Ltd	Jointly controlled entity	101	84
Beijing Southern Airlines Ground Services Co., Ltd	Jointly controlled entity	49	33
Southern Airlines (Group) Economic Development Company Ltd	Other related company	15	10
Southern Airlines (Group) Catering Co., Ltd	Other related company	58	47
Shenzhen Air Catering Company Limited	Other related company	9	–
Short-term loans			
SA Finance	Other related company	323	300

Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)
(Expressed in Renminbi)**47 RELATED PARTIES AND RELATED PARTY TRANSACTIONS (cont'd)****(e) Guarantees provided by related parties**

Other than the guarantees given by CSAHC and SA Finance to banks in respect of certain loans of the Group (Note 19 and Note 27), there were no guarantees provided to banks by other related parties in favour of the Group.

(f) The directors of the Company are of the opinion that the above transactions were carried out in the normal course of business and on normal commercial terms.

48 SEGMENTAL INFORMATION

The Group engages in a single operation, i.e. the provision of airline services. Geographic information about the Group's profit from principal activities is as follows:

	Domestic RMB million	Hong Kong and Macau regions RMB million	International (Note) RMB million	Total RMB million
2006				
Net sales from principal activities	37,491	1,371	8,185	47,047
Less: Cost of sales from principle activities	31,606	1,167	7,627	40,400
Business taxes and surcharges	1,167	20	134	1,321
Profit from principal activities	4,718	184	424	5,326
2005				
Net sales from principal activities	31,004	1,343	6,705	39,052
Less: Cost of sales from principal activities	26,582	1,208	6,507	34,297
Business taxes and surcharges	989	23	117	1,129
Profit from principal activities	3,433	112	81	3,626

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

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

Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)
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49 CONTINGENT LIABILITIES

- (i) Pursuant to the Reorganisation of CSAHC effected from 25 March 1995 (subsequently revised on 22 May 1997), 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.

- (ii) The Group leases from CSAHC certain land in Guangzhou and certain land and buildings in Wuhan, Haikou and Zhengzhou cities. 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 cities lack adequate documentation evidencing CSAHC's rights thereto.

Pursuant to the indemnity agreement signed with CSAHC on 22 May 1997, 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.

- (iii) Jet fuel costs account for a significant portion of the cost of sales from principal activities. Price level of jet fuel fluctuated in a significant manner in recent period and the Company anticipates that the price level of jet fuel to remain in significant fluctuation in the foreseeable future. The Company entered into fuel option contracts with certain overseas bankers to mitigate the risk of fluctuations of jet fuel price. At 31 December 2006, the Company had outstanding option contracts of approximately 12,300,000 barrels of crude oil at price ranging from US\$43 to US\$60 per barrel. The gain or loss of the option contracts will be determined by crude oil price at time of settlement of the contracts.

Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)
(Expressed in Renminbi)**50 COMMITMENTS****(i) Capital commitments**

At 31 December 2006, the Group and the Company had capital commitments as follows:

	The Group		The Company	
	2006	2005	2006	2005
	RMB million	RMB million	RMB million	RMB million
Commitment in respect of aircraft and flight equipment:				
– authorised and contracted for	66,881	45,628	59,967	33,955
Other commitments:				
– authorised and contracted for	420	90	420	90
– authorised but not contracted for	1,404	2,159	1,352	2,002
	1,824	2,249	1,772	2,092
	68,705	47,877	61,739	36,047

At 31 December 2006, the total future payments, including estimated amounts for price escalation through anticipated delivery dates for these aircraft and flight equipment are as follows:

	The Group	The Company
	RMB million	RMB million
Within 1 year	12,299	10,886
After 1 year but within 2 years	22,572	21,276
After 2 years but within 3 years	17,483	15,280
After 3 years	14,527	12,525
Total	66,881	59,967

Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)
(Expressed in Renminbi)

50 COMMITMENTS (cont'd)

(ii) Operating lease commitments

The Group's and the Company's commitments under non-cancellable aircraft and flight equipment operating leases were as follows:

	The Group		The Company	
	2006	2005	2006	2005
	RMB million	RMB million	RMB million	RMB million
Within 1 year	3,077	3,340	2,756	3,113
After 1 year but within 2 years	2,965	2,881	2,732	2,673
After 2 years but within 3 years	2,775	2,785	2,593	2,666
After 3 years	13,152	15,588	12,630	15,414
Total	21,969	24,594	20,711	23,866

(iii) Investment commitments

At 31 December 2006, the Group and the Company committed to make capital contribution in respect of:

	2006	2005
	RMB million	RMB million
Jointly controlled entities	83	83

Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)
(Expressed in Renminbi)**51 PRINCIPAL SUBSIDIARIES, ASSOCIATED COMPANIES AND JOINTLY CONTROLLED ENTITIES**

The particulars of the Company's principal subsidiaries, and the Group's associates and jointly controlled entities as at 31 December 2006 are as follows:

(i) Principal subsidiaries

Name of company	Place and date of establishment/ operation	Proportion of ownership interest held by the Company %	Issued/registered capital (Note a)	Principal activities
Guangxi Airlines Company Limited (Note b)	PRC 28 April 1994	100	170,900,000	Airline
Southern Airlines (Group) Shantou Airlines Company Limited	PRC 20 July 1993	60	280,000,000	Airline
Zhuhai Airlines Company Limited	PRC 8 May 1995	60	250,000,000	Airline
Xiamen Airlines Company Limited	PRC 11 August 1984	60	700,000,000	Airline
Guizhou Airlines Company Limited	PRC 12 November 1991	60	80,000,000	Airline
Guangzhou Nanland Air Catering Company Limited (Note c)	PRC 21 November 1989	75	120,000,000	Air catering
Guangzhou Baiyun International Logistic Company Limited	PRC 23 July 2002	61	50,000,000	Logistics operations
Zhuhai Xiang Yi Aviation Technology Company Limited	PRC 10 July 2002	51	USD43,620,849	Provision of flight simulation services
Xinjiang Civil Aviation Property Management Limited	PRC 12 February 2002	51.8	251,322,832	Property management
Guangzhou Air Cargo Company Limited	PRC 31 March 2004	70	238,000,000	Cargo services
China Southern West Australian Flying College Pty Limited	Australia 26 January 1971	65	AUD100,000	Pilot training services

Notes:

- (a) Expressed in RMB, unless otherwise stated.
- (b) For the purpose of unifying the airline operation of the Group, the assets and liabilities of Guangxi Airlines Company Limited were transferred to the Company on 31 December 2006.
- (c) This subsidiary is a Sino-foreign equity joint venture company established in the PRC.

Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)
(Expressed in Renminbi)

51 PRINCIPAL SUBSIDIARIES, ASSOCIATED COMPANIES AND JOINTLY CONTROLLED ENTITIES (cont'd)

(ii) Principal associates and jointly controlled entities

Name of company	Place and date of establishment/operation	Attributable equity interest		Issued/registered capital (Note a)	Principal activities
		Direct %	Indirect %		
Guangzhou Aircraft Maintenance Engineering Company Limited (Note b)	PRC 28 October 1989	50	–	USD27,500,000	Provision of aircraft repair and maintenance services
China Southern Airlines Group Finance Company Limited	PRC 28 June 1995	21.09	12.89	424,330,000	Provision of financial services
MTU Maintenance Zhuhai Co., Ltd (Note b)	PRC 6 April 2001	50	–	USD63,100,000	Provision of engine repair and maintenance services
China Postal Airlines Limited (Note b)	PRC 25 November 1996	49	–	394,900,000	Airline
Beijing Southern Airlines Ground Services Company Limited (Note b)	PRC 1 April 2004	50	–	18,000,000	Provision of airport ground services
Sichuan Airlines Corporation Limited	PRC 28 August 2002	39	–	350,000,000	Airline

Notes:

(a) Expressed in RMB, unless otherwise stated.

(b) These are jointly controlled entities. They were proportionately consolidated in the Group's consolidated financial statements.

Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)
(Expressed in Renminbi)**52 EXTRAORDINARY GAINS AND LOSSES**

In accordance with the requirements of "Questions and Answers on the Preparation of Information Disclosures of Companies Issuing Public Shares No.1 – Extraordinary Gains and Losses" (revised 2004), the extraordinary gains and losses of the Group are set out below:

	2006 RMB million	2005 RMB million
Extraordinary gains and losses for the year		
Gains/(losses) on disposal of fixed assets	333	(32)
Expired sales in advance of carriage	305	104
Net non-operating income and expenses excluding net gains/(losses) on disposal of fixed assets and expired sales in advance of carriage	60	(32)
Subsidy income	127	50
Taxation effect of the above items	(149)	(13)
Total	676	77

53 POST BALANCE SHEET EVENTS**(i) New Accounting Standards**

The Group will adopt the Accounting Standard for Business Enterprises issued by the MOF on 15 February 2006 ("New Accounting Standards"), with effective date from 1 January 2007, to supersede the current accounting standards for business enterprises and "Accounting Regulations for Business Enterprises" ("Current Accounting Standards"). When the Group adopts the New Accounting Standards, changes may be made to the accounting policies, accounting estimates under Current Accounting Standards, and thus may affect the financial position and the results of operations of the Group.

(ii) New Tax Law

On 16 March 2007, the Fifth Plenary Session of the Tenth National People's Congress passed the Corporate Income Tax Law of the People's Republic of China ("New Tax Law") which will take effect on 1 January 2008. The Company was established in the Guangzhou Economic and Technology Development Zone in Guangdong province, and was entitled to preferential income tax rate of 18% in accordance with the Income Tax Law of the People's Republic of China for Foreign Enterprises. Certain subsidiaries of the Company are entitled to preferential income tax rates in the range of 15% to 27% in accordance with relevant tax rules and regulations. For the entities which are entitled to preferential income tax rate lower than 25%, from 1 January 2008, the income tax rate is expected to increase to the standard rate of 25% over a five-year transition period. However, the New Tax Law has not set out the details as to how the existing preferential tax rates will increase to the standard rate of 25%.

Certain subsidiaries of the Company and jointly controlled entities of the Group have been granted the status of a high-tech enterprise and currently their applicable income tax rates are in the range of 7.5% to 15%. According to the New Tax Law, certain high-tech enterprises will continue to be entitled to a reduced tax rate of 15%. However, the detailed implementation rules regarding the preferential tax policies (e.g. the details of how a taxpayer can qualify as a high-tech enterprise under the New Tax Law) have yet to be made public. Consequently, the Company is not able to assess whether the subsidiaries and jointly controlled entities will qualify as a high-tech enterprise under the new tax law.

Notes to the Financial Statements (Cont'd)

(Prepared under PRC Accounting Rules and Regulations)
(Expressed in Renminbi)

53 POST BALANCE SHEET EVENTS (cont'd)

(ii) New Tax Law (cont'd)

Referring to above, the Company is not able to make an estimate of the expected financial effect of the New Tax Law on its deferred tax assets and liabilities. The expected financial effect of the New Tax Law, if any, will be reflected in the Group's and the Company's 2007 consolidated financial statements and financial statements. The enactment of the New Tax Law is not expected to have any financial effect on the amounts accrued in the balance sheet in respect of current tax payable.

(iii) Share reform proposal

As disclosed in the announcement dated 13 April 2007, the Company issued a notice to holders of the listed and circulating A Shares ("Circulating A Shares") to convene a relevant shareholders' meeting on 17 May 2007 ("Relevant Shareholders' Meeting") for the purpose of seeking shareholders' approval of the proposal for converting all the Company's unlisted and non-circulating shares ("Non-circulating Shares") to Circulating A Shares ("Share Reform Proposal"). CSAHC is the only holder of the Non-circulating Shares.

The consideration payable as proposed by CSAHC to the holders of Circulating A Shares in connection with the Share Reform Proposal is a total of 500,000,000 put warrants of the Company's shares ("Put Warrants"). The holders of the Circulating A Shares registered on the shareholders' register on 8 May 2007 will be granted 5 Put Warrants for every 10 A Shares held by such shareholders, equivalent to 0.9327 shares for every 10 A Shares. The exercise ratio is one warrant to one share and the initial exercise price of the Put Warrant is RMB7. The rights of the Put Warrants (European style) are exercisable by the holders during the last five trading days of the warrant period which is twelve months. CSAHC will announce the exercise method of rights under the Put Warrants within six months after the listing of the Put Warrants.

CSAHC undertakes that it will not trade or transfer any of the Company's shares it holds for a twelve-month period commencing from the effective date of the Share Reform Proposal ("Lock-up Period"). Upon expiration of the Lock-up Period, CSAHC may sell the Non-circulating Shares through trading on the Shanghai Stock Exchange, and the number of shares it will sell within the 12-month period and 24-month period will not exceed 5% and 10%, respectively, of the total number of shares held by CSAHC. The shares subject to restriction as mentioned above do not include those shares purchased by CSAHC upon the exercise of rights under the Put Warrants and after the implementation of the share reform plan.

In accordance with the provisions of "Provisional Measures of the Shanghai Stock Exchange for Warrants" and the relevant requirements of the Shanghai Stock Exchange, CSAHC will place deposits to China Securities Depository and Clearing Corporation Limited Shanghai Branch as a performance bond for the Put Warrants.

Up to the date of approval of these financial statements, the Share Reform Proposal was being communicated to the holders of the Circulating A Shares. The finalised share reform plan will be discussed for approval in the Relevant Shareholders' Meeting.

54 COMPARATIVE FIGURES

Certain items in these comparative figures have been reclassified to conform with the current year's presentation to facilitate comparison.