



中国南方航空  
CHINA SOUTHERN

CHINA SOUTHERN AIRLINES  
COMPANY LIMITED



H SHARE STOCK CODE: 1055  
A SHARE STOCK CODE: 600029  
ADR CODE: ZNH

**INTERIM  
REPORT  
2007**

All Shareholders:

The board of directors (the "Board") of China Southern Airlines Company Limited (the "Company") hereby announces the following unaudited operating results of the Company and its subsidiaries (collectively, the "Group") for the six months ended 30 June 2007.

## INTRODUCTION

The Group is one of the largest airlines in the People's Republic of China (the "PRC") in terms of number of passengers carried, number of hours flown, number of scheduled flights per week, route networks and size of aircraft fleet. The Group operates the most extensive route networks among the Chinese airlines. As at 30 June 2007, the Group operated an aggregate of 592 routes, of which 478 were domestic, 21 were Hong Kong and Macau, and 93 were international, to 154 cities. As at 30 June 2007, the Group operated a fleet of 318 aircraft, consisting primarily of Boeing 737 series, 747, 757, 777, Airbus 320 series, 300, 330, McDonnell Douglas 82 and 90 etc. The average age of the fleet of the Group was 6.89 years.

## REVIEW AND PROSPECTS

In the first half of 2007, the Group continued to implement its strategy on scheduled flight network optimisation and hub development, as well as striving to enhance service quality so as to satisfy customer needs and meet the entrance requirements of the international airlines alliances. Meanwhile, the Group continued to strengthen budget management and cost controls; to rationalise the way of acquiring aircraft so as to maintain a healthy gearing level and reduce financing costs; and to optimise the management performance assessment system based on efficiency of operation, thereby elevating the overall operating level and performance benchmarks of the Group.

The reporting period was characterised by a persistent strong national economy, a stable increase of market demand and an appreciation of Renminbi against major currencies such as US dollar. With assuring flight safety as the premise, the Group recorded a total traffic turnover of 4,250 million tonne kilometres and carried 26.4 million passengers and handled 403,000 tonnes of cargo and mail, representing increases of 14.6%, 16.6% and 7.2% respectively as compared to the corresponding period of last year. The passenger load factor was 71.9%, representing an increase of 1.7% as compared to the corresponding period of last year. Operating revenue was RMB24,556 million for the first half year, representing an increase of 19.2% as compared to the corresponding period of last year while profit attributable to equity shareholders of the Company was RMB168 million as compared with a loss of RMB825 million for the corresponding period of last year.

During the reporting period, the Company has recorded 4,000,000 safety flying hours and was granted the Four Stars Award by Civil Aviation Administration of China for flight safety, which is the highest award in the civil aviation industry in the PRC.

An adjustment was made by the government on fuel surcharge on domestic routes at the beginning of the year: fuel surcharge was revised from RMB60 to RMB50 per passenger for flight distance under 800 km and from RMB100 to RMB80 per passenger for flight distance above 800 km (inclusive), which came into effect on 21 January 2007. Jet fuel prices in the PRC in average were higher than those in the same period of last year. As a result of surging jet fuel prices and downward adjustments on fuel surcharges, the Group was subject to greater pressure on operating cost. To alleviate such pressure, the Company has strived to optimise its flight structure and deployment, enhance overall income level, adopt various measures to minimise fuel wastage and employ various financial derivative instruments.

The Group continued to push forward its implementation of the “dual-hub” operating strategy. Through building Beijing and Guangzhou as its regional hubs, the Company strived to enlarge its service network to provide better air transportation solutions for its existing and potential customers. During the reporting period, the Group launched 56 new flight routes, including 9 international flight routes. On 16 June 2007, Chongqing Airlines, a joint venture established by the Group and Chongqing Development and Investment Co., Ltd., was formally established, in which the Company holds 60% of its equity interests. The first flight of Chongqing Airlines was launched in July 2007, which added new momentum to the Group’s development in the central and western regions of the PRC. With a view to achieving economies of scale of its air cargo transportation, the Group is actively seeking cooperation with members of the SkyTeam Alliance to increase the proportion of air cargo in the overall transportation business. An Airbus A300-600 aircraft, the first passenger aircraft being converted into cargo aircraft, will also come into operation for cargo transportation during the year.

To enhance the quality of service, the Group, while improving its flight punctuality rates and inflight services, is the first among its peers to offer premium services such as boarding registration through internet and mobile phone, which was well received by its customers.

During the reporting period, various preparation work for admission to the SkyTeam Alliance has progressed smoothly, and the Company aims to be admitted by the end of this year. The membership will facilitate the Company to benefit from the rapid growth in air transportation demand as a result of the development of the global economy, thereby leading the Group to become an international airline with promising growth.

For the period under review, the Group’s total traffic revenue was RMB24,086 million, an increase of RMB3,863 million or 19.1% from the same period last year. Meanwhile, the Group’s total traffic volume increased by 14.6% to 4,250 million RTKs. The aggregate utilisation rate of the Group’s Boeing and Airbus aircraft was 9.39 hours per day for the period under review, a decrease of 0.14 hours or 1.5% from the same period last year.

Passenger revenue for the period under review was RMB22,392 million, up 20.2% from the same period last year, representing 93.0% of the Group’s total traffic revenue. Passenger traffic volume increased by 17.8% to 37,787 million RPKs.

Domestic passenger revenue was RMB18,357 million, up 20.1% from the same period last year. Domestic passenger revenue accounted for 82.0% of overall passenger revenue. Passenger capacity, in terms of ASKs, increased by 15.7% while passenger traffic volume, in terms of RPKs, increased by 18.7% from the same period last year, resulting in an increase in passenger load factor of 1.8 percentage points to 73.9%. During the reporting period, the passenger yield per RPK increased by 1.8% from RMB0.57 to RMB0.58.

On Hong Kong and Macau routes, the Group recorded passenger revenue of RMB540 million, a decrease of 12.3% from same period last year. Hong Kong and Macau passenger revenue accounted for 2.4% of total passenger revenue. Passenger capacity, in terms of ASKs, decreased by 28.2% while passenger traffic volume, in terms of RPKs decreased by 26.1% from the same period last year, resulting in an increase in passenger load factor of 1.8 percentage points to 62.4%. The passenger yield per RPK increased by 18.2% to RMB0.91.

Passenger revenue for the Group’s international routes amounted to RMB3,495 million, an increase of 28.0% from the same period last year. International passenger revenue accounted for 15.6% of total passenger revenue. Passenger capacity, in terms of ASKs, increased by 24.5% while passenger traffic volume, in terms of RPKs, increased by 20.1% from the same period last year, resulting in a decrease in passenger load factor of 2.3 percentage points to 63.3%. The passenger yield per RPK increased by 6.9% to RMB0.62.

Cargo and mail revenue was RMB1,694 million, an increase of 6.1% from the same period last year. Cargo and mail revenue accounted for 7.0% of total traffic revenue. Cargo and mail volume grew by 4.5% to 883 million RTKs from the same period last year, mainly due to the increasing traffic demand. The overall yield per cargo and mail tonne kilometre increased by 1.6% to RMB1.92.

Total operating expenses increased by 17.9% to RMB24,574 million from the same period last year, primarily due to the increase in fuel cost, landing and navigation fees, maintenance expenses, aircraft operating lease charge and depreciation resulting from the increase in traffic volume and fleet expansion during the period under review.

Flight operations expenses increased by 19.7% to RMB13,226 million from the same period last year. Of these expenses, fuel cost was RMB8,598 million, up 21.4% from the same period last year, mainly as a result of increases in fuel consumption and fuel prices. Aircraft operating lease charges increased by 27.0% to RMB1,801 million, mainly attributable to additional rental payments for new aircraft under operating leases. Air catering expenses increased by 9.9% to RMB608 million, primarily as a result of an increase in number of passengers carried during the period under review.

Maintenance expenses increased by 38.7% to RMB2,361 million, mainly due to an increase in general repair as a result of increase in flying hours during the period under review.

Aircraft and traffic servicing expenses increased by 16.0% to RMB3,974 million from the same period last year, reflecting primarily an increase in number of landing and takeoffs.

Promotion and sales expenses increased by 7.2% to RMB1,565 million from the same period last year, primarily as a result of an increase in traffic volume.

General and administrative expenses increased by 20.4% to RMB839 million from the same period last year, mainly due to an increase in the scale of operations.

As compared with the same period last year, depreciation and amortisation expenses increased by 3.8% to RMB2,546 million, reflecting primarily the effect of scheduled aircraft delivered during the second half of 2006 and the period under review.

Interest expense increased by 12.7% to RMB1,132 million in the period under review, primarily reflecting an increase in the balance of loan borrowings and average interest rate.

The Group recorded a net exchange gain of RMB1,266 million, mainly resulted from Renminbi appreciation during the period under review. Such amount represents mainly unrealised translation exchange gain on period end foreign currency denominated liabilities.

As a result of the aforementioned factors, for the six months ended 30 June 2007, the Group recorded a net profit attributable to equity shareholders of the Company of RMB168 million, as compared to a net loss attributable to equity shareholders of the Company of RMB825 million for the same period last year.



## LIQUIDITY, FINANCIAL RESOURCES AND CAPITAL STRUCTURE

As at 30 June 2007, the Group's current liabilities exceeded its current assets by RMB31,917 million, which include current instalments of bank and other loans and obligations under finance leases of RMB27,343 million. 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. In preparing the interim financial report, the directors of the Company have considered the Group's sources of liquidity and believe that adequate funding is available to fulfil the Group's short term obligations and capital expenditure requirements.

As at 30 June 2007, the Group's borrowings totalled RMB51,642 million, an increase of RMB2,404 million from RMB49,238 million as at 31 December 2006. The majority of such borrowings were denominated, to a large extent, in United States dollars and, to a smaller extent, in Japanese yen, Renminbi and Hong Kong dollars, with 24.3% of the total balance being fixed interest rate borrowings. Of such borrowings, RMB27,343 million, RMB5,822 million, RMB3,964 million, RMB2,109 million and RMB12,404 million will be repayable in the twelve months ending 30 June 2008, 2009, 2010, 2011, 2012 and thereafter respectively. As at 30 June 2007, cash and cash equivalents of the Group totalled RMB3,551 million, an increase of RMB1,287 million from RMB2,264 million as at 31 December 2006. Of such balance, 28.4% was denominated in foreign currencies. Net debts (total borrowings net of cash and cash equivalents) increased by 2.4% to RMB48,091 million from RMB46,974 million as at 31 December 2006.

As at 30 June 2007, total equity attributable to equity shareholders of the Company amounted to RMB10,356 million, an increase of RMB168 million from RMB10,188 million as at 31 December 2006, reflecting the profit attributable to equity shareholders of the Company recorded for the period under review. Total equity as at 30 June 2007 amounted to RMB12,347 million (As at 31 December 2006: RMB12,121 million).

Ratio of net debt to total equity of the Group as at 30 June 2007 and as at 31 December 2006 were both 3.9 times.

## FINANCIAL RISK MANAGEMENT POLICY

### Foreign currency risk

The Renminbi is not freely convertible into foreign currencies. All foreign exchange transactions involving Renminbi must take place either through the People's Bank of China ("PBOC") or other institutions authorised to buy and sell foreign exchange or at a swap centre.

The Group has significant exposure to foreign currency as substantially all of the Group's lease obligations and bank loans are denominated in foreign currencies. Depreciation or appreciation of the Renminbi against foreign currencies affects the Group's results significantly because the Group's foreign currency payments generally exceed its foreign currency receipts. The Group is not able to hedge its foreign currency exposure effectively other than by retaining its foreign currency denominated earnings and receipts to the extent permitted by the State Administration of Foreign Exchange, or subject to certain restrictive conditions, entering into forward foreign exchange contracts with authorised PRC banks.

The exchange rate of Renminbi to US dollar was set by the PBOC and had fluctuated within a narrow band prior to 21 July 2005. Since then, a managed floating exchange rate regime based on market supply and demand with reference to a basket of foreign currencies has been used and US dollar exchange rate has gradually declined against the Renminbi.

### Jet fuel price risk

The Group allows for the judicious use of approved derivative instruments such as swaps and options with approved counter-parties and within approved limits to manage the risk of surge of jet fuel price. In addition, counter-party credit risk is generally restricted to any gains on changes in fair value at any time, and not the principal amount of the instrument. Therefore, the possibility of material loss arising in the event of non-performance by counter-party is considered to be unlikely.

### CHARGES ON ASSETS

As at 30 June 2007, certain aircraft of the Group with an aggregate carrying value of approximately RMB33,299 million (31 December 2006: RMB30,075 million) were mortgaged under certain loan and lease agreements.

### CAPITAL AND INVESTING COMMITMENTS

As at 30 June 2007, the Group had capital commitments of approximately RMB58,773 million. Of such amounts, RMB56,480 million was related to the acquisition of aircraft and flight equipment and RMB2,293 million for other projects.

As at 30 June 2007, the Group was committed to make capital contributions of approximately RMB83 million and RMB720 million to a jointly controlled entity and a subsidiary respectively.

### CONTINGENT LIABILITIES

A writ of summons was issued on 30 May 2007 by two sales agents in Taiwan (the "plaintiffs") against the Company for the alleged breach of certain terms and conditions of a cooperative agreement (the "cooperative agreement"). The plaintiffs have made a claim against the Company for a total sum of approximately RMB107 million mainly in respect of the alleged non-payment of sales commission on air tickets sold in Taiwan during the period from 1 September 2004 to 31 August 2006. The plaintiffs have also claimed against the Company for an unspecified compensation for early termination of the cooperative agreement.

The directors of the Company consider that, given the nature of the claims and the preliminary status of the proceedings, it is not possible to estimate the eventual outcome of the claims with reasonable certainty at this stage. However, the directors of the Company are of the opinion that the claims are without merit and have instructed its legal advisor to defend the claims vigorously. The directors of the Company consider that the outstanding claim should have no material adverse effect on the financial position of the Group.

### PROSPECTS FOR THE SECOND HALF OF THE YEAR

In view of the stable growth of the PRC economy, it is anticipated that in the second half of 2007, domestic airlines will continue to benefit from the increasing market demand. However, persistent high oil prices and increasing market competition, as well as anticipated macro-economic control measures of the PRC government, will affect the operation of the industry to a certain extent. The Group will continue to appropriately implement its overall development strategies, proactively adjust itself to market needs, modify its flight network and capacity deployment, reinforce the market forecasting and revenue analysis of each route, and strengthen its sales and marketing efforts. The Group will strive to enhance its service quality whilst continuously improving its passenger load factor and yield, thereby achieving all operating targets for the year and benefitting from the stable economic growth of the PRC.

### DIVIDENDS

The Board does not propose to declare an interim dividend for the year 2007.

## STRUCTURE OF SHARE CAPITAL

As at 30 June 2007, the share capital of the Company comprised 4,374,178,000 shares, of which approximately 50.30% or 2,200,000,000 State-owned Shares were held by China Southern Air Holding Company (“CSAHC”), approximately 22.86% or 1,000,000,000 A Shares were held by the PRC investors and approximately 26.84% or 1,174,178,000 H Shares were held by Hong Kong and overseas investors.

Category of Shares	Number of shares held	Percentage to the total share capital (%)
State-owned Shares (held by CSAHC)	2,200,000,000	50.30%
H Shares	1,174,178,000	26.84%
A Shares	1,000,000,000	22.86%
Total share capital	4,374,178,000	100.00%

## SUBSTANTIAL SHAREHOLDERS

As at 30 June 2007, to the knowledge of the directors, chief executive and supervisors of the Company, the interests and short positions of the following persons other than the directors, chief executives or supervisors in the shares and underlying shares of the Company as recorded in the register of the Company required to be kept under section 336 of the Securities and Futures Ordinance (the “SFO”) or otherwise persons who have an interest of 10% or more in the Company’s shares are as follows:

Name of shareholder	Type of shareholding	Type of share	Number of shares held	% of the total issued H shares of the Company	% of the total issued share capital of the Company	Short position
CSAHC	Direct holding	State-owned share	2,200,000,000	–	50.30%	–
HKSCC Nominees Limited	Direct holding	H share	1,156,215,998	98.47%	26.43%	–

### Notes:

Based on the information available to the directors and supervisors of the Company (including such information as was available on the website of the Stock Exchange of Hong Kong Limited (the “Hong Kong Stock Exchange”) and so far as the directors and supervisors of the Company are aware, as at 30 June 2007:

- Among the 1,156,215,998 H Shares held by HKSCC Nominees Limited, Li Ka-Shing Unity Trustcorp Limited had an interest in an aggregate of 193,877,000 H Shares of the Company (representing approximately 16.51% of its then total issued H Shares) in the capacity as beneficiary of a trust.
- Among the 1,156,215,998 H Shares held by HKSCC Nominees Limited, J.P. Morgan Fleming Asset Management Holdings Inc. had an interest in an aggregate of 70,912,000 H Shares of the Company (representing approximately 6.04% of its then total issued H Shares). According to the information as disclosed in the website of the Hong Kong Stock Exchange and so far as the directors and supervisors of the Company are aware, J.P.Morgan Fleming Asset Management Holdings Inc. held its interest in the Company in the following manner:
  - 70,162,000 H Shares, representing approximately 5.98% of the Company’s then total issued H Shares, were held in the capacity as beneficial owner by JF Asset Management Limited, which was ultimately 100% held by J.P. Morgan Fleming Asset Management Holdings Inc.; and

- (b) 750,000 H Shares, representing approximately 0.06% of the Company's then total issued H Shares, were held in the capacity as investment manager by JF International Management Inc., which was approximately 99.99% held by J.P. Morgan Fleming Asset Management (Asia) Inc., which was ultimately 100% held by J.P. Morgan Fleming Asset Management Holdings Inc.
3. Among the 1,156,215,998 H Shares held by HKSCC Nominees Limited, 70,658,800 H Shares of the Company, representing approximately 6.02% of its then total issued H Shares, were held in the capacity as beneficial owner by JPMorgan Chase Bank. JPMorgan Chase Bank was wholly-owned by J.P. Morgan Chase & Co.
4. Among the 1,156,215,998 H Shares held by HKSCC Nominees Limited, Morgan Stanley International Incorporated had an interest in an aggregate of 111,121,932 H Shares of the Company (representing approximately 9.46% of its then total issued H Shares). According to the information as disclosed on the website of the Hong Kong Stock Exchange and so far as the directors and supervisors of the Company are aware, Morgan Stanley International Incorporated, held its interest in the Company in the following manner:
- (a) 743,332 H Shares, representing approximately 0.06% of the Company's then total issued H Shares, were held by Morgan Stanley Dean Witter Hong Kong Securities Limited, which was ultimately 100% held by Morgan Stanley Asia Pacific (Holdings) Limited, which, in turn, was 90% held by Morgan Stanley International Incorporated;
- (b) 108,670,000 H Shares, representing approximately 9.25% of the Company's then total issued H Shares, were held by Morgan Stanley Investment Management Company, which was ultimately 100% held by Morgan Stanley Asia Pacific (Holdings) Limited, which, in turn, was 90% held by Morgan Stanley International Incorporated;
- (c) 292,600 H Shares, representing approximately 0.02% of the Company's then total issued H Shares, were held by Morgan Stanley Asset & Investment Trust Management Co. Limited, which was 100% held by Morgan Stanley International Incorporated;
- (d) 714,000 H Shares, representing approximately 0.06% of the Company's then total issued H Shares, were held by Morgan Stanley & Co International Limited, which was ultimately 100% held by Morgan Stanley Group (Europe), which, in turn, was approximately 98.30% held by Morgan Stanley International Limited, which was 100% ultimately held by Morgan Stanley International Incorporated; and
- (e) 702,000 H Shares, representing approximately 0.06% of the Company's then total issued H Shares, were held by Morgan Stanley Capital (Luxembourg) S.A., which was approximately 93.75% held by Morgan Stanley International Incorporated.

According to the information as disclosed on the website of the Hong Kong Stock Exchange and so far as the directors and supervisors of the Company are aware, as at 30 June 2007, Morgan Stanley Dean Witter Hong Kong Securities Limited also had a short position in 616,000 H Shares of the Company (representing approximately 0.05% of its then total issued H Shares).

5. Among the 1,156,215,998 H Shares held by HKSCC Nominees Limited, 96,938,500 H Shares, representing approximately 8.26% of the Company's then total issued H Shares, were held by Space Dragon Limited as beneficial owner, which was 100% held by Cheung Kong Investment Company Limited.
6. Among the 1,156,215,998 H Shares held by HKSCC Nominees Limited, 96,938,500 H Shares, representing approximately 8.26% of the Company's then total issued H Shares, were held by Choicewell Limited as beneficial owner, which was ultimately 100% held by Hutchison Whampoa Limited.

Save as disclosed above, as at 30 June 2007, to the knowledge of the directors, chief executive and supervisors of the Company, no other person (other than the directors, chief executive or supervisors) had an interest or short position in the shares or underlying shares of the Company as recorded in the register of the Company required to be kept under section 336 of the SFO or otherwise had an interest of 10% or more in the Company's shares.

## PURCHASE, SALE OR REDEMPTION OF SHARES

Neither the Company nor any of its subsidiaries purchased, sold or redeemed any shares of the Company during the first half of 2007.



## INTERESTS OF THE DIRECTORS AND SUPERVISORS IN THE EQUITY OF THE COMPANY

As at 30 June 2007, none of the directors, chief executive or supervisors of the Company had interests or short positions in the shares, underlying shares and/or debentures (as the case may be) of the Company or its associated corporations (within the meaning of Part XV of the SFO) which were required to be notified to the Company and Hong Kong Stock Exchange pursuant to the SFO (including interests or short positions which are taken or deemed to have under such provisions of the SFO), or recorded in the register maintained by the Company pursuant to Section 352 of the SFO or which were required to be notified to the Company and Hong Kong Stock Exchange pursuant to the "Model Code for Securities Transactions by Directors of the Listed Companies" in Schedule 10 of the Rules Governing the Listing of Securities on the Hong Kong Stock Exchange (the "Listing Rules").

## HUMAN RESOURCES

As at 30 June 2007, the Group had an aggregate of 45,177 employees. The wages of the Group's employees consist of basic salaries and bonuses.

## DESIGNATED DEPOSITS AND OVERDUE TIME DEPOSITS

As at 30 June 2007, the Group's deposits placed with financial institutions or other parties did not include any designated deposits or overdue time deposits against which the Group failed to receive repayments.

## THE MODEL CODE

Having made specific enquiries with all the directors of the Company, the directors of the Company have for six months ended 30 June 2007 complied with the "Model Code for Securities Transactions by Directors of Listed Issuers" as set out in Appendix 10 of the Listing Rules. The Company has not adopted a code of conduct less stringent than the "Model Code for Securities Transactions by Directors of Listed Issuers" regarding securities transactions of the directors of the Company.

## THE CODE OF CORPORATE GOVERNANCE PRACTICES

The directors of the Company consider that, for the six months ended 30 June 2007, the Group was in compliance with the Code of Corporate Governance Practices set out in Appendix 14 of the Listing Rules.

## AUDIT COMMITTEE

The audit committee of the Company has reviewed with the management and the external auditors the accounting principles and practices adopted by the Group and discussed the financial reporting matters including the review of the interim report prepared in accordance with the International Financial Reporting Standards.

## MATERIAL LITIGATION

Save as disclosed in contingent liabilities on page 5, the Company was not involved in any material litigation.

By order of the Board

**Liu Shao Yong**

*Chairman of the Board*

Guangzhou, the PRC  
20 August 2007

## DOCUMENTS AVAILABLE FOR INSPECTION AND ADDRESS FOR INSPECTION

**Document available for inspection:** Original copy of the Company's 2007 interim report signed by the Chairman of the Board.

**Address for Inspection:** The Company Secretary Office of the China Southern Airlines Company Limited, No. 278, Ji Chang Lu, Guangzhou, the People's Republic of China.

**Website:** [www.cs-air.com](http://www.cs-air.com)

## OPERATING DATA SUMMARY

	Six months ended 30 June		2007 vs 2006	
	2007	2006	Increase/ (decrease)	(%)
<b>Capacity</b>				
Available seat kilometres (ASKs) (million)				
– Domestic	<b>42,724</b>	36,924	5,800	15.7
– Hong Kong and Macau	<b>954</b>	1,328	(374)	(28.2)
– International	<b>8,886</b>	7,138	1,748	24.5
<b>Total</b>	<b>52,564</b>	45,390	7,174	15.8
Available tonne kilometres (ATKs) (million)				
– Domestic	<b>4,972</b>	4,314	658	15.3
– Hong Kong and Macau	<b>107</b>	161	(54)	(33.5)
– International	<b>1,684</b>	1,418	266	18.8
<b>Total</b>	<b>6,763</b>	5,893	870	14.8
Kilometres flown (thousand)	<b>324,499</b>	278,044	46,455	16.7
Hours flown (thousand)	<b>518</b>	438	80	18.3
Number of landing and takeoff (thousand)	<b>262</b>	225	37	16.4

	Six months ended 30 June		2007 vs 2006	
	2007	2006	Increase/ (decrease)	(%)
<b>Traffic</b>				
Revenue passenger kilometres (RPKs) (million)				
– Domestic	31,570	26,605	4,965	18.7
– Hong Kong and Macau	595	805	(210)	(26.1)
– International	5,622	4,680	942	20.1
<b>Total</b>	<b>37,787</b>	<b>32,090</b>	<b>5,697</b>	<b>17.8</b>
Revenue tonne kilometres (RTKs) (million)				
– Domestic	3,334	2,849	485	17.0
– Hong Kong and Macau	59	83	(24)	(28.9)
– International	857	776	81	10.4
<b>Total</b>	<b>4,250</b>	<b>3,708</b>	<b>542</b>	<b>14.6</b>
Passenger tonne kilometres (million)				
– Domestic	2,814	2,375	439	18.5
– Hong Kong and Macau	53	72	(19)	(26.4)
– International	500	416	84	20.2
<b>Total</b>	<b>3,367</b>	<b>2,863</b>	<b>504</b>	<b>17.6</b>
Cargo and mail tonne kilometres (million)				
– Domestic	520	474	46	9.7
– Hong Kong and Macau	6	11	(5)	(45.5)
– International	357	360	(3)	(0.8)
<b>Total</b>	<b>883</b>	<b>845</b>	<b>38</b>	<b>4.5</b>
Passengers carried (thousand)				
– Domestic	23,789	20,294	3,495	17.2
– Hong Kong and Macau	673	792	(119)	(15.0)
– International	1,979	1,600	379	23.7
<b>Total</b>	<b>26,441</b>	<b>22,686</b>	<b>3,755</b>	<b>16.6</b>

	Six months ended 30 June		2007 vs 2006	
	2007	2006	Increase/ (decrease)	(%)
Cargo and mail carried (thousand tonne)				
– Domestic	<b>340</b>	309	31	10.0
– Hong Kong and Macau	<b>6</b>	9	(3)	(33.3)
– International	<b>57</b>	58	(1)	(1.7)
<b>Total</b>	<b>403</b>	376	27	7.2
<b>Load factors</b>				
Passenger load factor (RPK/ASK) (%)				
– Domestic	<b>73.9</b>	72.1	1.8	2.5
– Hong Kong and Macau	<b>62.4</b>	60.6	1.8	3.0
– International	<b>63.3</b>	65.6	(2.3)	(3.5)
<b>Total</b>	<b>71.9</b>	70.7	1.2	1.7
Average load factor (RTK/ATK) (%)				
– Domestic	<b>67.1</b>	66.0	1.1	1.7
– Hong Kong and Macau	<b>55.1</b>	51.6	3.5	6.8
– International	<b>50.9</b>	54.7	(3.8)	(6.9)
<b>Total</b>	<b>62.8</b>	62.9	(0.1)	(0.2)
<b>Breakeven load factor (%)</b>	<b>64.1</b>	64.9	(0.8)	(1.2)
<b>Yield</b>				
Yield per RPK (RMB)				
– Domestic	<b>0.58</b>	0.57	0.01	1.8
– Hong Kong and Macau	<b>0.91</b>	0.77	0.14	18.2
– International	<b>0.62</b>	0.58	0.04	6.9
<b>Total</b>	<b>0.59</b>	0.58	0.01	1.7
Yield per cargo and mail tonne kilometre (RMB)	<b>1.92</b>	1.89	0.03	1.6
Yield per RTK (RMB)				
– Domestic	<b>5.75</b>	5.62	0.13	2.3
– Hong Kong and Macau	<b>9.66</b>	8.12	1.54	19.0
– International	<b>5.08</b>	4.55	0.53	11.6
<b>Total</b>	<b>5.67</b>	5.45	0.22	4.0

	Six months ended 30 June		2007 vs 2006	
	2007	2006	Increase/ (decrease)	(%)
<b>Fleet</b>				
Total number of aircraft at period end				
– Boeing	<b>173</b>	143	30	21.0
– Airbus	<b>109</b>	85	24	28.2
– McDonnell Douglas	<b>25</b>	36	(11)	(30.6)
– Others	<b>11</b>	11	–	–
<b>Total</b>	<b>318</b>	275	43	15.6
Aircraft utilisation rate (hours per day)	<b>9.39</b>	9.53	(0.14)	(1.5)
<b>Financial</b>				
Operating cost per ASK (RMB)	<b>0.47</b>	0.46	0.01	2.2
Operating cost per ATK (RMB)	<b>3.63</b>	3.54	0.09	2.5



The Board of Directors of the Company hereby announces the unaudited consolidated interim results of the Group for the six months ended 30 June 2007, together with the comparative figures for the corresponding period of 2006 as follows:

#### A. Prepared in accordance with International Financial Reporting Standards ("IFRSs")

#### CONSOLIDATED INCOME STATEMENT

for the six months ended 30 June 2007 - unaudited

(Expressed in Renminbi)

	Note	Six months ended 30 June	
		2007 RMB million	2006 RMB million
Operating revenue			
Traffic revenue		<b>24,086</b>	20,223
Other operating revenue		<b>470</b>	381
<b>Total operating revenue</b>	<b>3</b>	<b>24,556</b>	20,604
Operating expenses			
Flight operations		<b>13,226</b>	11,053
Maintenance		<b>2,361</b>	1,702
Aircraft and traffic servicing		<b>3,974</b>	3,426
Promotion and sales		<b>1,565</b>	1,460
General and administrative		<b>839</b>	697
Depreciation and amortisation		<b>2,546</b>	2,453
Others		<b>63</b>	56
<b>Total operating expenses</b>		<b>24,574</b>	20,847
<b>Operating loss</b>		<b>(18)</b>	(243)
Non-operating income/(expenses)			
Interest income		<b>16</b>	18
Interest expense	6	<b>(1,132)</b>	(1,004)
Share of associates' results		<b>32</b>	4
Share of jointly controlled entities' results		<b>51</b>	78
Gain on derivative financial instruments, net		<b>69</b>	–
Gain on sale of property, plant and equipment, net		<b>80</b>	–
Exchange gain, net		<b>1,266</b>	279
Others, net		<b>84</b>	95
<b>Total net non-operating income/(expense)</b>		<b>466</b>	(530)
Profit/(loss) before taxation		<b>448</b>	(773)
Income tax expense	5	<b>(222)</b>	(11)
<b>Profit/(loss) for the period</b>	<b>6</b>	<b>226</b>	(784)
Attributable to:			
Equity shareholders of the Company		<b>168</b>	(825)
Minority interests		<b>58</b>	41
<b>Profit/(loss) for the period</b>		<b>226</b>	(784)
Earnings/(loss) per share	8		
Basic		<b>RMB0.04</b>	RMB(0.19)
Diluted		<b>RMB0.04</b>	RMB(0.19)

The notes on pages 18 to 27 form part of this interim financial report.

**CONSOLIDATED BALANCE SHEET**

at 30 June 2007 - unaudited

*(Expressed in Renminbi)*

	<i>Note</i>	<b>At 30 June 2007 RMB million</b>	At 31 December 2006 RMB million
<b>Non-current assets</b>			
Property, plant and equipment, net	9	<b>58,073</b>	56,335
Construction in progress		<b>1,230</b>	911
Lease prepayments		<b>506</b>	493
Interest in associates		<b>177</b>	149
Interest in jointly controlled entities		<b>921</b>	870
Other investments in equity securities		<b>330</b>	330
Lease and equipment deposits		<b>9,254</b>	9,458
Deferred tax assets		<b>195</b>	95
Other assets		<b>240</b>	260
		<b>70,926</b>	68,901
<b>Current assets</b>			
Inventories		<b>1,347</b>	1,315
Financial assets		<b>21</b>	–
Trade receivables	10	<b>1,776</b>	1,512
Other receivables		<b>939</b>	879
Prepaid expenses and other current assets		<b>623</b>	585
Amounts due from related companies		<b>150</b>	128
Cash and cash equivalents		<b>3,551</b>	2,264
		<b>8,407</b>	6,683
<b>Current liabilities</b>			
Financial liabilities		<b>13</b>	26
Bank and other loans	11	<b>24,369</b>	23,822
Obligations under finance leases		<b>2,974</b>	3,091
Trade and bills payables	12	<b>1,426</b>	1,909
Sales in advance of carriage		<b>1,542</b>	1,436
Taxes payable		<b>256</b>	126
Amounts due to related companies		<b>138</b>	254
Accrued expenses		<b>6,830</b>	5,463
Other liabilities		<b>2,776</b>	2,736
		<b>40,324</b>	38,863
<b>Net current liabilities</b>		<b>(31,917)</b>	(32,180)
<b>Total assets less current liabilities</b>		<b>39,009</b>	36,721

**CONSOLIDATED BALANCE SHEET** (continued)

at 30 June 2007 - unaudited

(Expressed in Renminbi)

	Note	At 30 June 2007 RMB million	At 31 December 2006 RMB million
<b>Non-current liabilities and deferred items</b>			
Bank and other loans	11	10,590	10,018
Obligations under finance leases		13,709	12,307
Provision for major overhauls		832	805
Provision for early retirement benefits		279	306
Deferred credits		750	792
Deferred tax liabilities		502	372
		<b>26,662</b>	24,600
<b>Net assets</b>			
		<b>12,347</b>	12,121
<b>Capital and reserves</b>			
Share capital		4,374	4,374
Reserves	13	5,982	5,814
<b>Total equity attributable to equity shareholders of the Company</b>			
		<b>10,356</b>	10,188
<b>Minority interests</b>			
		<b>1,991</b>	1,933
<b>Total equity</b>			
		<b>12,347</b>	12,121

Approved and authorised for issue by the Board of Directors on 20 August 2007.

**Liu Shao Yong**  
Director

**Si Xian Min**  
Director

**Xu Jie Bo**  
Director

The notes on pages 18 to 27 form part of this interim financial report.

**CONSOLIDATED STATEMENT OF CHANGES IN EQUITY**

for the six months ended 30 June 2007 - unaudited

*(Expressed in Renminbi)*

	Attributable to equity shareholders of the Company				Total	Minority interests	Total equity
	Share capital	Share premium	Other reserves	Accumulated losses			
	RMB million	RMB million	RMB million (Note)	RMB million	RMB million	RMB million	RMB million
At 1 January 2006	4,374	5,325	691	(390)	10,000	1,936	11,936
(Loss)/profit for the period	–	–	–	(825)	(825)	41	(784)
Acquisition of equity interest held by minority shareholders	–	–	–	–	–	(6)	(6)
Distributions to minority shareholders	–	–	–	–	–	(2)	(2)
At 30 June 2006	4,374	5,325	691	(1,215)	9,175	1,969	11,144
At 1 January 2007	4,374	5,325	732	(243)	10,188	1,933	12,121
Profit for the period	–	–	–	168	168	58	226
<b>At 30 June 2007</b>	<b>4,374</b>	<b>5,325</b>	<b>732</b>	<b>(75)</b>	<b>10,356</b>	<b>1,991</b>	<b>12,347</b>

Note: Other reserves represent statutory surplus reserve, statutory public welfare fund and discretionary surplus reserve.

The notes on pages 18 to 27 form part of this interim financial report.

**CONDENSED CONSOLIDATED CASH FLOW STATEMENT**

for the six months ended 30 June 2007 - unaudited

*(Expressed in Renminbi)*

	<b>Six months ended 30 June</b>	
	<b>2007</b>	2006
	<b>RMB million</b>	RMB million
Net cash inflows from operating activities	<b>1,601</b>	669
Net cash used in investing activities	<b>(687)</b>	(2,625)
Net cash inflows/(outflows) before financing activities	<b>914</b>	(1,956)
Net cash inflows from financing activities	<b>373</b>	3,460
Increase in cash and cash equivalents	<b>1,287</b>	1,504
Cash and cash equivalents at 1 January	<b>2,264</b>	2,901
Cash and cash equivalents at 30 June	<b>3,551</b>	4,405

Cash and cash equivalents at 1 January and 30 June of both 2007 and 2006 represent cash at bank and in hand.

The notes on pages 18 to 27 form part of this interim financial report.



## NOTES TO THE INTERIM FINANCIAL REPORT

for the six months ended 30 June 2006 - unaudited  
(Expressed in Renminbi)

### 1 Basis of preparation

This interim financial report of China Southern Airlines Company Limited (the "Company") and its subsidiaries (the "Group") has been prepared in accordance with the applicable disclosure provisions of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited, including compliance with International Accounting Standard 34 "Interim financial reporting" ("IAS 34") adopted by the International Accounting Standards Board ("IASB"). It was authorised for issuance on 20 August 2007.

At 30 June 2007, the Group's current liabilities exceeded its current assets by RMB31,917 million, which include current instalments of bank and other loans and obligations under finance leases of RMB27,343 million. 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. In preparing the interim financial report, the directors of the Company have considered the Group's sources of liquidity and believe that adequate funding is available to fulfil the Group's short term obligations and capital expenditure requirements. Accordingly, the interim financial report has been prepared on a basis that the Group will be able to continue as a going concern.

The interim financial report has been prepared in accordance with substantially the same accounting policies adopted in the 2006 annual financial statements. Please refer to Note 2 for the discussion of new and revised International Financial Reporting Standards ("IFRSs") adopted by the Group in 2007.

The preparation of an interim financial report in conformity with IAS 34 requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, income and expenses. Actual results may differ from these estimates.

In preparing this interim financial report, the significant judgements made by management in applying the Group's accounting policies and the key sources of estimation uncertainty were the same as those that applied to the 2006 annual financial statements.

The interim financial report contains condensed consolidated financial statements and selected explanatory notes. The notes include an explanation of events and transactions that are significant to an understanding of the changes in financial position and performance of the Group since the 2006 annual financial statements. The condensed consolidated interim financial statements and notes thereon do not include all of the information required for a full set of financial statements prepared in accordance with IFRSs. IFRSs include International Accounting Standards ("IAS") and related interpretations.

The interim financial report is unaudited, but has been reviewed by KPMG in accordance with Hong Kong Standards on Review Engagements 2410, "Review of interim financial information performed by the independent auditor of the entity" issued by the Hong Kong Institute of Certified Public Accountants. KPMG's independent review report to the Board of Directors is included on page 28.

The financial information relating to the financial year ended 31 December 2006 that is included in the interim financial report as being previously reported information does not constitute the Group's annual financial statements prepared under IFRSs for that financial year but is derived from those financial statements. The Group's annual financial statements for the year ended 31 December 2006 are available at the Company's registered office. The independent auditor has expressed an unqualified opinion on those financial statements in the audit report dated 16 April 2007.

## 2 New and revised IFRSs

The IASB has issued a number of new and revised IFRSs that are effective or available for early adoption for the current accounting period of the Group. The Board of Directors has determined the accounting policies to be adopted in the preparation of the Group's annual financial statements prepared under IFRSs for the year ending 31 December 2007, on the basis of IFRSs currently in issue.

The IFRSs that will be effective or are available for voluntary early adoption in the annual financial statements prepared under IFRSs for the year ending 31 December 2007 may be affected by the issue of additional interpretation(s) or other changes announced by the IASB subsequent to the date of issuance of this interim financial report. Therefore the policies that will be applied in the Group's financial statements for that period cannot be determined with certainty at the date of issuance of this interim financial report.

The adoption of these new and revised IFRSs did not result in significant changes to the Group's accounting policies applied in this interim financial report for the periods presented.

## 3 Revenue and segment reporting

The Group operates principally as a single business segment for the provision of air transportation services.

Turnover comprises revenues from airline and airline-related business and is stated net of sales tax.

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

	For the six months ended 30 June			
	Domestic	Hong Kong and Macau	International	Total
	RMB million	RMB million	RMB million	RMB million
<b>2007</b>				
Traffic revenue	<b>19,165</b>	<b>571</b>	<b>4,350</b>	<b>24,086</b>
Other operating revenue	<b>470</b>	–	–	<b>470</b>
Turnover	<b>19,635</b>	<b>571</b>	<b>4,350</b>	<b>24,556</b>
Operating profit/(loss)	<b>512</b>	<b>(19)</b>	<b>(511)</b>	<b>(18)</b>
<b>2006</b>				
Traffic revenue	16,017	674	3,532	20,223
Other operating revenue	381	–	–	381
Turnover	16,398	674	3,532	20,604
Operating profit/(loss)	266	(63)	(446)	(243)

#### 4 Seasonality of operations

Owing to the summer holiday period in July and August, the Group on average experiences higher traffic demands in the second half of the year. As a result, the first half year typically reports lower revenues and results than the second half.

#### 5 Income tax expense

	<b>Six months ended 30 June</b>	
	<b>2007</b>	2006
	<b>RMB million</b>	RMB million
PRC income tax	<b>192</b>	5
Deferred tax	<b>30</b>	6
	<hr/>	
Income tax expense	<b>222</b>	11

The statutory income tax rate in the PRC is 33%. The Company is taxed at a preferential rate of 18% and certain branches are taxed at rates ranging from 15% to 33%. The subsidiaries of the Group are taxed at rates ranging from 15% to 33%.

On 16 March 2007, the Fifth Plenary Session of the Tenth National People's Congress passed the Corporate Income Tax Law of the PRC ("new tax law") which will take effect on 1 January 2008. As a result of the new tax law, the statutory income tax rate currently adopted by the Company and its subsidiaries will change from 33% to 25% with effect from 1 January 2008 over a five-year transitional period. The existing preferential tax rates currently enjoyed by the Company and its subsidiaries will also be gradually migrated to the new standard rate of 25% over a five-year transitional period. As the detailed instruction for the transition to the new tax rate is yet to be issued, the Group estimated that the applicable income tax rate under the preferential tax policy will be expired at the shorter of the existing preferential tax period and the five-year transitional period. The change in the carrying amount of the deferred tax assets and liabilities, as a result of the change in tax rate, is reflected in the interim financial report of the Group for the six months ended 30 June 2007.

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

## 6 Profit/(loss) for the period

	Six months ended 30 June	
	2007	2006
	RMB million	RMB million
Profit/(loss) for the period is arrived at after charging/(crediting):		
Interest on bank and other loans	1,049	836
Finance charges on obligations under finance leases	363	272
Less: borrowing costs capitalised	(280)	(104)
	<b>1,132</b>	1,004
Jet fuel costs	8,598	7,080
Depreciation		
– Owned assets	1,779	1,651
– Assets acquired under finance leases	756	811
Amortisation of deferred credits	(42)	(26)
Other amortisation	11	16
Operating lease charges		
– Aircraft and flight equipment	1,801	1,418
– Land and buildings	159	148
Staff costs	2,576	2,124
Share of associates' taxation	5	5
Share of jointly controlled entities' taxation	11	9
Dividend income from unlisted securities	–	(1)

## 7 Dividends

The Board of Directors does not recommend the payment of an interim dividend for the six months ended 30 June 2007. No interim dividend was paid in respect of the six months ended 30 June 2006.

## 8 Earnings/(loss) per share

The calculation of basic earnings/(loss) per share for the six months ended 30 June 2007 is based on the profit attributable to equity shareholders of the Company of RMB168 million (six months ended 30 June 2006: loss of RMB825 million) and the weighted average number of shares in issue during the period of 4,374 million (six months ended 30 June 2006: 4,374 million).

The amount of diluted earnings/(loss) per share is the same as basic earnings/(loss) per share as there were no dilutive potential ordinary shares in existence during both the current and prior periods.

## 9 Property, plant and equipment, net

During the six months ended 30 June 2007, the Group acquired aircraft with an aggregate cost of RMB3,910 million (six months ended 30 June 2006: RMB395 million).

**10 Trade receivables**

Credit terms granted by the Group to sales agents and other customers generally range from one to three months. An ageing analysis of trade receivables, net of impairment losses for bad and doubtful debts, is set out below:

	<b>At 30 June 2007</b>	At 31 December 2006
	RMB million	RMB million
Within 1 month	<b>1,419</b>	1,355
More than 1 month but less than 3 months	<b>321</b>	131
More than 3 months but less than 12 months	<b>33</b>	24
More than 12 months	<b>3</b>	2
	<b>1,776</b>	1,512

**11 Bank and other loans**

Bank and other loans are analysed as follows:

	<b>At 30 June 2007</b>	At 31 December 2006
	RMB million	RMB million
Non-interest bearing and unsecured	<b>22</b>	22
Interest bearing and secured	<b>9,113</b>	8,726
Interest bearing and unsecured	<b>25,824</b>	25,092
Total bank and other loans	<b>34,959</b>	33,840
Less: loans due within one year classified as current liabilities	<b>(24,369)</b>	(23,822)
	<b>10,590</b>	10,018

**12 Trade and bills payables**

The ageing analysis of trade and bills payables is as follows:

	<b>At 30 June 2007</b>	At 31 December 2006
	RMB million	RMB million
Within 1 month	<b>803</b>	1,125
More than 1 month but less than 3 months	<b>257</b>	448
More than 3 months but less than 6 months	<b>366</b>	336
	<b>1,426</b>	1,909



### 13 Reserves

No transfer to statutory reserves has been made during the six months ended 30 June 2007 (six months ended 30 June 2006: Nil).

### 14 Commitments

#### (a) Capital commitments

At 30 June 2007, the Group had capital commitments as follows:

	<b>At 30 June 2007 RMB million</b>	At 31 December 2006 RMB million
Commitments in respect of aircraft and flight equipment		
– authorised and contracted for	<b>56,480</b>	66,881
Other commitments		
– authorised and contracted for	<b>485</b>	420
– authorised but not contracted for	<b>1,808</b>	1,404
	<b>2,293</b>	1,824
	<b>58,773</b>	68,705

#### (b) Investing commitments

At 30 June 2007, the Group was committed to make capital contributions of RMB83 million and RMB720 million to a jointly controlled entity and a subsidiary respectively (31 December 2006: RMB83 million to a jointly controlled entity).

### 15 Material related party transactions

#### (a) Key management personnel remuneration

Key management personnel receive compensation in the form of fees, salaries, allowances, benefits in kind, discretionary bonuses and retirement scheme contributions. Key management personnel received total compensation of RMB2,188,000 for the six months ended 30 June 2007 (six months ended 30 June 2006: RMB2,112,000). Such remuneration is included in "staff costs" as disclosed in Note 6.

#### (b) Contributions to post-employment benefit plans

The Group participates in various defined contribution retirement plans organised by municipal and provincial governments for its staff.

**15 Material related party transactions** (continued)

(c) *Transactions with China Southern Air Holding Company ("CSAHC") and its affiliates (the "CSAHC Group"), and associates and jointly controlled entities of the Group*

	<b>Six months ended 30 June</b>	
	<b>2007</b>	2006
	<b>RMB million</b>	RMB million
<i>Expenses paid to the CSAHC Group</i>		
Handling charges	<b>9</b>	14
Air catering supplies	<b>93</b>	90
Commission expense	<b>7</b>	21
Sundry aviation supplies	<b>23</b>	29
Lease charges for land and buildings	<b>50</b>	45
Property management fee	<b>13</b>	9
<i>Expenses paid to an associate and jointly controlled entities</i>		
Repairing charges	<b>671</b>	617
Flight simulation service charges	<b>54</b>	73
Ground service charges	<b>19</b>	24
Interest expense	<b>7</b>	6
<i>Income from an associate and jointly controlled entities</i>		
Rental income	<b>16</b>	16
Interest income	<b>3</b>	3

(d) *Balances with the CSAHC Group, and associates and jointly controlled entities of the Group*

	<b>At 30</b>	At 31
	<b>June 2007</b>	December 2006
	<b>RMB million</b>	RMB million
<i>Receivables</i>		
The CSAHC Group	<b>5</b>	4
An associate	<b>5</b>	2
Jointly controlled entities	<b>140</b>	122
<i>Payables</i>		
The CSAHC Group	<b>107</b>	178
Jointly controlled entities	<b>31</b>	87

Amounts due from/to the CSAHC Group, and associates and jointly controlled entities of the Group are unsecured, interest free and have no fixed terms of repayment.

**15 Material related party transactions** (continued)

- (e) *Loans from and deposits placed with China Southern Airlines Group Finance Company Limited ("SA Finance") (a PRC authorised financial institution controlled by CSAHC and an associate of the Group)*

At 30 June 2007, loans from SA Finance amounted to RMB270 million (31 December 2006: RMB300 million). The loans are unsecured, interest bearing at floating interest rates as published by the People's Bank of China ("PBOC") and are repayable within one year. The loans are guaranteed by CSAHC (included in the amount as disclosed in Note (f) below).

At 30 June 2007, the Group's deposits with SA Finance amounted to RMB875 million (31 December 2006: RMB629 million). The applicable interest rates were determined in accordance with the rates published by the PBOC.

- (f) *Guarantees from CSAHC and SA Finance*

Certain bank loans were guaranteed by the following parties:

	<b>At 30 June 2007 RMB million</b>	At 31 December 2006 RMB million
CSAHC	<b>1,297</b>	1,484
SA Finance	<b>4</b>	5

- (g) *Transactions with other state-controlled entities*

The Company is a state-controlled entity and operates in an economic regime currently dominated by entities directly or indirectly controlled by the PRC government ("state-controlled entities") through its government authorities, agencies, affiliations and other organisations.

Other than those disclosed in this interim financial report, the Group conducts transactions with other state-controlled entities which include but are not limited to the following:

- Transportation services;
- Leasing arrangements;
- Purchase of equipment;
- Purchase of ancillary materials and spare parts;
- Ancillary and social services; and
- Financial services arrangement.

These transactions are conducted in the ordinary course of the Group's business on terms comparable to those with other entities that are not state-controlled. The Group has established its buying, pricing strategy and approval process for purchases and sales of products and services. Such buying, pricing strategy and approval processes do not depend on whether the counterparties are state-controlled entities or not.

**15 Material related party transactions** (continued)*(g) Transactions with other state-controlled entities* (continued)

Having considered the potential for transactions to be impacted by related party relationships, the Group's pricing strategy, buying and approval processes, and what information would be necessary for an understanding of the potential effect of the relationship on the financial statements, the directors of the Company are of the opinion that the following transactions with other state-controlled entities require disclosure:

- (i) The Group's transactions with other state-controlled entities, including state-controlled banks in the PRC

	<b>Six months ended 30 June</b>	
	<b>2007</b>	2006
	<b>RMB million</b>	RMB million
Jet fuel cost	<b>6,934</b>	5,619
Interest income	<b>10</b>	13
Interest expense	<b>921</b>	597

- (ii) The Group's balances with other state-controlled entities, including state-controlled banks in the PRC

	<b>At 30</b>	At 31
	<b>June 2007</b>	December 2006
	<b>RMB million</b>	RMB million
Cash and deposits at bank	<b>2,266</b>	1,434
Short-term bank loans and current portion of long-term bank loans	<b>22,962</b>	21,209
Long-term bank loans, less current portion	<b>8,879</b>	8,223

- (iii) Guarantees from other state-controlled entities, including state-controlled banks in the PRC

	<b>At 30</b>	At 31
	<b>June 2007</b>	December 2006
	<b>RMB million</b>	RMB million
Guarantees on certain bank loans of the Group	<b>62</b>	201
Guarantees on certain documentary letters of credit issued by the Group	<b>177</b>	–

*(h) Loan from a minority shareholder*

At 30 June 2007, loan from a minority shareholder amounted to RMB19 million (31 December 2006: RMB19 million). The loan is unsecured, interest free and repayable within five years.

## 16 Contingent liabilities

A writ of summons was issued on 30 May 2007 by two sales agents in Taiwan (the “plaintiffs”) against the Company for the alleged breach of certain terms and conditions of a cooperative agreement (the “cooperative agreement”). The plaintiffs have made a claim against the Company for a total sum of approximately RMB107 million mainly in respect of the alleged non-payment of sales commission on air tickets sold in Taiwan during the period from 1 September 2004 to 31 August 2006. The plaintiffs have also claimed against the Company for an unspecified compensation for early termination of the cooperative agreement.

The directors of the Company consider that, given the nature of the claims and the preliminary status of the proceedings, it is not possible to estimate the eventual outcome of the claims with reasonable certainty at this stage. However, the directors of the Company are of the opinion that the claims are without merit and have instructed its legal advisor to defend the claims vigorously. The directors of the Company consider that the outstanding claim should have no material adverse effect on the financial position of the Group.

## 17 Post balance sheet events

On 16 July 2007, the Company entered into a purchase agreement with Airbus SNC for the purchase of twenty Airbus A320 series aircraft scheduled for deliveries from 2009 to 2010. According to the information provided by Airbus SNC, the catalogue price for one Airbus A320 series aircraft is in the range from US\$66.5-85.9 million.

On 16 July 2007, Xiamen Airlines Company Limited, a subsidiary of the Company, entered into a purchase agreement with Boeing Company for the purchase of twenty-five Boeing B737-800 series aircraft scheduled for deliveries from 2011 to 2013. According to the information provided by Boeing Company, the catalogue price for one Boeing B737-800 series aircraft is in the range of US\$70.5-79 million.

On 14 August 2007, the Company entered into agreements with CSAHC, pursuant to which the Company agreed to acquire and CSAHC agreed to sell (1) the entire equity interest in China Southern Airlines Group Air Catering Company Limited; (2) certain assets of Guangzhou BiHuaYuan Training Centre including certain properties and office facilities; and (3) certain assets of Nan Lung Travel & Express (Hong Kong) Limited, including certain properties and office facilities and the 51% equity interest in Nan Lung International Freight Limited, for a total consideration of RMB270 million.

On 14 August 2007, the Company entered into an agreement with CSAHC, pursuant to which the Company agreed to sell and CSAHC agreed to acquire the 90% equity interest in Guangzhou Aviation Hotel for a consideration of RMB75 million.

On 20 August 2007, the Company entered into a purchase agreement with Boeing Company for the purchase of fifty-five Boeing 737-700 and Boeing 737-800 aircraft scheduled for deliveries from 2011 to 2013. According to the information provided by Boeing Company, the catalogue prices for one Boeing B737-700 and one B737-800 aircraft are in the range of US\$57-67.5 million and US\$70.5-79 million respectively.



## REVIEW REPORT TO THE BOARD OF DIRECTORS OF CHINA SOUTHERN AIRLINES COMPANY LIMITED

### INTRODUCTION

We have reviewed the interim financial report set out on pages 13 to 27 which comprises the consolidated balance sheet of China Southern Airlines Company Limited as of 30 June 2007 and the related consolidated income statement, consolidated statement of changes in equity and condensed consolidated cash flow statement for the six-month period then ended and explanatory notes. The Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited require the preparation of an interim financial report to be in compliance with the relevant provisions thereof and International Accounting Standard 34 "Interim financial reporting" issued by the International Accounting Standards Board. The directors are responsible for the preparation and presentation of the interim financial report in accordance with International Accounting Standard 34.

Our responsibility is to form a conclusion, based on our review, on the interim financial report and to report our conclusion solely to you, as a body, in accordance with our agreed terms of engagement, and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

### SCOPE OF REVIEW

We conducted our review in accordance with Hong Kong Standards on Review Engagements 2410, "Review of interim financial information performed by the independent auditor of the entity" issued by the Hong Kong Institute of Certified Public Accountants. A review of the interim financial report consists of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with Hong Kong Standards on Auditing and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly we do not express an audit opinion.

### CONCLUSION

Based on our review, nothing has come to our attention that causes us to believe that the interim financial report as at 30 June 2007 is not prepared, in all material respects, in accordance with International Accounting Standard 34 "Interim financial reporting".

#### **KPMG**

*Certified Public Accountants*

8th Floor, Prince's Building  
10 Chater Road, Central  
Hong Kong, The People's Republic of China

20 August 2007

**B. Prepared in accordance with PRC Accounting Standards for Business Enterprises (2006) ("PRC GAAP")****CONSOLIDATED INCOME STATEMENT**

For the six months ended 30 June 2007 – unaudited

*(Expressed in Renminbi)*

	<b>Six months ended 30 June</b>	
	<b>2007</b>	2006
	<b>RMB million</b>	RMB million
Operating revenue	<b>25,210</b>	21,144
Less: Cost of operations	<b>21,971</b>	18,686
Business taxes and surcharges	<b>699</b>	548
Selling expenses	<b>1,605</b>	1,488
General and administrative expenses	<b>818</b>	690
Financial expenses/(income)	<b>(104)</b>	752
Add: Gain in change of fair value of derivative financial instruments	<b>34</b>	–
Investment income	<b>118</b>	80
Including: share of associates' and jointly controlled entities' results	<b>83</b>	82
Operating income/(loss)	<b>373</b>	(940)
Add: Non-operating income	<b>263</b>	153
Less: Non-operating expenses	<b>13</b>	8
Including: loss on disposal of non-current assets	<b>3</b>	1
Profit/(loss) before taxation	<b>623</b>	(795)
Less: Income tax	<b>251</b>	9
Net profit/(loss) for the period	<b>372</b>	(804)
Net profit/(loss) attributable to		
Equity shareholders of the Company	<b>308</b>	(854)
Minority interests	<b>64</b>	50
Earnings/(loss) per share		
Basic	<b>RMB0.07</b>	RMB(0.20)
Diluted	<b>RMB0.07</b>	RMB(0.20)

**CONSOLIDATED BALANCE SHEET**

At 30 June 2007 – unaudited

*(Expressed in Renminbi)*

	At <b>30 June 2007</b> RMB million	At 31 December 2006 RMB million
<b>Assets</b>		
<b>Current assets</b>		
Cash at bank and on hand	3,551	2,264
Trading financial assets	21	–
Trade receivables	1,781	1,512
Payments in advance	641	603
Dividends receivable	33	33
Other receivables	1,029	956
Inventories	1,347	1,315
	<b>8,403</b>	6,683
<b>Non-current assets</b>		
Long-term receivables	29	29
Long-term equity investments	1,455	1,375
Investment properties	201	206
Fixed assets	57,741	55,834
Construction in progress	9,766	9,591
Intangible assets	712	713
Equipment lease deposits	723	783
Long-term deferred expenses	62	38
Deferred tax assets	188	115
	<b>70,877</b>	68,684
Total assets	<b>79,280</b>	75,367

**CONSOLIDATED BALANCE SHEET** (continued)

At 30 June 2007 – unaudited

(Expressed in Renminbi)

	At 30 June 2007 RMB million	At 31 December 2006 RMB million
<b>Liabilities and shareholders' equity</b>		
<b>Current liabilities</b>		
Short-term loans	22,134	19,907
Trading financial liabilities	13	26
Trade payables	6,808	6,028
Sales in advance of carriage	1,542	1,436
Wages and other welfare payables	1,020	952
Taxes payable	692	526
Interest payable	445	449
Other payables	2,451	2,528
Long-term liabilities due within one year	5,188	6,964
Total current liabilities	40,293	38,816
<b>Non-current liabilities</b>		
Long-term loans	10,590	10,018
Obligations under finance leases	13,709	12,307
Provision for major overhauls	832	805
Deferred credits	750	792
Other provisions	287	314
Deferred tax liabilities	506	374
Total non-current liabilities	26,674	24,610
Total liabilities	66,967	63,426
<b>Shareholders' equity</b>		
Share capital	4,374	4,374
Capital reserve	5,898	5,898
Surplus reserve	732	732
Retained profits/(accumulated losses)	(693)	(1,001)
Total equity attributable to equity shareholders of the Company	10,311	10,003
Minority interests	2,002	1,938
Total equity	12,313	11,941
Total liabilities and equity	79,280	75,367

## NOTES

### 1 Principal accounting policies

#### (a) *Business combination and consolidated financial statements*

##### (i) Business combination involving entities under common control

A business combination involving entities or businesses under common control is a business combination in which all of the combining entities or businesses are ultimately controlled by the same party or parties both before and after the business combination, and that control is not transitory. The assets and liabilities that the acquirer receives in the acquisition are accounted for at the acquiree's carrying amount on the acquisition date. The difference between the carrying amount of the acquired net assets and the carrying amount of the consideration paid for the acquisition (or the total nominal value of shares issued) is initially recognised in the capital reserve, and any shortfall then recognised in retained profits. The acquisition date is the date on which the acquirer effectively obtains control of the acquiree.

##### (ii) Business combination involving entities not under common control

A business combination involving entities or businesses not under common control is a business combination in which all of the combining entities or businesses are not ultimately controlled by the same party or parties both before and after the business combination. The Group's asset consideration for the acquisition, and the liabilities incurred or assumed on the purchase date are measured at fair value. The difference between the fair value and the carrying amount is recognised in profit or loss. The purchase date is the date on which the Group effectively obtains control of the acquiree.

The Group allocates the cost of a business combination on the purchase date and recognises the fair value of the acquiree's various identifiable assets, liabilities or contingent liabilities as they are acquired.

The excess of the cost of a business combination over the fair value of the identifiable net assets acquired is recognised as goodwill.

When the cost of a business combination is less than the fair value of the identifiable net assets acquired, the Group reassesses the measurement of the fair value of the various identifiable assets, liabilities or contingent liabilities acquired, as well as the measurement of the cost of the combination. Any excess remaining after that reassessment is recognised in profit or loss.

##### (iii) Consolidated financial statements

The scope of the consolidated financial statements is defined by the controlling interest and includes investee units in which the Company, directly or indirectly through its subsidiaries, holds over 50% of the voting rights (except where evidence indicates that the Company cannot exercise control); or holds 50% or less of the voting rights but can exercise control over the investee units.

A subsidiary acquired by the Company, through a business combination involving entities under common control, is included in the scope of the Company's consolidated financial statements once the Company begins to exercise ultimate control over it. In preparing the consolidated financial statements, the subsidiary's operating results are included in the Company's consolidated income statement once the Company begins to exercise ultimate control over it. The opening balance of the consolidated financial statements and prior periods' financials are adjusted accordingly.

## 1 Principal accounting policies (continued)

### (a) Business combination and consolidated financial statements (continued)

#### (iii) Consolidated financial statements (continued)

The operating results of a subsidiary acquired by the Company through a business combination involving entities not under common control are included in the Company's consolidated income statement from the purchase date. The operating results of the acquired subsidiary included in the consolidated income statement are measured at the fair value of the various identifiable assets, liabilities, and contingent liabilities acquired on the purchase date.

Where the accounting policies and accounting period adopted by the subsidiary are different from those adopted by the Company, necessary adjustments are made to the subsidiary's financial statements according to the Company's accounting policies and accounting period. All significant inter-company balances and transactions, and any unrealised gains arising from inter-company transactions, have been eliminated on consolidation.

(iv) The above policies are applicable to business combinations occurred on and after 1 January 2007.

### (b) Translation of foreign currencies

Capital contribution in foreign currency has been translated into Renminbi at the exchange rates prevailing at the dates of each contribution received. Other foreign currency transactions are translated into Renminbi at the exchange rates prevailing on the transaction dates or at rates that approximate the actual exchange rates.

The rates of exchange at date of the transaction are quoted by the People's Bank of China ("PBOC rates"). The rates that approximate the actual exchange rates are determined by a systematic and reasonable method, it is an average exchange rate approximates the actual exchange rate at date of the transaction.

Foreign currency monetary items are translated at the exchange rates prevailing at the balance sheet date. Exchange gains and losses on foreign currency translation, except for those directly related to the principal and interest of specific borrowings for the acquisition, construction or production of qualifying assets (see Note 1(s)), are dealt with in profit or loss. For foreign currency non-monetary items measured at historical cost, the amount in the reporting currency shall not be changed. Foreign currency non-monetary items measured at fair value are translated using the exchange rates at the date when the fair value was determined. After translation, the difference between the translated amount and the original amount in the reporting currency is recognised as capital reserve, or dealt with in profit or loss, if measured at fair value and with changes in the fair value charged to profit or loss.

When the financial statements of foreign operations are translated into Renminbi, the assets and liabilities are translated at the exchange rate prevailing at the balance sheet date; apart from "Retained Profits", the items in shareholders' equity are translated at exchange rates at the dates of the relevant transactions. The items in revenue and expenses are translated at the exchange rates that approximate the actual exchange rates at dates of the relevant transactions. The resulting exchange differences are recognised directly in equity and are presented as a separate component of equity.

## 1 Principal accounting policies (continued)

### (c) Cash equivalents

Cash equivalents held by the Group are short-term and highly liquid investments which are readily convertible into known amounts of cash and are subject to an insignificant risk of changes in value.

### (d) 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 borrowing costs may be capitalised as part of the cost of certain produced inventories when it meets the capitalisation requirement. The actual 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.

Consumables are amortised at the full amount and recognised as cost of related assets, or dealt with in profit or loss when issued for use.

Inventories are recorded by perpetual method.

### (e) Long-term equity investments

#### (i) Investment in subsidiaries

For a long-term equity investment resulting from a business combination involving entities under common control, the Group's initial investment cost is the carrying amount of its share of the shareholders' equity in the subsidiary on the acquisition date. The difference between the initial investment cost and the cash paid, non-monetary assets transferred, and the carrying amount of the liabilities assumed by the Group, is reflected in the share premium account under capital reserve, and any shortfall is then recognised in retained profits.

In terms of long-term equity investment resulting from a business combination involving entities not under common control, the cost of the business combination confirmed on the acquisition date is recognised as the Group's initial investment cost.

For the long-term equity investment not resulting from a business combination, the Group's initial investment cost is the actual consideration paid.

The Company uses the cost method to account for its long-term equity investment in subsidiaries.

The Company provides for impairment losses on long-term equity investment in its subsidiaries in accordance with Note 1(j).

## 1 Principal accounting policies (continued)

### (e) Long-term equity investments (continued)

#### (ii) Investment in joint ventures and associates

Joint ventures are enterprises under the joint control of the Group and other investors as outlined in contractual arrangements. The joint control refers to the control exercised over economic activities in accordance with contractual agreements and exists only when the controlling investors concur on significant financial and operational decisions related to economic activities.

Associates are those over which the Group exercises significant influence. The Group has the right to participate in making financial and operating policy decisions, but it has no control or joint control with other parties over the formulation of these policies.

The initial investment cost of a joint venture and an associate is recorded at the consideration paid or at the contractual consideration specified in the investment contract or agreement, where long-term equity investment is injected as capital contribution.

The long-term equity investment in investee units under the Group's joint control or substantial influence is accounted for using the equity method.

- Where the initial investment cost of a long-term equity investment is greater than the share of the identifiable net assets' fair value at the time of investment, the former is accounted for as the investment cost. Where the initial investment cost of the long-term equity investment is less than the share of the identifiable net assets' fair value at the time of investment, the latter is accounted for as the investment cost. The difference between the long-term equity investment cost and the initial investment cost is recognised in profit or loss.
- After having invested in joint ventures and associates, the Group adjusts the carrying amount of its long term equity investment according to the share of owner's equity of investee units.

The Group's entitlement or assumed share of the investee units' realised net profits or losses is determined based on the fair value of the investee units' various identifiable assets at the time when the investee units are acquired by the Group. Where the accounting policies and the accounting periods of the investee units differ from those of the Group, necessary adjustments are made to the investee units' financial statements in accordance with the Group's accounting policies and accounting period when accounting for the investee units' results using the equity method.

The Group provides for impairment losses on long-term equity investment in joint ventures and associates in accordance with note 1(j).



**1 Principal accounting policies** (continued)*(e) Long-term equity investments* (continued)

- (iii) Long-term equity investment in investee enterprises not under the Group's control, joint control, or significant influence or without quoted prices in active markets or a reliable estimate of fair values

The initial cost of investment in these entities is originally recognised in the same way as the initial investment cost and measurement principles for joint ventures and associates. The cost method is used for subsequent measurement.

In accordance with note 1(k), the Group provides for impairment loss on long-term equity investments without quoted prices in active markets or a reliable estimate of fair values, which are stated using the cost method.

*(f) Investment property*

The Group measures investment property using the cost model. The investment property is stated in the balance sheet at cost less accumulated depreciation and impairment losses (see note 1 (j)). Depreciation policies of buildings and land use rights held as investment property are set out in note 1(g) and 1(i).

*(g) Fixed assets and construction in progress*

Fixed assets refer to the tangible assets held by the Group for use in the provision of services and administrative purposes with a useful life over one financial year.

Fixed assets are stated in the balance sheet at cost or revalued amount less accumulated depreciation and impairment losses (see note 1(j)). Construction in progress is stated in the balance sheet at cost less impairment losses (see note 1(j)).

All direct and indirect costs related to the purchase or construction of fixed assets, incurred before the assets are ready for their intended uses, are capitalised as construction in progress. Those costs include borrowing costs for the acquisition, construction, and production of qualifying fixed assets.

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

## 1 Principal accounting policies (continued)

### (g) Fixed assets and construction in progress (continued)

The cost or valuation of items of fixed assets of the Group, less their estimated residual value, is depreciated using the straight-line method over their estimated useful lives. The respective annual depreciation rates for fixed assets are as follows:

	<b>Annual depreciation rate</b>
Owned and finance leased aircraft	4.75%-6.33%
Other flight equipment:	
– Jet engines	4.75%-6.33%
– Others, including high value rotables	6.33%-40.00%
Buildings	3.17%
Machinery, equipment and motor vehicles	9.50%-19.00%

### (h) 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 fixed assets acquired by way of finance leases are stated under fixed assets at an amount equal to the lower of the fair value of the leased assets and the present value of the minimum lease payments at the inception of the lease. 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. The direct costs related to the finance lease are capitalised as cost of the assets acquired under finance leases. Depreciation of leased assets is calculated using the straight line method.

If at inception of the lease, it is reasonably certain that the Group will obtain the ownership of the assets by the end of the lease term then the assets should be depreciated over the expected useful life of the assets. 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.

The unrecognised finance charges under finance leases are amortised using an effective rate of interest method within the lease term. At the balance sheet date, payables under finance leases are netted against the unrecognised finance charges under finance leases and included in obligations under finance leases or long-term liabilities due within one year in the balance sheet.

Contingent rental payments are recognised as expenses in the accounting period in which they are incurred.

The Group makes provision for impairment losses on assets acquired under finance leases (see note 1(j)).

## 1 Principal accounting policies (continued)

### (h) Leased assets (continued)

#### (ii) Assets held under operating leases

Rental payments under operating leases are charged as cost of related assets or 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.

#### (iii) Assets held for use in operating leases

The assets held for use in operating leases are depreciated in accordance with the Group's depreciation policies, as set out in note 1(g). Impairment losses are provided for in accordance with the accounting policy set out in note 1(j). Revenue derived from operating leases is recognised in the income statement using the straight-line method over the lease term. Contingent rental income is recognised as income in the accounting period in which they are incurred.

### (i) Intangible assets

Intangible assets are stated in the balance sheet at cost less accumulated amortisation and provision for impairment losses (see note 1(j)). Intangible assets with definite useful lives are amortised at cost less the estimated residual value and the provision for impairment loss over their estimated useful lives using the straight-line method. The respective useful lives for intangible assets are as follows:

Land use rights	30-70 years
Software	2-10 years

Where the beneficial period of assets cannot be determined, the Group recognises the intangible assets with indefinite useful lives. At balance sheet date, the Group has no intangible assets with indefinite useful lives.

### (j) Provision for impairment

Internal and external sources of information are reviewed at each balance sheet date for indications of impairment for the following assets, including:

- Fixed assets
- Construction in progress
- Assets acquired under finance leases
- Intangible assets with definite useful lives
- Investment property measured using cost model
- Long-term equity investments (except for long-term equity investments which have neither quoted prices in active markets nor a reliable estimate of fair values, and are stated using the cost method) etc.

Assets with indications of impairment are tested for impairment to estimate the recoverable amount.

## 1 Principal accounting policies (continued)

### (j) Provision for impairment (continued)

An asset unit is the smallest identifiable group of assets that generates cash inflows largely independent of the cash inflows from other assets or groups of assets. It comprises assets which generate cash inflows. In identifying an asset unit, the Group primarily considers the asset unit's ability to independently generate cash inflows in addition to the management of production and operational activities, and the use or disposal of assets.

The recoverable amount is the higher of the net amount of the asset's (or asset unit's) fair value less the costs of disposal, and the present value of the asset's (or asset unit's) estimated future cash flows arising from the continuous use of the asset (or asset unit) and from the disposal of the asset (or asset unit) at the end of its useful life.

The calculation of the recoverable amount shows that if the recoverable amount is less than the carrying amount of the asset (or asset unit), its carrying amount is reduced to the recoverable amount. The amount by which the carrying amount is reduced is the impairment loss, which is recognised in profit or loss. At the same time, a provision is made for the corresponding impairment.

Once the impairment loss is recognised, it cannot be reversed in subsequent accounting periods.

### (k) Financial instruments

The Group's financial instruments include cash at bank and on hand, receivables, payables and loans, etc.

#### (i) Recognition and measurement of financial assets and financial liabilities

Financial assets and financial liabilities are initially recognised at fair value. The transaction costs for financial assets or financial liabilities designated to be measured at fair value, and with changes in the fair value charged to profit or loss, are directly charged to profit or loss. The transaction costs for other categories of financial assets or financial liabilities are included in the initial recognised amount.

- Financial assets and financial liabilities designated to be measured at fair value, and with changes in the fair value charged to profit or loss (including trading financial assets or financial liabilities)

After initial recognition, the financial assets and financial liabilities designated to be measured at fair value, and with changes in the fair value charged to profit or loss, are measured at fair value, and the gains or losses arising from changes in the fair value are recognised in profit or loss.

## 1 Principal accounting policies (continued)

### (k) Financial instruments (continued)

#### (i) Recognition and measurement of financial assets and financial liabilities (continued)

##### – Receivables

Receivables are non-derivative financial assets with fixed or determinable payments which are not quoted in active markets.

After the initial recognition, receivables are measured at amortised cost using the effective interest rate method.

##### – Other financial liabilities

Other financial liabilities are financial liabilities other than the financial liabilities measured at fair value and with changes in the fair value charged to profit and loss.

Other financial liabilities are accounted for using effective interest rate method to record the amortised cost after the initial recognition. The effective interest rate is the rate that exactly discounts the expected stream of future cash payments or receipts over the expected life or applicable shorter period of the financial liabilities to the net carrying amount of the financial liability on initial recognition.

#### (ii) Impairment of financial assets

The Group reviews the carrying amount of financial assets, except those measured at fair value, and with changes in the fair value charged to profit or loss, at each balance sheet date, and on objective evidence of impairment, makes provision for it.

##### – Receivables

When the present value of the estimated future cash flow of receivables (excluding unrealised future credit loss), discounted at the original effective interest rate, is less than the carrying amount, the carrying amount of receivables is reduced to the present value. This reduced amount is the financial assets' impairment loss and is charged to profit or loss.

If in subsequent period the amount of an impairment loss decreases and the decrease can be linked objectively to an event occurring after the impairment loss was recognised, the impairment loss is reversed through profit or loss. A reversal of an impairment loss shall not result in the assets carrying amount exceeding that which would have been determined had no impairment loss been recognised in prior years.

## 1 Principal accounting policies (continued)

### (k) Financial instruments (continued)

#### (iii) Estimation of fair value

If the market for a financial asset or financial liability is active, the quoted prices in the active market are used to determine its fair value. If the market for a financial instrument is not active, valuation techniques are used to establish its fair value.

Valuation techniques include using recent arm's length market transactions between knowledgeable, willing parties, with reference to the current fair value of another financial instrument that is substantially the same, discounted cash flow analysis, and option pricing models. The Group regularly assesses its valuation methods to test their validity.

#### (iv) De-recognition of financial assets and financial liabilities

The Group derecognises a financial asset when the contractual right to receive cash flows from the financial asset expires, or where the Group substantially transfers all risks and rewards of ownership.

Where the entire transfer of financial assets meets conditions applicable to de-recognition, the difference between the following amounts are recognised in profit or loss:

- the carrying amount of the transferred financial assets;
- the sum of the consideration received from the transfer.

Where the obligations for financial liabilities are completely or partially discharged, the entire or part of financial assets, financial liabilities are de-recognised.

### (l) Employee benefits

Employee benefits include various payments and other related expenses paid in return for services rendered by employees. All benefits payable (other than termination benefits) in the accounting period in which services are rendered by employees are recognised in liability, and the cost of assets or expenses are correspondingly increased.

#### (i) Retirement benefits

Pursuant to the relevant laws and regulations in the PRC, the Group has joined a basic social retirement plan for employees set up by the local labour and social security organisation. The Group contributes to the retirement scheme in accordance with the contribution base and rate set by the local government. The contributions are charged to profit or loss on an accrual basis. When employees retire, the local labour and social security organisation is responsible for paying their basic social pension.

#### (ii) Housing accumulation fund and other social insurance

In addition to retirement benefits, the Group pays toward a housing accumulation fund and other social insurance covering basic medical care, unemployment, work injury and maternity, etc. for its employees in accordance with legal and regulatory requirements and policies. The Group makes monthly contributions to the provident fund and the above social insurance based on the employees' salaries. The contributions are charged to profit or loss on an accrual basis.

## 1 Principal accounting policies (continued)

### (l) *Employee benefits* (continued)

#### (iii) Termination benefits

The Group provides termination benefits if it decides to terminate an employee's employment before their contract of employment has expired, or makes an offer to encourage voluntary redundancy. The termination benefits, which are the liabilities anticipated from the termination, are recognised in profit or loss after both the following conditions have been satisfied:

- the Group has a detailed formal plan for the termination of employment or has made an offer of voluntary redundancy, which will be implemented shortly;
- the Group has no realistic possibility of unilateral withdrawal from the termination or the voluntary redundancy offer.

### (m) *Income tax*

Current tax and movements in deferred tax (or income) are recognised in profit or loss except to the extent that they relate to transactions or events recognised directly in equity, in which case they are recognised in equity.

Deferred tax assets and liabilities arise from deductible and taxable temporary differences respectively, being the differences between the carrying amounts of assets and liabilities and their tax bases. Deferred tax assets also arise from unused tax losses and unused tax credits in subsequent years. Deferred tax assets are recognised to the extent that it is probable that future taxable income will be available to offset deductible temporary differences.

Temporary differences in a transaction, which is not a business combination, and at the time of transaction, affects neither accounting profit nor taxable profit (or unused tax losses), will not result in deferred tax.

Current tax liabilities (assets) for the current and prior periods shall be measured at the amount expected to be paid to (recovered from) the taxation authorities, using the tax rates that have been enacted at the balance sheet date.

The carrying amounts of deferred tax assets and liabilities shall be measured at the tax rates that are expected to apply to the period when the asset is realised or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted at the balance sheet date.

### (n) *Provisions and contingent liabilities*

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

In terms of a potential obligation resulting from a past transaction or event, yet to be confirmed by uncertain future events that may or may not occur, or a present obligation resulting from a past transaction or event, 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 potential or present obligation is disclosed as a contingent liability.

## 1 Principal accounting policies (continued)

### (o) Revenue recognition

Revenue is the total inflow of economic benefits generated from the Group's normal activities, which causes shareholders' fund to increase but is unrelated to a shareholder's injection of capital. Revenue is recognised only when it is probable that economic benefits will flow to the enterprise and cause assets to increase or liabilities to decrease, and that the amount of the economic benefits' inflow can be measured reliably. Revenue is recognised specifically as follows:

- (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) Income from the use of the intangible assets by third-party is recognised with reference to the agreed chargeable hours and calculation method stipulated in the relevant contracts or agreements.

### (p) 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 prepayments.

### (q) Repair and maintenance expenses

Routine repair, maintenance expenses and major overhaul expenses are recognised in profit or loss when incurred.

In respect of own and finance leased aircraft, components within the aircraft subject to replacement during major overhaul are depreciated over the average expected period between major overhauls.

In respect of aircraft held under operating leases, a provision is made on straight-line basis 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.

### (r) Government grants

Government grants are the gratuitous monetary assets or non-monetary assets that the Group receives from the government, excluding capital injection by the government as an investor. Government subsidy in relation to investment and other purposes, where relevant governmental documents specify that such subsidy is recorded in capital reserve account, is accounted as capital injection by government.

Government grants are recognised in profit or loss when there is reasonable assurance that they will be received and that the Group will comply with their conditions.

Monetary assets of government grants are calculated as the amount received or receivable, whereas non-monetary assets are measured at fair value or nominal amount.



## 1 Principal accounting policies (continued)

### (r) Government grants (continued)

The asset-related government grants received in prior years are recognised as deferred income, and amortised in profit or loss over the assets' useful lives. Revenue-related government grants are recognised as deferred income, and stated in profit or loss for the period in which the costs are charged if the grants compensate the Group for future expenses or losses; or directly recognised in profit or loss if the grants compensate the Group for past expenses or losses.

### (s) Borrowing costs

Borrowing costs directly attributable to the acquisition, construction or production of qualifying assets are capitalised into the cost of the related assets. Other borrowing costs are recognised as financial expenses in profit or loss when incurred.

During the period of capitalisation, the Group calculates the amount of borrowing costs to be capitalised in each accounting period according to the following method:

- Borrowing cost on aggregate specific borrowings for acquisition, construction or production of qualifying assets accrued based on effective interest rate, offsetting against interest income or investment income on portion of specific borrowing not being utilised for the qualifying assets, are capitalised.
- Borrowing cost on general borrowings for acquisition, construction or production of qualifying assets to be capitalised is determined based on the aggregate amount of qualifying assets less balance of specific borrowings and applying weighted average interest rate of general borrowings.

Period of capitalisation refers to the time-period that the Group begins capitalisation of the borrowing costs to the cessation of capitalisation, excluding the period that the capitalisation is suspended. The Group suspends the capitalisation of borrowing costs if the development of a qualifying asset has been suspended abnormally and the suspension is over 3 months.

### (t) Dividends

Dividend proposed or approved, after the balance sheet date but before the date on which the financial statements are authorised for issue, which is not recognised as a liability on the balance sheet date, is separately disclosed in the notes to the financial statements.

### (u) Frequent flyer award programmes

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

**1 Principal accounting policies** (continued)*(v) Related parties*

If the Group controls, jointly controls or exercises significant influence over another party, or vice versa, or where the Group and one party are subject to control, joint control or significant influence from another party, they are considered to be related parties. Related parties may be individuals or enterprises. Where enterprises are subject to state control but are otherwise unrelated, they are not related parties. The related parties for the Group including but not limited to:

- (1) the parent company of the Company;
- (2) the subsidiaries of the Company;
- (3) Other enterprises of a common parent;
- (4) The owner with common control over the Group;
- (5) The owner with significant influence over the Group;
- (6) The associates of the Group;
- (7) The jointly controlled entities of the Group;
- (8) Close family members of major individual owner of the Group;
- (9) Close family members of key management personnel of the Group;
- (10) The key management personnel of the Company's parent;
- (11) Close family members of the key management personnel of the Company's parent; and
- (12) Other enterprises under the control, common control or significant influence of the Group's major individual owner, key management personnel or their close family members.

Apart from the related parties identified by the requirement of Accounting Standards for Business Enterprises (2006) ("ASBE 2006"), according to the "Administrative procedures on the information disclosure of listed companies" issued by China Securities Regulatory Commission, the following enterprises or individuals (including but not limited to) are also the Group's related parties:

- (13) the enterprises or individuals with the same voting intention holding 5% or more of the Company' share capital;

**1 Principal accounting policies** (continued)*(v) Related parties* (continued)

- (14) the individual and the close family member of the individual, who directly or indirectly holds 5% or more of the Company's share capital;
- (15) in the past 12 months, or under the arrangement of relevant agreements in the following 12 months, the enterprises or individuals mentioned above in (1), (2) and (13);
- (16) in the past 12 months, or under the arrangement of relevant agreements in the following 12 months, the enterprises or individuals mentioned above in either of (9), (10) and (14); and
- (17) enterprises other than the Company and its subsidiaries that are under the direct or indirect control of the enterprises or individuals mentioned in (9), (10), (14) and (16); or the enterprises or individuals mentioned in (9), (10), (14) and (16) who are the director or key management personnel of enterprises other than the Company and its subsidiaries.

*(w) Segmental reporting*

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

In accordance with the Group's internal financial reporting system, the Group has chosen business segment information as the primary reporting format and geographical segment information as the secondary reporting format for the purposes of these financial statements.

Segment revenue, expenses, results, assets and liabilities include items directly attributable to a segment as well as those that can be allocated on a reasonable basis to that segment.

The segment capital expenditure represents the total capital expenditure incurred for acquisition or construction of long-term assets (including tangible and intangible assets).

Items that could not be allocated to segments mainly include interest income and expenses, dividend income, long-term equity investment, non-operating income and income tax expenses, etc.

## 2 Changes of accounting policies

The Company started to implement the ASBE 2006 since 1 January 2007 to replace the old accounting standards. In this interim report, adjustments are made on the comparative figures in accordance with "ASBE No. 38 – First-time Adoption of ASBE", "Experts' Opinions on Implementation of ASBE" issued by Accounting Standard Committee of Ministry of Finance and etc., in respect of the transactions and events affected by the changes in accounting policies.

The impact of changes in accounting policies to the Group's net profit and total equity attributable to equity shareholders of the Company are summarised as follows:

	<b>2006 Net profit attributable to equity shareholders of the Company</b> RMB Million	<b>2006 Total equity attributable to equity shareholders of the Company at the year end</b> RMB Million	<b>2006 Total equity attributable to equity shareholders of the Company at the beginning of the year</b> RMB Million
Net profit and equity before adjustments	118	10,074	9,951
Provision for early retirement benefits	(392)	(392)	–
Fair value of fuel oil instruments	(26)	(26)	–
Investment in associates	(49)	(146)	(97)
Gains on aircraft sale and leaseback transactions	(35)	125	160
Interest capitalisation	374	385	11
Effect of the above adjustment on taxation	13	(17)	(30)
Subtotal	(115)	(71)	44
Net profit and equity after adjustments	3	10,003	9,995

## 3 Effects of significant differences between financial statements prepared in accordance with PRC GAAP and IFRSs

(A) Effects of significant differences between PRC GAAP and IFRSs on net results are analysed as follows:

	<i>Note</i>	<b>Six months ended 30 June</b>	
		<b>2007</b> RMB Million	2006 RMB Million
Net profit/(loss) attributable to equity shareholders of the Company in the financial statements prepared under PRC GAAP		<b>308</b>	(854)
Adjustments:			
Losses on staff housing benefits	(a)	<b>(12)</b>	(13)
Revaluation of land use rights	(b)	<b>1</b>	2
Capitalisation of overhaul costs	(c)	<b>(162)</b>	49
Effect of minority interests of the above adjustments		<b>4</b>	–
Effect of the above adjustments on taxation		<b>29</b>	(9)
Net profit/(loss) attributable to equity shareholders of the Company in financial statements prepared under IFRSs		<b>168</b>	(825)

### 3 Effects of significant differences between financial statements prepared in accordance with PRC GAAP and IFRSs (continued)

(B) Effects of significant differences between PRC GAAP and IFRSs on shareholders' equity are analysed as follows:

	<i>Note</i>	<b>At 30 June 2007 RMB Million</b>	At 31 December 2006 RMB Million
Total equity attributable to equity shareholders of the Company in the financial statements prepared under PRC GAAP		<b>10,311</b>	10,003
Adjustments:			
Losses on staff housing benefits	<i>(a)</i>	<b>132</b>	144
Revaluation of land use rights	<i>(b)</i>	<b>(153)</b>	(154)
Capitalisation of overhaul costs	<i>(c)</i>	<b>86</b>	248
Government grants	<i>(d)</i>	<b>(43)</b>	(43)
Effect of minority interests of the above adjustments		<b>12</b>	8
Effect of the above adjustments on taxation		<b>11</b>	(18)
Total equity attributable to equity shareholders of the Company in the financial statements prepared under IFRSs		<b>10,356</b>	10,188

- (a) In accordance with PRC GAAP, losses on lump sum housing benefits executed by CSAHC on behalf of the Group are charged to retained profits as of 1 January 2001 pursuant to the relevant regulations. Under IFRSs, losses on lump sum housing benefits are charged to the income statement in the obligatory periods stipulated by the relevant contracts.
- (b) In accordance with PRC GAAP, land use rights are carried at revalued amounts. Under IFRSs, land use rights are carried at cost with effect from 1 January 2002. Accordingly, the unamortised surplus on revaluation of the land use rights was reversed against shareholders' equity.
- (c) Prior to 2007, major overhaul costs on owned and finance leased aircraft and engines are recognised in the income statement when incurred under PRC GAAP. Under ASBE (2006) and IFRSs which are effective on 1 January 2007 and 1 January 2005 respectively, major overhaul costs on owned and finance leased aircraft and engines are capitalised and depreciated over the expected overhaul periods on a straight-line basis. This accounting policy is applied prospectively under financial statements prepared in accordance with PRC GAAP and IFRSs.
- (d) Prior to 2007, government grants relating to purchase of property, plant and equipment are credited to capital reserve under PRC GAAP. Under ASBE (2006) which is effective on 1 January 2007, such government grants are recognised as deferred income and amortised according to the respective useful life of corresponding assets. Under IFRSs, government grants relating to purchase of property, plant and equipment are offset against the cost of assets when utilised; other government grants are charged to the income statement when received.