

Repairs and maintenance expenses which accounted for 12.6% of total operating expenses, increased by 25.1% from RMB1,406 million in 1999 to RMB1,759 million in 2000. The increase was primarily attributable to a 31.2% increase in aircraft maintenance and repair charges from RMB966 million in 1999 to RMB1,267 million in 2000, mainly as a result of the effect of fleet expansion in recent years, in particular the additions of wide-body aircraft, which require more expensive maintenance.

Aircraft and traffic servicing expenses, which accounted for 14.8% of total operating expenses, increased by 10.3% from RMB1,876 million in 1999 to RMB2,069 million in 2000. The increase was resulted from a 10.9% rise in landing and navigation fees from RMB1,763 million in 1999 to RMB1,955 million in 2000, as the number of flights increased.

Promotional and marketing expenses, which accounted for 9.8% of total operating expenses, increased by 16.3% from RMB1,184 million in 1999 to RMB1,378 million in 2000. The increase was due to a 27.1% increase in commission and bonuses paid to sales agents caused by the rise in traffic revenue and increased competition.

General and administrative expenses, which accounted for 5.8% of total operating expenses, increased by 7.2% from RMB755 million in 1999 to RMB809 million in 2000. This was mainly due to an increase in staff salaries and welfare benefits of approximately 8.5% from RMB329 million in 1999 to RMB357 million in 2000 and increased scale of operations.

Depreciation and amortisation, which accounted for 13.3% of total operating expenses, increased by 3.1% from RMB1,808 million in 1999 to RMB1,864 million in 2000. This was primarily as a result of an expansion of the Airbus simulator facilities as well as an increase in various operational building complexes and machinery during the year.

Operating Profit

Operating profit decreased by 36.1% from RMB1,850 million in 1999 to RMB1,182 million in 2000, as operating revenue increased by RMB1,878 million or 14.1% from 1999, while operating expenses increased by RMB2,546 million or 22.2% over the same period.

Non-operating Income/(Expenses)

Interest expense decreased by 9.9% from RMB1,192 million in 1999 to RMB1,074 million in 2000 mainly reflecting the scheduled debt repayments during the year.

Interest income decreased by 15.9% from RMB107 million in 1999 to RMB90 million in 2000. This was mainly attributable to a decrease in domestic deposit rates as well as a fall in cash balances.

The Group recognised a net profit on sale of fixed assets of RMB373 million in 2000, which mainly derived from the sale of four Boeing 757-200 aircraft to independent third parties pursuant to certain sale and leaseback arrangements.

During 2000, the Group recorded a net exchange gain of RMB319 million predominantly due to its Japanese yen denominated borrowings as a result of the Japanese Yen depreciation. The majority of these are unrealised translation gains.

Taxation

The Group is subject to PRC income tax at a rate of 33%.

Taxation expense increased by 164.7% from RMB128 million in 1999 to RMB339 million in 2000, reflecting primarily an increase in profit before taxation. A deferred tax asset of RMB370 million was recognised at 31 December, 2000 in respect of the unrelieved PRC tax losses brought forward from prior years. Such tax losses are available for carry-forward to offset against future PRC taxable profits for a maximum period of 5 years.

Minority Interests

Minority interests decreased by 42.7% from RMB158 million in 1999 to RMB91 million in 2000, primarily as a result of a decrease in net profits of the Group's Airline Subsidiaries.

Liquidity, Financial Resources and Capital Structure

As at 31 December, 2000, the Group's borrowings totaled RMB15,764 million, representing a decrease of RMB2,764 million from RMB18,528 million last year. Such borrowings were denominated, to a larger extent, in United States dollars and, to a smaller extent, in Japanese yen, with almost all being fixed interest rate borrowings. Of such borrowings, RMB2,559 million, RMB2,262 million, RMB2,291 million, RMB1,778 million and RMB6,874 million will be repayable in 2001, 2002, 2003, 2004, 2005 and thereafter respectively. As at 31 December, 2000, cash and cash equivalents of the Group totaled RMB4,197 million, a decrease of 8.5% from RMB4,588 million last year. About 25.4% of cash and cash equivalents at 31 December, 2000, were denominated in foreign currencies (mainly in United States dollars). Net debts (total borrowings net of cash and cash equivalents) decreased by 17.0% to RMB11,567 million.

As at 31 December, 2000, the Group's shareholders' equity amounted to RMB8,881 million, representing an increase of RMB501 million from RMB8,380 million last year.

Net debt/equity ratio of the Group at 31 December, 2000 was 1.30 times, as compared to 1.66 times last year.

Financial Risk Management Policy

In the normal course of business, the Group is exposed to fluctuations in foreign currencies and jet fuel prices. The Group's exposure to foreign currencies was as a result of its foreign currency debts. 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 Group is required to procure a majority of its jet fuel consumption domestically at PRC spot market prices. There are currently no effective means available to manage the Group's exposure associated with the fluctuations in domestic jet fuel prices.

Charges on Assets

As at 31 December, 2000, aircraft of the Group with an aggregate carrying value of approximately RMB15,616 million (1999: RMB17,109 million) were pledged as collateral under certain loan and lease agreements. Details of the charges are set out in notes 10, 21 and 22 to the consolidated financial statements.

Commitments and Contingencies

At 31 December, 2000, the Group had capital commitments of approximately RMB7,424 million. Of such amounts, RMB3,162 million was related to the acquisition of aircraft and related flight equipment and RMB3,540 million was related to the Group's facilities and equipment to be constructed and installed at the Guangzhou new airport. The remaining amount of RMB722 million was related to the Group's other airport and office facilities and equipment, overhaul and maintenance bases and training facilities. The Group's capital expenditures are generally subject to receipt of various approvals of PRC Government and may be subject to change depending on the timing of such approvals, prevailing market condition, the availability of financing and other relevant factors.

As at 31 December, 2000, the Group was committed to make a capital contribution of approximately RMB261 million to a new joint venture company proposed to be established in the PRC for the provision of repairs and maintenance services to aircraft engines.

Details of the capital and investing commitments are set out in note 29 to the consolidated financial statements.

Major contingent liabilities of the Group at 31 December, 2000 are set out in note 30 to the consolidated financial statements.