

1 Background of the Company

China Southern Airlines Company Limited (the “Company”) and its subsidiary companies (the “Group”) are principally engaged in the provision of domestic, Hong Kong regional and international passenger, cargo and mail airline services, with flights operating primarily from the Guangzhou Baiyun International Airport, which is both the main hub of the Group’s route network and the location of its corporate headquarters.

The Company was established in the People’s Republic of China (the “PRC”, “China” or the “State”) on 25 March, 1995 as a joint stock limited company as part of the reorganisation (the “Reorganisation”) of the Company’s holding company, China Southern Air Holding Company (“CSAHC”) (formerly named as Southern Airlines (Group)). CSAHC is a state-owned enterprise under the supervision of the PRC central government.

The Company’s H Shares and American Depositary Shares (“ADS”) (each ADS representing 50 H Shares) are listed on the Stock Exchange of Hong Kong Limited and the New York Stock Exchange, respectively since July 1997.

2 Principal accounting policies

(a) Statement of compliance

The financial statements of the Group and the Company have been prepared in accordance with International Financial Reporting Standards (“IFRS”) promulgated by the International Accounting Standards Board and the disclosure requirements of the Hong Kong Companies Ordinance. IFRS includes International Accounting Standards (“IAS”) and related interpretations.

(b) Basis of preparation

The financial statements of the Group and the Company are prepared on the historical cost basis as modified by the revaluation of certain fixed assets. The accounting policies have been consistently applied by the Group and the Company and except for a change in accounting policy for land use rights (refer to Note 26(f)), are consistent with those used in the previous year.

2 Principal accounting policies (cont'd)

(c) Basis of consolidation

The consolidated financial statements of the Group include the financial statements of the Company and all of its subsidiaries made up to 31 December each year. Subsidiaries are those enterprises controlled by the Group. Control exists when the Group has the power, directly or indirectly, to govern the financial and operating policies of an enterprise so as to obtain benefits from its activities. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control effectively commences until the date that control effectively ceases.

The results of subsidiaries are included in the consolidated profit and loss account and the share attributable to minority shareholders is deducted from or added to the consolidated profit after taxation. Losses attributable to minority shareholders of partly owned subsidiaries are accounted for based on the respective equity owned by the minority shareholders up to the amount of the capital contribution and reserves attributable to the minority shareholders. Thereafter, all further losses are assumed by the Company.

All significant intercompany balances and transactions have been eliminated on consolidation.

(d) Interest-bearing borrowings

Interest-bearing borrowings are recognised initially at cost, less attributable transaction costs. Subsequent to initial recognition, interest-bearing borrowings are stated at amortised cost with any difference between cost and redemption value being recognised in the profit and loss account over the period of the borrowings on an effective interest basis.

(e) Investments

(i) *Investments in subsidiaries*

Investments in subsidiaries in the Company's balance sheet are stated at cost, less impairment losses (refer to accounting policy n).

(ii) *Investments in associated companies and jointly controlled entities*

An associated company is an entity in which the Group or the Company has significant influence, but not control or joint control, over its management, including participating in the financial and operating policy decisions.

2 Principal accounting policies (cont'd)

(e) Investments (cont'd)

A jointly controlled entity is an entity which operates under a contractual agreement between the Group or the Company and other parties, where the contractual agreement establishes the Group or the Company and one or more of the other parties share joint control over the economic activity of the entity.

The consolidated profit and loss account includes the Group's share of the results of its associated companies and jointly controlled entities for the year. In the consolidated balance sheet, the investments in associated companies and jointly controlled entities are stated at the Group's attributable share of net assets. When the Group's share of losses exceeds the carrying amount of the associated company or jointly controlled entity, the carrying amount is reduced to nil and recognition of further losses is discontinued except to the extent that the Group has incurred obligations in respect of the associated company or jointly controlled entity.

The results of associated companies and jointly controlled entities are included in the Company's profit and loss account to the extent of dividends received and receivable, providing such dividends are in respect of a period ending on or before that of the Company and the Company's right to receive the dividend is established before 31 December each year. In the Company's balance sheet, investments in associated companies and jointly controlled entities are stated at cost, less impairment losses (refer to accounting policy n).

(iii) *Other investments*

Other investments are stated at cost less impairment losses (refer to accounting policy n). Other investments represent unquoted available-for-sale equity securities of companies established in the PRC. There is no quoted market price for such equity securities and accordingly a reasonable estimate of the fair value could not be made without incurring excessive costs.

2 Principal accounting policies (cont'd)

(f) Fixed assets and depreciation

Fixed assets are stated at cost or revalued amount less accumulated depreciation and impairment losses (refer to accounting policy n). Revaluations are performed periodically to ensure that the carrying amount does not differ materially from that which would be determined using fair value at the balance sheet date.

Depreciation is provided to write off the cost, or revalued amount where appropriate, of the fixed assets over their estimated useful lives on a straight line basis, after taking into account their estimated residual values, as follows:

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

No depreciation is provided in respect of construction in progress.

(g) Leased assets

Flight equipment under finance leases is stated at an amount equal to lower of its fair value and the present value of minimum lease payments at inception of the lease, and is amortised on a straight line basis over the shorter of the lease term or estimated useful life of the asset to residual value. In cases where title to the asset will be acquired by the Group at the end of the lease, the asset is amortised on a straight line basis over the estimated useful life of the asset to its residual value.

Amounts payable in respect of finance leases are apportioned between interest charges and reductions of obligations based on the interest rates implicit in the leases. Interest charges are included in the profit and loss account to provide a constant periodic rate of charge over the lease term.

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

2 Principal accounting policies (cont'd)**(g) Leased assets (cont'd)**

Operating lease payments are charged to the profit and loss account on a straight line basis over the terms of the related leases.

(h) Construction in progress

Construction in progress represents office buildings, various infrastructure projects under construction and equipment pending installation, and is stated at cost. Cost comprises direct costs of construction as well as interest charges during the periods of construction and installation. Capitalisation of these costs ceases and the construction in progress is transferred to fixed assets when the asset is substantially ready for its intended use, notwithstanding any delays in the issue of the relevant commissioning certificates by the relevant PRC authorities.

(i) Lease prepayments

Lease prepayments represent the purchase costs of land use rights and are amortised on a straight line basis over the period of land use rights, whichever is shorter (Note 26(f)).

(j) Inventories

Inventories, which consist primarily of expendable spare parts and supplies, are stated at cost less any applicable provision for obsolescence, and are expensed when used in operations. Cost represents the average unit cost. Inventories held for disposal is stated at the lower of cost and net realisable value. Net realisable value represents estimated resale price.

(k) Trade and other receivables

Trade and other receivables are stated at cost less impairment losses. Impairment losses are established based on evaluation of the recoverability of these accounts at the balance sheet date.

2 Principal accounting policies (cont'd)

(l) Deferred expenditure

Custom duties and other direct costs in relation to modifying, introducing and certifying certain operating leased aircraft are deferred and amortised over the terms of the related leases.

Lump sum housing benefits payable to employees of the Group are deferred and amortised on a straight line basis over a period of 10 years, which represents the vesting benefit period of the employees.

(m) Cash and cash equivalents

Cash and cash equivalents consist of cash in hand and balances with banks and other financial institutions with an original maturity within three months. For the purpose of the consolidated cash flow statement, cash and cash equivalents are presented net of bank overdrafts, if any.

(n) Impairment loss

The carrying amounts of the Group's and the Company's assets, other than inventories (refer to accounting policy j) and deferred tax assets (refer to accounting policy u) are reviewed periodically in order to assess whether the recoverable amounts have declined below the carrying amounts. These assets are tested for impairment whenever events or changes in circumstances indicate that their recorded carrying amounts may not be recoverable. When such a decline has occurred, the carrying amount is reduced to the recoverable amount. The recoverable amount is the greater of the net selling price and the value in use. In determining the value in use, expected future cash flows generated by the asset are discounted to their present value. The amount of the reduction is recognised as an expense in the profit and loss account.

The Group and the Company assess at each balance sheet date whether there is any indication that an impairment loss recognised for an asset in prior years may no longer exist. An impairment loss is reversed if there has been a favourable change in the estimates used to determine the recoverable amount. A subsequent increase in the recoverable amount of an asset, when the circumstances and events that led to the write-down or write-off cease to exist, is recognised as income. The reversal is reduced by the amount that would have been recognised as depreciation had the write-down or write-off not occurred.

2 Principal accounting policies (cont'd)

(o) Deferred credits

In connection with the acquisition or operating lease of certain aircraft and engines, the Group receives various credits. Such credits are deferred until the aircraft and engines are delivered, at which time they are either applied as a reduction of the cost of acquiring the aircraft and engines, resulting in a reduction of future depreciation, or amortised as a reduction of rental expense for aircraft and engines under operating leases.

(p) Revenue recognition

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

Interest income is recognised as it accrues unless collectability is in doubt. Dividend income is recognised when the Group's right to receive the dividend is established.

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

(q) Traffic commissions

Traffic commissions are expensed when the transportation is provided and the related revenue is recognised. Traffic commissions for transportation not yet provided are recorded on the balance sheet as a prepaid expense.

(r) Maintenance and overhaul costs

Routine maintenance and repairs and overhauls in respect of owned aircraft and aircraft held under finance leases are expensed in the profit and loss account as and when incurred. In respect of aircraft held under operating leases, a provision is made over the lease term for the estimated cost of scheduled overhauls required to be performed on the related aircraft prior to their return to the lessors.

2 Principal accounting policies (cont'd)

(s) Translation of foreign currencies

Foreign currency transactions during the year are translated into Renminbi at the applicable rates of exchange prevailing on the transaction dates.

Foreign currency monetary balances at the balance sheet date are translated into Renminbi at the exchange rates quoted by the People's Bank of China ruling at that date. Exchange differences are dealt with in the profit and loss account.

(t) Borrowing costs

Borrowing costs are expensed in the profit and loss account as and when incurred, except to the extent that they are capitalised as being directly attributable to the acquisition or construction of an asset which necessarily takes a substantial period of time to get ready for its intended use.

(u) Deferred taxation

Deferred tax is provided using the balance sheet liability method on all temporary differences between the carrying amounts for financial reporting purposes and the amounts used for taxation purposes, except differences relating to the initial recognition of assets or liabilities which affect neither accounting nor taxable profit/loss.

The tax value of losses expected to be available for utilisation against future taxable income is recognised as a deferred tax asset and offset against the deferred tax liability attributable to the same legal tax unit and jurisdiction. Net deferred tax assets are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

(v) Retirement benefits

Contributions to retirement schemes and additional retirement benefits paid to retired employees are charged to the profit and loss account as and when incurred.

2 Principal accounting policies (cont'd)

(w) Frequent flyer award programmes

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

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

(x) Provisions

A provision is recognised in the balance sheet when the Group or the Company has a legal or constructive obligation as a result of a past event, and it is probable that an outflow of economic benefits will be required to settle the obligations. If the effect is material, provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability.

(y) Related parties

For the purposes of these financial statements, parties are considered to be related to the Group if the Group has the ability, directly or indirectly, to control the party or exercise significant influence over the party in making financial and operating decisions, or vice versa, or where the Group and the party are subject to common control or common significant influence. Related parties may be individuals or entities.

2 Principal accounting policies (cont'd)

(z) Segmental reporting

The Group operates principally as a single business segment for the provision of air transportation services. The analysis of turnover and operating profit by geographical segment is based on the following criteria:

- (i) Traffic revenue from domestic services within the PRC (excluding Hong Kong) is attributed to the domestic operation. Traffic revenue from inbound / outbound services between the PRC and Hong Kong, and the PRC and overseas destinations is attributed to the Hong Kong regional operation and international operation respectively.
- (ii) Other revenue from ticket selling, general aviation and ground services, air catering and other miscellaneous services is attributed on the basis of where the services are performed.

(aa) Use of estimates

The preparation of the financial statements of the Group and the Company in accordance with IFRS requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

18:00 HONG KONG	CHINA SOUTHERN	CZ3501	C
18:00 LOS ANGELES	UNITED AIRLINES	UA 818	D
18:55 BEIJING	CHINA SOUTHERN	CZ3195	D
19:00 HONOLULU	NORTHWEST	JD 19	A
20:00 SHANGHAI	CHINA SOUTHERN	CZ 882	B
22:55 SYDNEY	ANSETT	NH 173	B
	BRISBANE		

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3 Turnover

Turnover comprises revenues from airline and airline-related business and is stated net of sales tax and contributions to the CAAC Infrastructure Development Fund. An analysis of turnover is as follows:

	2002	2001
	RMB'000	RMB'000
Traffic revenue		
Passenger	15,695,622	15,055,496
Cargo and mail	1,786,270	1,406,036
	17,481,892	16,461,532
Other operating revenue		
Commission income	137,928	129,157
General aviation income	68,225	61,292
Ground services income	78,616	55,388
Air catering income	38,077	29,523
Aircraft lease income	46,640	65,486
Net income from a lease arrangement (Note 10)	51,682	-
Others	115,560	77,280
	536,728	418,126
	18,018,620	16,879,658

Pursuant to various sales tax rules and regulations, the Group is required to pay sales tax to national and local tax authorities at the following rates:

Types of revenue	Applicable sales tax rates
Traffic revenue	3% (2001: 3%) of traffic revenue. All inbound international and Hong Kong regional flights are exempted from sales tax.
Other operating revenue	3% (2001: 3%) of commission income, general aviation income and ground services income, and 3% to 5% (2001: 3% to 5%) of other operating revenue.

Sales tax incurred during the year ended 31 December, 2002, netted off against revenue, amounted to RMB557,784,000 (2001: RMB535,473,000).

3 Turnover (cont'd)

In addition, the Group is required to pay contributions to the CAAC Infrastructure Development Fund which are calculated at the rates of 5% and 2%, respectively (2001: 5% and 2%, respectively) of the domestic and international/Hong Kong regional traffic revenue. Contributions to the CAAC Infrastructure Development Fund payable by the Group for the year ended 31 December, 2002 totalled RMB798,386,000 (2001: RMB759,385,000).

Pursuant to approval documents issued by the CAAC, the Group imposes a fuel surcharge on passengers carried by its domestic and Hong Kong regional flights at the following prescribed rates:

Applicable flights and periods	Rates of fuel surcharge
<i>Domestic flights</i>	
From 1 January, 2001 to 5 February, 2001	Not more than 20% of published fare or RMB150 per passenger, whichever is lower
From 6 February, 2001 to 31 December, 2001	Not more than 14% of published fare or RMB150 per passenger, whichever is lower
From 1 January, 2002 to 9 October, 2002	Not more than 8% of published fare
From 10 October, 2002 onward	Not more than 14% of published fare
<i>Hong Kong regional flights</i>	
From 1 January, 2001 to 31 December, 2001	RMB64 to RMB70 per passenger
From 1 January, 2002 onward	Nil

The fuel surcharge forms part of the traffic revenue of the Group. For the year ended 31 December, 2002, the fuel surcharge revenue of the Group totalled approximately RMB554 million (2001: RMB1,001 million).

4 Profit before taxation and minority interests

	2002	2001
	RMB'000	RMB'000
Profit before taxation and minority interests is arrived at after charging:		
<i>Operating expenses</i>		
Jet fuel	3,519,005	3,548,860
Aircraft maintenance	2,134,705	1,844,836
Routes	4,297,767	4,104,870
Depreciation		
– owned assets	1,301,601	1,260,020
– assets held under finance leases	537,692	542,442
Amortisation of deferred expenditure	578	12,512
Operating lease charges		
– aircraft and flight equipment	1,416,524	1,912,832
– land and buildings	129,982	91,857
Staff costs		
– salaries, wages and welfare	1,538,617	1,272,249
– contributions to retirement schemes	131,622	77,833
Office and administration	452,432	472,613
Auditors' remuneration	8,200	7,400
Other	523,818	330,661
	15,992,543	15,478,985
<i>Interest expense</i>		
Interest on bank and other loans wholly repayable within five years	335,953	148,554
Interest on other loans	142,679	169,703
Finance charges on obligations under finance leases	544,747	620,687
Less: borrowing costs capitalised	(64,186)	(5,227)
Net interest expense	959,193	933,717
and after crediting:		
Amortisation of gains on sale and leaseback transactions	2,579	15,379
Dividend income from unlisted investments	7,116	2,704

The profit attributable to shareholders for the year ended 31 December, 2002 includes a profit of RMB381,305,000 (2001: RMB112,134,000) which has been dealt with in the financial statements of the Company.

5 Gain/(loss) on sale of fixed assets

Gain/(loss) on sale of fixed assets represents:

	2002	2001
	RMB'000	RMB'000
Aircraft (Note)	199,394	59,855
Staff quarters (Note 28)	(17,624)	(110,723)
Flight equipment and others	(11,030)	(5,021)
	170,740	(55,889)

Note:

Pursuant to certain sale and leaseback arrangements, the Group sold four Boeing 757-200 aircraft and two Airbus 320-200 aircraft respectively during 2002 and 2001 to independent third parties and then entered into operating leases with such parties to lease back the aircraft for a period of eight to nine years. For the year ended 31 December, 2002, the Group recognised a profit of RMB199,394,000 (2001: RMB59,855,000), being the excess of the sale proceeds which approximated the aircraft's fair value on the date of disposal, over the aircraft's net book value and related disposal costs.

6 Emoluments of directors, supervisors and senior management**(a) Directors' and supervisors' emoluments**

	2002	2001
	RMB'000	RMB'000
Fees	103	106
Salaries, allowances and benefits in kind	970	848
Retirement benefits	67	53
Bonuses	264	293
	1,404	1,300

Included in the above were fees of RMB103,000 (2001: RMB106,000) paid to non-executive independent directors during the year.

6 Emoluments of directors, supervisors and senior management (cont'd)

(a) Directors' and supervisors' emoluments (cont'd)

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

	2002 Number	2001 Number
Nil to HK\$1,000,000 (RMB1,061,000 equivalent)	14	14

(b) Senior management's emoluments

Details of emoluments paid to the five highest paid individuals (including directors and supervisors) of the Group during the year are as follows:

	2002 RMB'000	2001 RMB'000
Salaries, allowances and benefits in kind	1,496	1,070
Retirement benefits	24	17
	1,520	1,087

An analysis of emoluments paid to the five highest paid individuals (including directors and supervisors) by number of individuals and emolument ranges is as follows:

	2002 Number	2001 Number
Directors and supervisors	1	1
Employees	4	4
	5	5
Nil to HK\$1,000,000 (RMB1,061,000 equivalent)	5	5

7 Taxation

Taxation in the consolidated profit and loss account comprises:

	2002 RMB'000	2001 RMB'000
PRC income tax	71,651	37,032
Share of taxation of associated companies and jointly controlled entities	9,424	8,085
	81,075	45,117
Deferred taxation (Note 16)	317,152	275,402
	398,227	320,519

Pursuant to the income tax rules and regulations of the PRC, the Group is liable to PRC income tax at a rate of 33%.

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

Actual taxation expense in the consolidated profit and loss account differed from the amount computed by applying the PRC income tax rate of 33% to consolidated profit before taxation and minority interests as a result of the following:

	2002 RMB'000	2001 RMB'000
Profit before taxation	1,139,099	795,256
Expected PRC income tax at 33%	375,903	262,434
Adjustments:		
Gains on sale and leaseback transactions and their amortisation	(851)	(5,075)
Rate differential on subsidiaries taxed at 15%	(60,530)	(51,245)
Non-deductible expenses	61,454	154,152
Other, net	22,251	(39,747)
	398,227	320,519

7 Taxation (cont'd)

In accordance with relevant PRC tax regulations, a PRC lessee is liable to pay PRC withholding tax in respect of any lease payments regularly made to an overseas lessor. Depending on the circumstances, this tax is generally imposed at a fixed rate ranging from 10% to 20% of the lease payments, or in certain cases, the interest components of such payments. Pursuant to an approval document from the State Tax Bureau, lease arrangements executed prior to 1 September, 1999 are exempted from PRC withholding tax.

For the year ended 31 December, 2002, the PRC withholding tax payable by the Group in respect of the leases executed on or after 1 September, 1999 of RMB14,305,000 (2001: RMB11,962,000) has been included as part of the operating lease charges for the year.

8 Dividends

No interim dividend was paid during the year ended 31 December, 2002 (2001: Nil).

The board of directors of the Company does not recommend the payment of a final dividend in respect of the year ended 31 December, 2002.

A final dividend of RMB0.02 per share totalling RMB67,484,000 in respect of the previous financial year was approved and paid during the year.

9 Basic earnings per share

The calculation of basic earnings per share is based on the consolidated profit attributable to shareholders of RMB575,761,000 (2001: RMB340,225,000) and the weighted average number of shares in issue during the year of 3,374,178,000 (2001: 3,374,178,000).

The amount of diluted earnings per share is not presented as there were no dilutive potential ordinary shares in existence for both years.

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(Expressed in Renminbi)

10 Fixed assets

	Buildings	Aircraft Owned	Aircraft Held under finance leases	Other flight equipment, including rotable spares	Machinery, equipment and vehicles	Total
	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000
The Group						
Cost or valuation:						
At 1 January, 2002	2,966,159	8,391,125	11,454,527	5,858,622	1,539,889	30,210,322
Additions	30,273	5,508,494	540,874	470,860	157,353	6,707,854
Transferred from construction in progress	214,505	-	-	20,881	22,488	257,874
Through acquisitions of subsidiaries	83,339	-	-	-	13,297	96,636
Reclassification on exercise of purchase options	-	535,423	(535,423)	-	-	-
Disposals	(86,460)	(924,325)	-	-	(65,263)	(1,076,048)
At 31 December, 2002	3,207,816	13,510,717	11,459,978	6,350,363	1,667,764	36,196,638
Representing:						
Cost	2,770,606	8,174,944	6,123,034	4,109,293	1,259,822	22,437,699
Valuation - 1996	437,210	5,335,773	5,336,944	2,241,070	407,942	13,758,939
	3,207,816	13,510,717	11,459,978	6,350,363	1,667,764	36,196,638
Accumulated depreciation:						
At 1 January, 2002	348,820	1,734,225	2,238,389	2,464,189	1,072,484	7,858,107
Charge for the year	113,888	480,710	537,692	442,155	264,848	1,839,293
Reclassification on exercise of purchase options	-	276,586	(276,586)	-	-	-
Written back on disposal	(16,141)	(345,672)	-	-	(59,778)	(421,591)
At 31 December, 2002	446,567	2,145,849	2,499,495	2,906,344	1,277,554	9,275,809
Net book value:						
At 31 December, 2002	2,761,249	11,364,868	8,960,483	3,444,019	390,210	26,920,829
At 31 December, 2001	2,617,339	6,656,900	9,216,138	3,394,433	467,405	22,352,215

10 Fixed assets (cont'd)

	Buildings	Aircraft Owned	Held under finance leases	Other flight equipment, including rotable spares	Machinery, equipment and vehicles	Total
	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000
The Company						
At 1 January, 2002	1,046,800	4,450,388	11,454,527	3,699,221	863,127	21,514,063
Additions	750	4,991,873	540,874	194,066	66,021	5,793,584
Transferred from construction in progress	35,327	-	-	-	14,899	50,226
Reclassification on exercise of purchase options	-	535,423	(535,423)	-	-	-
Disposals	(770)	(924,325)	-	-	(45,387)	(970,482)
At 31 December, 2002	1,082,107	9,053,359	11,459,978	3,893,287	898,660	26,387,391
Representing:						
Cost	897,587	5,439,445	6,123,034	2,433,170	665,986	15,559,222
Valuation - 1996	184,520	3,613,914	5,336,944	1,460,117	232,674	10,828,169
	1,082,107	9,053,359	11,459,978	3,893,287	898,660	26,387,391
Accumulated depreciation:						
At 1 January, 2002	109,403	1,106,766	2,238,389	1,764,095	676,134	5,894,787
Charge for the year	47,463	289,683	537,692	332,642	137,815	1,345,295
Reclassification on exercise of purchase options	-	276,586	(276,586)	-	-	-
Written back on disposal	(492)	(345,672)	-	-	(37,435)	(383,599)
At 31 December, 2002	156,374	1,327,363	2,499,495	2,096,737	776,514	6,856,483
Net book value:						
At 31 December, 2002	925,733	7,725,996	8,960,483	1,796,550	122,146	19,530,908
At 31 December, 2001	937,397	3,343,622	9,216,138	1,935,126	186,993	15,619,276

10 Fixed assets (cont'd)

Substantially all of the Group's buildings are located in the PRC. The Group was formally granted the rights to use the twenty parcels of land in Guangzhou, Shenzhen, Zhuhai, Beihai, Changsha, Shantou, Haikou, Zhengzhou, Guiyang and Wuhan by the relevant PRC authorities for a period of 30 to 70 years, which expire between 2020 and 2068. For other land in the PRC on which the Group's buildings are erected, the Group was formally granted the rights to use such land for periods of one to five years commencing in the second quarter of 1997 pursuant to various lease agreements between the Company and CSAHC. The leases with initial one-year term are automatically renewable for another one-year period unless the Group gives appropriate notice of termination. In this connection, rental payments totalling RMB15,224,000 (2001: RMB15,224,000) were paid to CSAHC during 2002 in respect of these leases.

In compliance with the PRC rules and regulations governing initial public offering of shares by PRC joint stock limited companies, the fixed assets of the Group as at 31 December, 1996 were revalued. This revaluation was conducted by Guangzhou Assets Appraisal Corp., a firm of independent valuers registered in the PRC, on a depreciated replacement cost basis, and approved by the China State-owned Assets Administration Bureau.

In accordance with IAS 16 "Property, plant and equipment", subsequent to the 1996 revaluation, which was based on replacement costs, the fixed assets of the Group are carried at revalued amount, being the fair value at the date of the revaluation less any subsequent accumulated depreciation and impairment losses. Revaluation is performed periodically to ensure that the carrying amount does not differ materially from that which would be determined using fair value at the balance sheet date. In accordance with the revaluation performed by the directors in respect of fixed assets held by the Group as at 31 December, 2000, the carrying amounts of fixed assets did not differ materially from their respective fair value.

10 Fixed assets (cont'd)

The effect of the above revaluation was to increase future annual depreciation charges of the Group by approximately RMB33,000,000. Had the fixed assets of the Group and the Company been stated at cost, that is, the effect of the revaluation was excluded, the net book values of fixed assets of the Group and the Company as at 31 December, 2002 would have been approximately RMB26,811,543,000 and RMB19,440,211,000 respectively (2001: RMB22,457,489,000 and RMB15,531,066,000, respectively), made up as follows:

	The Group		The Company	
	2002 RMB'000	2001 RMB'000	2002 RMB'000	2001 RMB'000
Buildings	2,982,468	2,942,666	1,002,979	983,174
Aircraft				
– owned	14,694,256	9,660,992	9,841,868	5,325,222
– held under finance leases	11,939,534	11,934,083	11,939,534	11,934,083
Flight equipment and others	8,927,679	8,308,997	5,163,355	4,933,760
	38,543,937	32,846,738	27,947,736	23,176,239
Less: Accumulated depreciation	11,732,394	10,389,249	8,507,525	7,645,173
	26,811,543	22,457,489	19,440,211	15,531,066

As at 31 December, 2002, certain aircraft of the Group and the Company with an aggregate carrying value of approximately RMB14,782,559,000 and RMB12,893,592,000 respectively (2001: RMB14,295,480,000 and RMB12,104,631,000, respectively) were pledged as collateral under certain loan and lease agreements (see Notes 21 and 22).

During the year, the Group entered into arrangements to lease several of its aircraft to independent third parties. The terms of such leases generally range from one to six months. Depreciation of the relevant aircraft recognised during the period from the date of commencement of the leases to 31 December, 2002 or the expiry date of the leases, whichever is earlier, totalled RMB4,176,000 (2001: RMB9,671,000).

10 Fixed assets (cont'd)

In June 2002, the Company entered into an arrangement (the "Arrangement") with certain independent third parties under which the Company sold an aircraft and then immediately leased back the aircraft for a period of 26 years. As agreed, the lease payment obligations, with pre-determined net present value totalling RMB1,295,680,000 equivalent, is to be satisfied solely out of the sale proceeds and such amount has been placed irrevocably by the Company in form of deposits and debt securities in favour of the lessor. The Company has an option to purchase the aircraft at the 16.6th year and the agreed purchase price is to be satisfied by the balances of the deposits and debt securities outstanding at that date. In the event that the lease agreement is early terminated by the Company, the Company is liable to pay a pre-determined penalty to the lessor. As long as the Company complies with the lease agreement, the Company is entitled to the quiet use of, and continued possession and use or operation of, the aircraft. Since the Company retains substantially all risks and rewards incident to ownership of the aircraft and enjoys substantially the same rights to its use as before the Arrangement, no adjustment has been made to the fixed assets. As at 31 December, 2002, the net present value of the lease commitments and the corresponding defeased deposits and debt securities amounted to RMB1,322,843,000. As a result of the Arrangement, the Company received a net cash benefit of RMB51,682,000 which has been recognised as income for the year.

Time	Origin	Destination	Airline	Flight	Class	Time
18:00	HONGKONG	GUANGZHOU	CHINA SOUTHERN	CZ3501	C	17:30
18:00	LOS ANGELES	HONGKONG	UNITED AIRLINES	UA 818	D	
18:55	BEIJING	HONGKONG	CHINA SOUTHERN	CZ3195	D	18:45
19:00	HONOLULU	HONGKONG	NORTHWEST	JD 19	A	
20:00	SHANGHAI	HONGKONG	CHINA SOUTHERN	CZ 882	B	
22:55	SYDNEY	BRISBANE	ANSETT	NH 173	B	

and reading books used in 31 African countries opened Monday at a gallery in

11 Construction in progress

Construction in progress comprises expenditure incurred on the construction of buildings, staff quarters and other operating facilities not yet substantially completed at 31 December, 2002, details as follows:

	2002	2001
	RMB'000	RMB'000
The Company		
Guangzhou new airport base	432,580	63,766
Guangzhou ticket selling office	45,988	33,345
Hubei catering building	23,407	14,404
Zhengzhou training centre	21,988	22,289
Material and engineering system	21,063	16,044
Haikou new airport facilities	–	48,711
Guangzhou aviation medical centre	–	17,661
Other	70,485	44,652
	615,511	260,872
Subsidiaries		
Fuzhou Chang Le airport facilities	14,839	9,954
Xiamen flight training facilities	–	32,088
Other	31,002	37,149
	45,841	79,191
	661,352	340,063

12 Interest in subsidiaries

	The Company	
	2002 RMB'000	2001 RMB'000
Unlisted shares/capital contributions, at cost	1,086,793	948,647
Amounts due from subsidiaries	319,217	1,031,811
	1,406,010	1,980,458

In August 2002, the Company acquired 90% equity interest in each of Guangzhou Aviation Hotel, Southern Airlines Advertising Company and South China International Aviation & Travel Services Company (the "Acquired Subsidiaries") from CSAHC at an aggregate cash consideration of approximately RMB107,846,000. Such consideration is determined by reference to the valuation reports prepared by GZAA Incorporated, a firm of independent valuers registered in the PRC. The acquisitions have been accounted for using the purchase method of accounting. The Acquired Subsidiaries' aggregate net profit for the period from the date of acquisition to 31 December, 2002 amounting to approximately RMB295,000 has been included in the Group's consolidated profit and loss account for the year ended 31 December, 2002.

Details of the Company's subsidiaries are set out in Note 35.

13 Interest in associated companies

	The Group		The Company	
	2002 RMB'000	2001 RMB'000	2002 RMB'000	2001 RMB'000
Share of attributable net assets other than goodwill	692,026	531,055	-	-
Unlisted capital contributions, at cost	-	-	428,840	292,340
Impairment loss for investment in associated company	-	-	(61,267)	(61,267)
	692,026	531,055	367,573	231,073

Details of the Group's associated companies are set out in Note 36.

14 Interest in jointly controlled entities

	The Group		The Company	
	2002 RMB'000	2001 RMB'000	2002 RMB'000	2001 RMB'000
Share of attributable net assets other than goodwill	461,962	174,338	–	–
Unlisted capital contributions, at cost	–	–	474,042	178,372
	461,962	174,338	474,042	178,372

Details of the Company's jointly controlled entities are set out in Note 36.

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

	2002 RMB'000	2001 RMB'000
Non-current assets	290,088	64,152
Current assets	326,712	114,033
Current liabilities	(154,838)	(3,847)
Net assets	461,962	174,338
Income	–	–
Expenses	(3,352)	(4,034)
Net profit	(3,352)	(4,034)

15 Deferred expenditure

Deferred expenditure mainly comprises custom duties and other direct costs incurred in respect of the Group's operating leased aircraft upon the inception of the respective leases and lump sum housing benefits payable to eligible employees of the Group:

	The Group		The Company	
	2002 RMB'000	2001 RMB'000	2002 RMB'000	2001 RMB'000
Custom duties and other direct costs	257,509	257,509	168,265	168,265
Lump sum housing benefits (Note 28)	260,000	–	260,000	–
	517,509	257,509	428,265	168,265
Less: Accumulated amortisation	234,206	209,326	155,629	136,335
	283,303	48,183	272,636	31,930

16 Deferred taxation

Movements in net deferred tax liabilities are as follows:

	The Group		The Company	
	2002 RMB'000	2001 RMB'000	2002 RMB'000	2001 RMB'000
Balance at 1 January,	(519,577)	(244,175)	(293,991)	(63,832)
Land use rights adjustment (Note 26 (f))	57,495	–	57,495	–
	(462,082)	(244,175)	(236,496)	(63,832)
Transferred from profit and loss account (Note 7)	(317,152)	(275,402)	(270,581)	(230,159)
Balance at 31 December,	(779,234)	(519,577)	(507,077)	(293,991)

16 Deferred taxation (cont'd)

The net deferred tax liabilities at 31 December, 2002 were made up of the taxation effects of:

	The Group		The Company	
	2002 RMB'000	2001 RMB'000	2002 RMB'000	2001 RMB'000
Deferred tax assets:				
Tax losses	149,338	175,926	149,338	175,926
Repairs and maintenance accruals	63,896	171,122	69,385	176,611
Repair charges capitalised	319,697	265,319	259,147	196,131
Accrued expenses	311,893	295,597	311,893	295,597
Other	129,423	122,321	144,463	168,300
Total deferred tax assets	974,247	1,030,285	934,226	1,012,565
Deferred tax liabilities:				
Undistributed profits of subsidiaries	254,210	219,330	254,210	219,330
Repairs and maintenance accruals	78,083	73,851	-	-
Depreciation of fixed assets	1,403,278	1,237,532	1,187,093	1,087,226
Other	17,910	19,149	-	-
Total deferred tax liabilities	1,753,481	1,549,862	1,441,303	1,306,556
Net deferred tax liabilities	(779,234)	(519,577)	(507,077)	(293,991)

(Expressed in Renminbi)

17 Inventories

	The Group		The Company	
	2002 RMB'000	2001 RMB'000	2002 RMB'000	2001 RMB'000
Expendable spare parts and maintenance materials	489,554	433,778	106,376	129,517
Other supplies	56,146	33,240	11,758	19,020
	545,700	467,018	118,134	148,537

None of the above inventories was carried at net realisable value at 31 December, 2001 and 2002.

18 Trade receivables

Credit terms granted by the Group to sales agents and other customers generally range from one to three months. The ageing analysis of trade receivables, net of impairment losses, is as follows:

	The Group		The Company	
	2002 RMB'000	2001 RMB'000	2002 RMB'000	2001 RMB'000
Within 1 month	576,789	419,765	394,744	263,850
More than 1 month but less than 3 months	88,133	128,388	62,536	82,493
More than 3 months but less than 12 months	6,854	8,389	7,650	5,467
	671,776	556,542	464,930	351,810

As at 31 December, 2002, the Group and the Company had an amount due from fellow subsidiary of RMB89,550,000 (2001: RMB55,115,000) which was included in trade receivables.

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

19 Amounts due to related companies

Amounts due to related companies, which represent balances with the Company's holding company and with the CAAC and its affiliates, are unsecured, interest free and repayable on demand.

20 Cash and cash equivalents

Cash and cash equivalents comprise cash at bank and in hand and deposits with Southern Airlines Group Finance Company Limited ("SA Finance"), a PRC authorised financial institution controlled by CSAHC and an associated company of the Group. In accordance with the financial agreement dated 22 May, 1997 between the Company and SA Finance, all the Group's deposits accepted by SA Finance at 31 December, 2002 were simultaneously placed with several designated major PRC banks by SA Finance. As at 31 December, 2002, the Group's and the Company's deposits with SA Finance amounted to RMB900,979,000 and RMB877,449,000 respectively (2001: RMB1,341,126,000 and RMB1,316,709,000 respectively).

21 Bank and other loans

	The Group		The Company	
	2002 RMB'000	2001 RMB'000	2002 RMB'000	2001 RMB'000
Bank loans due:				
Within one year	5,240,726	2,177,516	3,479,322	1,379,277
In the second year	839,036	880,836	522,482	517,018
In the third to fifth year, inclusive	3,730,849	1,992,143	3,143,413	1,299,383
After the fifth year	1,262,549	751,615	962,477	295,282
	11,073,160	5,802,110	8,107,694	3,490,960
Other loans due:				
In the second year	3,000	3,000	–	–
	11,076,160	5,805,110	8,107,694	3,490,960
Portion classified as current liabilities	(5,240,726)	(2,177,516)	(3,479,322)	(1,379,277)
	5,835,434	3,627,594	4,628,372	2,111,683

(Expressed in Renminbi)

21 Bank and other loans (cont'd)

As at 31 December, 2002, bank loans of the Group and the Company totalling RMB4,117,778,000 and RMB2,783,418,000 respectively (2001: RMB3,741,749,000 and RMB2,092,616,000 respectively) were secured by mortgages over certain of the Group's and the Company's aircraft.

As at 31 December, 2002, certain bank loans of the Group and the Company were guaranteed by the following parties:

	The Group		The Company	
	2002 RMB'000	2001 RMB'000	2002 RMB'000	2001 RMB'000
Export-Import Bank of the United States	2,680,801	2,744,093	1,536,835	1,435,313
Bank of China	604,010	892,390	433,706	552,037
China Construction Bank	76,134	105,266	76,134	105,266
CSAHC	3,340,118	1,298,344	2,280,118	1,098,344
SA Finance	561,531	–	550,000	–
	7,262,594	5,040,093	4,876,793	3,190,960

21 Bank and other loans (cont'd)

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

Interest rate and final maturity		The Group		The Company	
		2002 RMB'000	2001 RMB'000	2002 RMB'000	2001 RMB'000
RMB denominated loans:					
Loans for construction projects	Floating interest rates ranging from 4.94% to 6.21% per annum at 31 December, 2002, with maturities through 2009	893,838	115,562	850,000	100,000
	Non-interest bearing loans from a municipal government authority, repayable in 2004	3,000	3,000	-	-
Loans for purchase of aircraft	Floating interest rates ranging from 5.02% to 5.49% per annum at 31 December, 2002, with maturities through 2012	2,310,268	485,700	2,231,768	321,700
U.S. dollar denominated loans:					
Loans for purchase of aircraft	Fixed interest rates ranging from 5.00% to 8.33% per annum at 31 December, 2002, with maturities through 2011	3,426,038	3,741,749	2,111,768	2,092,616
Loan for purchase of flight equipment	Fixed interest rate of 8.35% per annum at 31 December, 2002, with maturity through 2004	20,090	27,994	-	-
		6,653,234	4,374,005	5,193,536	2,514,316
Less: loans due within one year classified as current liabilities		(817,800)	(746,411)	(565,164)	(402,633)
		5,835,434	3,627,594	4,628,372	2,111,683

As at 31 December, 2002, bank and other loans of the Group and the Company included short-term bank loans totalling RMB4,422,926,000 and RMB2,914,158,000 respectively (2001: RMB1,431,105,000 and RMB976,644,000, respectively). On such date, the Group's and the Company's weighted average interest rate on short term borrowings were 3.11% and 2.66% respectively (2001: 4.28% and 4.10% respectively).

21 Bank and other loans (cont'd)

As at 31 December, 2002, the Group had banking facilities with several PRC commercial banks for providing loan finance up to an approximate amount of RMB12,360 million (2001: RMB1,500 million). As at 31 December, 2002, an approximate amount of RMB7,258 million (2001: RMB300 million) was utilised.

22 Obligations under finance leases

The Group and the Company have commitments under finance lease agreements in respect of aircraft and related equipment expiring during the years 2003 to 2011. As at 31 December, 2002, future payments under these finance leases, which were 78% and 22% respectively (2001: 79% and 21% respectively) denominated in United States dollars and Japanese yen, are as follows:

	2002			2001		
	Payments RMB'000	Interest RMB'000	Obligations RMB'000	Payments RMB'000	Interest RMB'000	Obligations RMB'000
The Group and the Company						
Balance due:						
Within one year	2,006,392	439,694	1,566,698	1,960,822	508,893	1,451,929
In the second year	1,624,381	351,237	1,273,144	1,891,234	412,673	1,478,561
In the third to fifth year, inclusive	4,153,235	647,988	3,505,247	4,075,079	807,570	3,267,509
After the fifth year	1,960,607	107,247	1,853,360	3,203,544	257,980	2,945,564
	9,744,615	1,546,166	8,198,449	11,130,679	1,987,116	9,143,563
Less: Balance due within one year classified as current liabilities			(1,566,698)			(1,451,929)
			6,631,751			7,691,634

Certain lease financing arrangements comprised finance leases between the Company and certain of its subsidiaries, and corresponding borrowings between such subsidiaries and banks. The Company has guaranteed the subsidiaries' obligations under the bank borrowings and accordingly, the relevant leased assets and obligations are recorded in the balance sheet to reflect the substance of the transactions. The future payments under these leases have therefore been presented by the Company and the Group in amounts that reflect the payments under the bank borrowings between the subsidiaries and banks.

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

22 Obligations under finance leases (cont'd)

Security, including charges over the assets concerned and relevant insurance policies, is provided to the lessors.

As at 31 December, 2002, certain of the Group's and the Company's aircraft with carrying amounts of RMB8,960,483,000 (2001: RMB9,216,138,000) were pledged to secure facilities with financial institutions granted to lessors totalling RMB8,198,449,000 (2001: RMB9,143,563,000).

23 Accounts payable

The ageing analysis of accounts payable is as follows:

	The Group		The Company	
	2002 RMB'000	2001 RMB'000	2002 RMB'000	2001 RMB'000
Due within 1 month or on demand	164,442	140,172	88,645	101,977
Due after 1 month but within 3 months	157,731	194,665	89,290	128,177
Due after 3 months but within 6 months	210,307	255,863	119,054	189,716
	532,480	590,700	296,989	419,870

As at 31 December, 2002, the Group and the Company had an amount due to fellow subsidiary of RMB267,468,000 (2001: RMB433,278,000) which was included in accounts payable.

All of the accounts payable are expected to be settled within one year.

(Expressed in Renminbi)

24 Provision for major overhauls

Details of provision for major overhauls in respect of aircraft held under operating leases are as follows:

	The Group		The Company	
	2002 RMB'000	2001 RMB'000	2002 RMB'000	2001 RMB'000
Balance at 1 January,	187,125	241,895	48,154	79,917
Additional amount provided	49,051	12,889	33,460	17,444
Amount utilised	(42,289)	(67,659)	(18,225)	(49,207)
Balance at 31 December,	193,887	187,125	63,389	48,154
The balance of provision for major overhauls at 31 December, 2002 comprised:				
Current portion (included in accrued expenses)	52,000	61,464	–	–
Non-current portion	141,887	125,661	63,389	48,154
	193,887	187,125	63,389	48,154

25 Share capital

	2002	2001
	RMB'000	RMB'000
Registered capital:		
2,200,000,000 domestic shares of RMB1.00 each	2,200,000	2,200,000
1,174,178,000 H shares of RMB1.00 each	1,174,178	1,174,178
	3,374,178	3,374,178
Issued and paid up capital:		
2,200,000,000 domestic shares of RMB1.00 each	2,200,000	2,200,000
1,174,178,000 H shares of RMB1.00 each	1,174,178	1,174,178
	3,374,178	3,374,178

All the domestic and H shares rank *pari passu* in all material respects.

Pursuant to an extraordinary general meeting of shareholders held on 21 May, 2002, a resolution was passed for the Company to issue not more than 1,000,000,000 A shares of par value of RMB1.00 each. As at the date of approval of these financial statements, no A shares have been issued.

(Expressed in Renminbi)

26 Reserves

Movements on reserves during the year comprise:

	Note	The Group		The Company	
		2002 RMB'000	2001 RMB'000	2002 RMB'000	2001 RMB'000
Share premium					
Balance at 1 January,		3,813,659	3,813,659	3,813,659	3,813,659
Land use rights adjustment	(f)	(129,703)	-	(129,703)	-
Balance at 31 December,		3,683,956	3,813,659	3,683,956	3,813,659
Statutory surplus reserve	(a)				
Balance at 1 January,		391,867	381,216	121,943	121,943
Adjustments from adoption of new PRC accounting regulations	(c)	(106,007)	-	163,917	-
Transfer from profit and loss account		51,335	10,651	51,335	-
Balance at 31 December,		337,195	391,867	337,195	121,943
Statutory public welfare fund	(b)				
Balance at 1 January,		225,440	219,877	114,558	114,558
Adjustments from adoption of new PRC accounting regulations	(c)	(79,533)	-	31,349	-
Transfer from profit and loss account		25,667	5,563	25,667	-
Balance at 31 December,		171,574	225,440	171,574	114,558
Discretionary surplus reserve	(d)				
Balance at 1 January,		69,867	63,852	-	-
Adjustments from adoption of new PRC accounting regulations	(c)	-	-	69,867	-
Transfer from profit and loss account		6,736	6,015	6,736	-
Balance at 31 December,		76,603	69,867	76,603	-
Retained profits,					
Balance at 1 January,		1,346,652	1,028,656	467,716	355,582
Adjustments from adoption of new PRC accounting regulations	(c)	185,540	-	(265,133)	-
Land use rights adjustment	(f)	12,970	-	12,970	-
Profit for the year		575,761	340,225	381,305	112,134
Appropriations to reserves		(83,738)	(22,229)	(83,738)	-
Dividend paid		(67,484)	-	(67,484)	-
Balance at 31 December,		1,969,701	1,346,652	445,636	467,716
Total		6,239,029	5,847,485	4,714,964	4,517,876

26 Reserves (cont'd)

Notes:

- (a) According to the PRC Company Law and the Articles of Association of the Company and certain of its subsidiaries, the Company and the relevant subsidiaries are required to transfer 10% of their annual net profits after taxation, as determined under relevant PRC accounting regulations, to a statutory surplus reserve until the reserve balance reaches 50% of the registered capital. The transfer to this reserve must be made before distribution of a dividend to shareholders.

Statutory surplus reserve can be used to offset prior years' losses, if any, and may be converted into share capital by the issue of new shares to shareholders in proportion to their existing shareholding or by increasing the par value of the shares currently held by them, provided that the balance after such issue is not less than 25% of the registered capital.

- (b) According to the PRC Company Law and the Articles of Association of the Company and certain of its subsidiaries, the Company and the relevant subsidiaries are required to transfer between 5% to 10% of their annual net profits after taxation, as determined under PRC accounting regulations, to the statutory public welfare fund. This fund can only be utilised on capital items for the collective benefits of the Company's and the relevant subsidiaries' employees such as the construction of dormitories, canteen and other staff welfare facilities. This fund is non-distributable other than in liquidation. The transfer to this reserve must be made before distribution of a dividend to shareholders.

- (c) During 2002, the Group and the Company adopted certain new PRC accounting regulations which resulted in adjustments to the amounts of the Group's and Company's profits determined under PRC accounting regulations in respect of prior years and corresponding adjustments to amounts appropriated to the statutory surplus reserve, statutory public welfare fund and discretionary surplus reserve for the prior years.

- (d) The transfer to this reserve from the profit and loss account is subject to the approval of shareholders at general meetings. Its usage is similar to that of statutory surplus reserve.

- (e) Under PRC Company Law and the Company's Articles of Association, the net profit after taxation as reported in the PRC statutory financial statements of the Company can only be distributed as dividends after allowances have been made for:

- (i) making up cumulative prior years' losses, if any;
- (ii) allocations to the statutory surplus reserve of at least 10% of after-tax profit, until the fund aggregates to 50% of the Company's registered capital;
- (iii) allocations of 5% to 10% of after-tax profit to the Company's statutory public welfare fund; and

26 Reserves (cont'd)

- (iv) allocations to the discretionary surplus reserve, if approved by the shareholders.

Pursuant to the Articles of Association of the Company, the net profit of the Company for the purpose of profit distribution is deemed to be the lesser of (i) the net profit determined in accordance with the PRC accounting principles and financial regulations and (ii) the net profit determined in accordance with IFRS; or if the financial statements of the Company are not prepared in accordance with IFRS, the accounting standards of one of the countries in which its shares are listed.

- (f) In the current year, the Group adopted IAS 40 "Investment Property". According to IAS 40, the land use rights which were previously included in fixed assets at revaluation base are now presented as lease prepayments and carried at historical cost base with effect from 1 January, 2002. Accordingly, the unamortised surplus on previous revaluations of the land use rights, net of related deferred tax asset, are reversed to the share premium and retained profits accounts. The effect of this change did not have a material impact on the Group's financial condition and results of operations in the periods prior to the change. As such, comparative figures of fixed assets, lease prepayments and reserves have not been adjusted for but have been reclassified to conform with the current year's presentation.

27 Related party transactions

Substantially all transactions undertaken by the Group during the year were effected on such terms as have been determined by the CAAC and other relevant PRC authorities. In addition, many of the involved counter parties were either regulated by or connected with such authorities.

Both domestic and international routes on which the Group and other PRC airlines offer scheduled services are allocated by the CAAC. International airfares are subject to bilateral agreements between the CAAC, acting on behalf of the PRC government, and other governments. Domestic airfares are regulated jointly by the CAAC and the PRC Price Administrative Bureau.

Furthermore, the Group obtained various supplementary administrative and financial services provided by CSAHC and its affiliates during the normal course of its business.

27 Related party transactions (cont'd)

The following is a summary of significant recurring transactions carried out in the normal course of business between the Group, CSAHC, the CAAC and its affiliates during the year:

	Note	2002 RMB'000	2001 RMB'000
<i>Expenses</i>			
Handling charges	(a)	36,306	16,161
Jet fuel supplies	(b)	2,373,956	2,586,688
Aircraft insurance	(c)	256,238	123,439
Wet lease rentals	(d)	26,164	300,000
Guarantee fees	(e)	1,025	1,490
Ticket reservation service charges	(f)	107,234	110,134
Passenger departure and cargo handling charges	(g)	62,111	57,424
Aircraft and traffic servicing charges	(h)	1,667,706	1,527,600
Advertising expenses	(i)	3,275	9,940
Sundry aviation supplies	(j)	101,350	86,386
Commission expense	(k)	481,446	547,186
Air catering expense	(l)	29,058	22,707
Repairing charges	(m)	592,311	534,828
Contributions to retirement schemes	(n)	–	77,833
Post retirement medical and other welfare benefits	(o)	–	16,900
Housing benefits	(p)	85,000	85,000
Lease charges for land and buildings	(q)	15,224	15,224
<i>Income</i>			
Ground services income	(r)	39,735	23,513
Wet lease rentals	(s)	27,599	–
Interest income	(t)	10,530	13,771
Commission income	(u)	81,931	89,842
<i>Others</i>			
Acquisition of aircraft and related spare parts and vehicles	(v)	946,866	–
Acquisition of subsidiaries	(w)	107,846	–

Notes:

- (a) Handling charges represent fees payable to Southern Airlines (Group) Import and Export Trading Company, a wholly owned subsidiary of CSAHC, in connection with the procurement of aircraft and flight equipment on the Group's behalf. Handling charges are calculated based on a fixed percentage of the purchase value and other charges.
- (b) Jet fuel supplies represent purchases of jet fuel at the then prevailing state controlled prices from China Aviation Oil Supply Company, Lan Tian Oil Supply Company and certain other suppliers which are controlled by the CAAC.

27 Related party transactions (cont'd)

(c) Aircraft insurance represents insurance premiums payable to the CAAC which arranges aviation insurance covering hull, war and passenger liability risk on behalf of the PRC airlines with the People's Insurance (Property) Company of China. Insurance premiums are allocated to individual PRC airlines by the CAAC based on the value of the airlines' aircraft and after taking into account the claims history of the airlines.

(d) During 2001, wet lease rentals totalling RMB300,000,000 were paid to Zhongyuan Airlines, a subsidiary of CSAHC, pursuant to wet lease agreements in respect of three Boeing 737-300 aircraft and two Boeing 737-37K aircraft. No such rentals were paid in 2002 since the termination of lease arrangements in January 2002.

During 2002, wet lease rentals totalling RMB26,164,000 were paid to Xingjian Airlines, a subsidiary of CSAHC, pursuant to a wet lease agreement in respect of a Boeing 757-200 aircraft effective October 2002.

(e) Guarantee fees represent charges collected by the CAAC and paid to PRC banks in respect of guarantees provided by these banks in connection with aircraft acquisitions of the Group. As at 31 December, 2002, back-to-back guarantees provided by the CAAC in favour of the Group to these banks amounted to approximately RMB680,144,000 (2001: RMB997,656,000). Guarantee fees are charged at rates ranging from 0.085% to 0.3% of the guaranteed amount.

(f) Ticket reservation service charges represent fees payable to the CAAC in respect of computer reservation services rendered by the CAAC at charges determined based on the utilisation of the computer reservation system.

(g) Passenger departure and cargo handling charges are payable to the CAAC for use of the computerised passenger departure and cargo handling systems installed at certain PRC airports. The charges are levied based on the utilisation of these systems.

(h) Aircraft and traffic servicing charges represent take-off and landing fees payable to various PRC airports in respect of take-off and landing slots allocated to the Group and other ancillary services provided. Fees are payable by the Group based on the scale rates published by the CAAC.

(i) Advertising expenses represent expense reimbursements to Southern Airlines Advertising Company ("SAAC"), for promotional services rendered to the Group. SAAC was a subsidiary of CSAHC up to July 2002. In August 2002, the Company acquired 90% equity interest in SAAC from CSAHC (see Note 12).

(j) Sundry aviation supplies represent purchases of other supplies from Southern Airlines (Group) Economic Development Company, a subsidiary of CSAHC. Prices charged by this supplier to the Group are similar to those charged to other PRC airlines.

(k) Commission expense represents commissions payable to the CAAC's sales offices, other PRC airlines and certain subsidiaries of CSAHC in connection with services provided in exchange for air tickets sold by them. These commissions are calculated based on a fixed rate ranging from 1.5% to 12% on the ticket value.

27 Related party transactions (cont'd)

- (l) Air catering expense represents purchases of inflight meals and related services from Shenzhen Air Catering Company Limited, a cooperative joint venture established in the PRC, in respect of which CSAHC is entitled to 33% of its profits after tax.
- (m) Repairing charges represent fees incurred by the Group in connection with comprehensive maintenance services rendered by Guangzhou Aircraft Maintenance Engineering Company Limited, an associated company of the Company.
- (n) Previously, the Group paid contributions through CSAHC towards certain defined contribution retirement schemes organised by relevant PRC government agencies for the benefit of employees. With effect from 1 January, 2002, the Group pays the contributions directly to the agencies. Previously, the Group also paid contributions towards a supplementary defined contribution retirement scheme organised by CSAHC for the benefit of employees. With effect from 1 January, 2002, the scheme has been handed over to relevant PRC government agency (see Note 28).
- (o) Previously, the Group paid a fixed annual fee to CSAHC in return for CSAHC providing medical and other welfare services to the retired employees of the Group. With effect from 1 January, 2002, such arrangement was terminated and the services are now provided by the Group itself (see Note 28).
- (p) Housing benefits represent a fixed annual fee payable to CSAHC in respect of the provision of quarters to the eligible employees of the Group (see Note 28).
- (q) Charges were paid to CSAHC under certain lease agreements in respect of certain land and buildings in the PRC (see Note 10).
- (r) Ground services income represents the attributable share of fees received from other airlines in respect of ground services at Guangzhou Baiyun International Airport provided by the Company together with Baiyun International Airport Group. The Company was entitled to 50% of the service fees for the year ended 31 December, 2002 (2001: 50%).
- (s) During the period from August to October 2002, the Company received wet lease rentals totalling RMB27,599,000 from wet leasing of an Airbus 320-200 aircraft to Sichuan Airlines Corporation Limited, an associated company of the Company.
- (t) Interest income represents interest received from deposits placed with SA Finance. The applicable interest rate is determined in accordance with the deposit rate published by the People's Bank of China (see Note 20).
- (u) Commission income represents commissions receivable from other PRC airlines in connection with air tickets sold by the Group for which the carriage was provided by such airlines. Commission is calculated based on a fixed rate ranging from 3% to 9% on the ticket value.

27 Related party transactions (cont'd)

- (v) During the year, the Group acquired five Boeing 737-300/37K aircraft and related spare parts and certain vehicles from Zhongyuan Airlines, a subsidiary of CSAHC, at a consideration of approximately RMB1,096,866,000. The consideration was satisfied by cash of approximately RMB132,130,000 together with an assumption by the Group of Zhongyuan Airlines' debts of approximately RMB964,736,000. In addition, the Group received reimbursements of wet lease rentals totalling RMB150,000,000 which it paid to Zhongyuan Airlines during the period from 1 July, 2001 to 31 December, 2001. Such reimbursements have been applied to reduce the purchase costs of the acquired assets.
- (w) As disclosed in Note 12, in August 2002, the Group acquired 90% equity interest in certain subsidiaries from CSAHC at an aggregate cash consideration of approximately RMB107,846,000.

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

The directors of the Company are of the opinion that the above transactions with related parties were entered into in the normal course of business and on normal commercial terms or in accordance with the agreements governing such transactions.

28 Retirement and housing benefits

Employees of the Group participate in several defined contribution retirement schemes organised separately by PRC municipal governments in regions where the major operations of the Group are located. The Group is required to contribute to these schemes at the rates ranging from 14% to 19% (2001: 14% to 17%) of salary costs including certain allowances. A member of the retirement schemes is entitled to pension benefits equal to a fixed proportion of the salary at the retirement date. The retirement benefit obligations of all existing and future retired staff of the Group are assumed by these schemes.

In addition, the Group was selected as one of the pilot enterprises to establish a supplementary defined contribution retirement scheme for the benefit of employees. In this connection, employees of the Group participate in a supplementary defined contribution retirement scheme whereby the Group is required to make defined contributions at a rate of 4.5% of total salaries. This scheme which was previously organised by CSAHC has been handed over to relevant PRC government agencies since 1 January, 2002. The Group has no obligation for the payment of pension benefits beyond the contributions described above. Contributions to the retirement schemes are charged to the profit and loss account as and when incurred.

The Group is also required to provide retirees with medical benefits, transportation subsidies and other welfare facilities. Previously, the Group paid a fixed annual fee to CSAHC in return for CSAHC providing such benefits to the retired employees of the Group. With effect from 1 January, 2002, such arrangement was terminated and the services are now provided by the Group itself.

28 Retirement and housing benefits (cont'd)

Furthermore, pursuant to the comprehensive services agreement (the "Services Agreement") dated 22 May, 1997 between the Company and CSAHC, CSAHC agrees to provide adequate quarters to eligible employees of the Group as and when required. In return, the Group agrees to pay a fixed annual fee of RMB85,000,000 to CSAHC for a ten-year period effective 1 January, 1995.

During 2001 and 2002, the Group provided additional quarters at its own expense to certain employees who are not eligible for quarters pursuant to the Services Agreement. These quarters were provided to the employees in accordance with the relevant PRC housing reform policy. The excess of the cost of these additional quarters over the considerations received by the Group from the employees of RMB110,723,000 and RMB17,624,000 were charged to expenses for 2001 and 2002 respectively.

Subsequently, pursuant to an additional staff housing benefit scheme effective September 2002, the Group has agreed to pay lump sum housing allowances to certain employees who have not received quarters from CSAHC or the Group according to the relevant PRC housing reform policy, for subsidising their purchases of housing. Such expenditure has been deferred and amortised on a straight line basis over a period of 10 years, which represents the vesting benefit period of the employees. An employee who quits prior to the end of the vesting benefit period is required to pay back a portion of the lump sum housing benefits determined on a pro-rata basis of the vesting benefit period remained. The Group has the right to effect a charge on the employee's house and to enforce repayment through selling the house in the event of default in repayment. Any shortfall in repayment would be charged against profit and loss account. As at 31 December, 2002, the Group already made payments totalling RMB46,325,000 under the scheme and recorded its remaining contractual liabilities totalling RMB213,675,000 as accrued liabilities on its balance sheet.

29 Commitments

(a) Capital commitments

As at 31 December, 2002, the Group and the Company had capital commitments as follows:

	The Group		The Company	
	2002 RMB'000	2001 RMB'000	2002 RMB'000	2001 RMB'000
Commitments in respect of aircraft and related equipment (Note)				
– authorised and contracted for	5,875,996	12,052,703	5,875,996	11,600,308
Commitments in respect of investments in the Guangzhou new airport				
– authorised and contracted for	525,700	157,250	525,700	157,250
– authorised but not contracted for	2,601,720	3,338,984	2,601,720	3,338,984
	3,127,420	3,496,234	3,127,420	3,496,234
Other commitments				
– authorised and contracted for	43,887	43,011	42,968	38,126
– authorised but not contracted for	500,545	475,164	245,440	256,151
	544,432	518,175	288,408	294,277
	9,547,848	16,067,112	9,291,824	15,390,819

29 Commitments (cont'd)

(a) Capital commitments (cont'd)

Note:

As at 31 December, 2002, the Group had on order fifteen Boeing 737-800 aircraft and certain flight equipment, scheduled for deliveries in 2003 to 2005. Deposits of RMB1,659,964,000 have been made towards the purchase of these aircraft and related equipment. As at 31 December, 2002, the approximate total future payments, including estimated amounts for price escalation through anticipated delivery dates for these aircraft and related equipment are as follows:

	The Group		The Company	
	2002 RMB'000	2001 RMB'000	2002 RMB'000	2001 RMB'000
Year ending				
31 December,				
2002	–	5,741,839	–	5,289,444
2003	2,801,451	3,192,272	2,801,451	3,192,272
2004	2,343,978	2,391,690	2,343,978	2,391,690
2005	730,567	726,902	730,567	726,902
	5,875,996	12,052,703	5,875,996	11,600,308

As at 31 December, 2002, the Group's and the Company's attributable share of the capital commitments of jointly controlled entities was as follows:

	The Group and the Company	
	2002 RMB'000	2001 RMB'000
Authorised and contracted for	63,723	47,820
Authorised but not contracted for	518,000	671,408
	581,723	719,228

29 Commitments (cont'd)

(b) Operating lease commitments

As at 31 December, 2002, commitments under non-cancellable aircraft and flight equipment operating leases were as follows:

	The Group		The Company	
	2002 RMB'000	2001 RMB'000	2002 RMB'000	2001 RMB'000
Payments due				
Within one year	1,280,060	1,573,046	1,044,720	1,360,272
In the second to fifth year, inclusive	4,358,474	3,773,384	3,772,227	3,128,249
After the fifth year	2,898,104	289,530	2,893,237	219,774
	8,536,638	5,635,960	7,710,184	4,708,295

(c) Investing commitments

As at 31 December, 2002, the Company was committed to make a capital contribution of approximately RMB60 million and RMB201 million respectively (2001: RMB82 million and RMB304 million respectively) to its jointly controlled entity and associated company.

30 Contingent liabilities

- (a) The Company has been advised by its PRC lawyers that, except for liabilities constituting or arising out of or relating to the businesses assumed by the Company in the Reorganisation, no other liabilities were assumed by the Company, and the Company is not jointly and severally liable for other debts and obligations incurred by CSAHC prior to the Reorganisation. There are not, however, any definitive PRC regulations or other pronouncements confirming such conclusion.
- (b) The Group leases from CSAHC certain land in Guangzhou and certain land and buildings in Wuhan, Haikou and Zhengzhou. The Group has a significant investment in buildings and other leasehold improvements located on such land. However, such land in Guangzhou and such land and buildings in Wuhan, Haikou and Zhengzhou lack adequate documentation evidencing CSAHC's rights thereto.

30 Contingent liabilities (cont'd)

With respect to the facilities in Guangzhou, CSAHC has received written assurance from the CAAC to the effect that CSAHC is entitled to continued use and occupancy of the land in Guangzhou. The Company understands that the CAAC is basing its conclusion on an agreement among certain government authorities relating to such land. Such assurance does not constitute formal evidence of CSAHC's right to transfer, mortgage or lease such real property interests. The Group cannot predict the magnitude of the effect on its financial condition or results of operations to the extent that its use of one or more of these parcels of land or the related facilities were successfully challenged. CSAHC has agreed to indemnify the Group against any loss or damage caused by any challenge or interference with the Group's use of any of its land and buildings.

31 Fair value of financial instruments and concentration of risk

Financial assets of the Group include cash and cash equivalents, investments, trade receivables and other receivables. Financial liabilities of the Group include bank and other loans, accounts payable and obligations under finance leases.

Liquidity risk

As at 31 December, 2002, the Group's net current liabilities amounted to RMB7,016 million (2001: RMB3,696 million). For the year ended 31 December, 2002, the Group recorded a net cash inflow from operating activities of RMB3,698 million (2001: RMB2,224 million), a net cash outflow from investing activities and financing activities of RMB2,745 million (2001: RMB3,604 million) and an increase in cash and cash equivalents of RMB953 million (2001: RMB1,380 million (decrease)).

With regard to 2003 and thereafter, the liquidity of the Group is primarily dependent on its ability to maintain adequate cash inflow from operations to meet its debt obligations as they fall due, and on its ability to obtain adequate external finance to meet its committed future capital expenditures. With regard to its short-term bank loans outstanding at 31 December, 2002 of approximately RMB4,423 million, the Group has obtained firm commitments from several PRC banks to renew such loans as they fall due during 2003. With regard to the future capital commitments, the Group has already entered into loan financing agreements with several PRC banks to provide loan finance up to an approximate amount of RMB5,102 million and sought letters of intent from several PRC banks to provide the remaining required loan finance of approximately RMB5,876 million. The directors of the Company believe that such financing will be available to the Group.

31 Fair value of financial instruments and concentration of risk (cont'd)**Liquidity risk (cont'd)**

The directors of the Company have carried out a detailed review of the cash flow forecast of the Group for the twelve months ending 31 December, 2003. Based on such forecast, the directors have determined that adequate liquidity exists to finance the working capital and capital expenditure requirements of the Group during that period. In preparing the cash flow forecast, the directors have considered historical cash requirements of the Group as well as other key factors, including the availability of the above-mentioned loan finance which may impact the operations of the Group during the next twelve-month period. The directors are of the opinion that the assumptions and sensitivities which are included in the cash flow forecast are reasonable. However, as with all assumptions in regard to future events, these are subject to inherent limitations and uncertainties and some or all of these assumptions may not be realised.

Business risk

The Group conducts its principal operations in the PRC and accordingly is subject to special considerations and significant risks not typically associated with investments in equity securities of the United States of America and Western European companies. These include risks associated with, among others, the political, economic and legal environment, influence of the CAAC over many aspects of its operations, and competition, in the passenger, cargo and mail airlines services industry.

Interest rate risk

The interest rates and terms of repayment of the Group's bank and other loans, and finance lease obligations are disclosed in Notes 21 and 22, respectively.

Foreign currency risk

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

31 Fair value of financial instruments and concentration of risk (cont'd)

Credit risks

Substantially all of the Group's cash and cash equivalents are deposited with PRC financial institutions.

A significant portion of the Group's air tickets are sold by agents participating in the Billing and Settlement Plan ("BSP"), a clearing scheme between airlines and sales agents organised by International Air Transportation Association. As at 31 December, 2002, the balance due from BSP agents amounted to RMB353,246,000 (2001: RMB226,135,000).

Self insurance risk

The Group maintains a limited amount of property insurance in respect of certain personal and real property.

Fair value

The carrying amounts and estimated fair values of significant financial assets and liabilities at 31 December, 2001 and 2002 are set out below:

	2002		2001	
	Carrying amount RMB'000	Fair value RMB'000	Carrying amount RMB'000	Fair value RMB'000
The Group				
Cash and cash equivalents	3,771,043	3,771,043	2,817,863	2,817,863
Bank and other loans, current portion	5,240,726	5,326,511	2,177,516	2,208,056
Bank and other loans, non-current portion	5,835,434	6,111,052	3,627,594	3,752,143
The Company				
Cash and cash equivalents	2,960,337	2,960,337	2,137,582	2,137,582
Bank and other loans, current portion	3,479,322	3,546,409	1,379,277	1,399,479
Bank and other loans, non-current portion	4,628,372	4,811,961	2,111,683	2,196,480

31 Fair value of financial instruments and concentration of risk (cont'd)**Fair value (cont'd)**

The following methods and assumptions were used to estimate the fair value for each class of financial instruments:

(i) *Cash and cash equivalents, and short-term bank and other loans*

The carrying values approximate fair value because of the short maturities of these instruments.

(ii) *Long-term bank and other loans*

The fair value has been estimated by applying a discounted cash flow approach using interest rates available to the Group for similar indebtedness.

The economic characteristics of the Group's leases vary from lease to lease. It is impractical to compare such leases with those prevailing in the market within the constraints of timeliness and cost for the purpose of estimating the fair value of such leases. Other investments represent unquoted available-for-sale equity securities of companies established in the PRC. There is no quoted market price for such equity securities and accordingly a reasonable estimate of the fair value could not be made without incurring excessive costs.

Fair value estimates are made at a specific point in time and are based on relevant market information about the financial instruments. These estimates are subjective in nature and involve uncertainties and matters of significant judgement and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

32 Segmental information

Geographic information about the Group's turnover and operating profit are as follows:

	Hong Kong			Total RMB'000
	Domestic RMB'000	regional RMB'000	*International RMB'000	
2002				
Traffic revenue	13,197,589	1,118,695	3,165,608	17,481,892
Other revenue	485,046	–	51,682	536,728
Total turnover	13,682,635	1,118,695	3,217,290	18,018,620
Operating profit	1,614,975	193,440	217,662	2,026,077
2001				
Traffic revenue	12,924,892	1,182,492	2,354,148	16,461,532
Other revenue	359,895	58,231	–	418,126
Total turnover	13,284,787	1,240,723	2,354,148	16,879,658
Operating profit	1,090,154	219,686	90,833	1,400,673

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

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

33 Reconciliation and supplementary statement of cash flow information

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

	2002 RMB'000	2001 RMB'000
Profits before taxation and minority interests	1,139,099	795,256
Depreciation and amortisation of fixed assets	1,839,293	1,802,462
Other amortisation	9,816	12,512
Amortisation of deferred credits	(7,217)	(18,483)
Share of associated companies' results	(36,988)	(53,077)
Share of jointly controlled entities' results	3,352	4,034
(Gain)/loss on sale of fixed assets	(170,740)	55,889
Interest income	(52,618)	(49,878)
Interest expense	959,193	933,717
Unrealised exchange loss/(gain), net	174,978	(292,630)
Increase in inventories	(76,472)	(2,033)
(Increase)/decrease in trade receivables	(110,749)	232,228
(Increase)/decrease in other receivables	(166,004)	42,938
Decrease (Increase) in prepaid expenses and other assets	123,924	(136,600)
(Decrease)/increase in amounts due to related companies	(193,175)	98,040
Decrease in accounts payable	(61,843)	(167,599)
Increase in bills payable	1,299,680	-
Increase in sales in advance of carriage	19,985	31,036
Increase/(decrease) in accrued expenses	86,215	(132,121)
(Decrease)/increase in other liabilities	(33,032)	70,254
Increase/(decrease) in provision for major overhauls	16,226	(40,422)
Cash inflows from operations	4,762,923	3,185,523

- (b) Disclosure of non-cash investing and financing activities

During the year, the Group assumed from Zhongyuan Airlines, debts totalling RMB964,736,000 in partly satisfaction of the consideration payable for acquisition of five Boeing 737-300/37K aircraft and other assets from Zhongyuan Airlines (Note 27(v)).

33 Reconciliation and supplementary statement of cash flow information (cont'd)

(c) Effect of acquisition of subsidiaries

	2002 RMB'000	2001 RMB'000
Net assets acquired:		
Fixed assets	96,636	–
Cash and cash equivalents	17,355	–
Trade receivables and other current assets	20,681	–
	134,672	–
Accounts payable	3,623	–
Accrued expenses and other liabilities	11,220	–
	14,843	–
Net assets value	119,829	–
Consideration paid	107,846	–
Cash and cash equivalents acquired	17,355	–
Net cash outflow from acquisition of subsidiaries	90,491	–

34 Ultimate holding company

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

(Expressed in Renminbi)

35 Subsidiaries

The particulars of the Company's principal subsidiaries at 31 December, 2002 are as follows:

Name of company	Place and date of establishment/ operation	Attributable equity interest		Issued/ registered capital*	Principal activities
		Direct %	Indirect %		
China Southern Airlines (Group) Shenzhen Co. (a)	PRC 14 October, 1993	100	-	808,980,000	Airline
China Southern Airlines (Group) Zhuhai Helicopter Company Limited (a)	PRC 31 August, 1983	100	-	100,000,000	Helicopter transportation
Guangxi Airlines Company Limited (a)	PRC 28 April, 1994	60	-	170,900,000	Airline
Southern Airlines Group Shantou Airlines Company Limited (a)	PRC 20 July, 1993	60	-	280,000,000	Airline
Zhuhai Airlines Company Limited (a)	PRC 8 May, 1995	60	-	250,000,000	Airline
Xiamen Airlines Company Limited (a)	PRC 11 August, 1984	60	-	554,730,000	Airline
Guizhou Airlines Company Limited (a)	PRC 12 November, 1991	60	-	80,000,000	Airline
Baiyun Xinhua (Guangzhou) Air Cargo Service Co. (b)	PRC 4 January, 1989	70	-	7,380,000	Cargo forwarding
Guangzhou Nanland Air Catering Company Limited (b)	PRC 21 November, 1989	51	-	55,980,000	Air catering
China Southern West Australian Flying College Pty Ltd	Australia 26 January, 1971	65	-	A\$100,000	Pilot training services

35 Subsidiaries (cont'd)

Name of company	Place and date of establishment/ operation	Attributable equity interest		Issued/ registered capital#	Principal activities
		Direct %	Indirect %		
Guangzhou Baiyun International Logistic Company Ltd	PRC 23 July, 2002	61	–	20,000,000	Logistics operations
Guangzhou Aviation Hotel	PRC 8 January, 1997	90	–	63,290,000	Hotel operation
Southern Airlines Advertising Company	PRC 3 March, 1994	90	–	2,000,000	Aviation advertising
South China International Aviation & Travel Services Company	PRC 11 May, 1992	90	–	2,100,000	Travel services
CZ Flamingo Limited	Cayman Islands 8 December, 1993	100	–	US\$1,000	Aircraft leasing
CZ Skylark Limited	Cayman Islands 17 November, 1993	100	–	US\$1,000	Aircraft leasing
CZ Kapok Limited	Cayman Islands 26 October, 1993	100	–	US\$1,000	Aircraft leasing
CSA-I Limited	Cayman Islands 1 September, 1993	100	–	US\$1,000	Aircraft leasing
CZ93B Limited	Cayman Islands 11 May, 1993	100	–	US\$1,000	Aircraft leasing
CZ97A Limited	Cayman Islands 2 January, 1997	100	–	US\$1,000	Aircraft leasing
Zhong Yuan 99A Limited	Cayman Islands 15 February, 1999	100	–	US\$1,000	Aircraft leasing
CXA92A Limited	Cayman Islands 3 August, 1992	–	60	US\$1,000	Aircraft leasing
CXA93A Limited	Cayman Islands 1 July, 1993	–	60	US\$1,000	Aircraft leasing

(Expressed in Renminbi)

35 Subsidiaries (cont'd)

Name of company	Place and date of establishment/ operation	Attributable equity interest		Issued/ registered capital#	Principal activities
		Direct %	Indirect %		
CXA95B Limited	Cayman Islands 7 July, 1995	-	60	US\$1,000	Aircraft leasing
CXA95C Limited	Cayman Islands 16 October, 1995	-	60	US\$1,000	Aircraft leasing
CXA98A Limited	Cayman Islands 20 March, 1998	-	60	US\$1,000	Aircraft leasing
Xiamen Aviation Property Development Company (a)	PRC 22 June, 1993	-	60	5,000,000	Property development
Xiamen Aviation Advertising Company Limited (a)	PRC 17 December, 1992	-	60	620,218	Aviation advertising
Xiamen Aviation Suppliers Limited (a)	PRC 30 July, 1997	-	60	8,560,000	Aviation suppliers
Xiamen Aviation Development Company Limited (a)	PRC 18 February, 1998	-	54	5,000,000	Hotel management
Bai Lu Finance Limited	Hong Kong 22 February, 1996	-	54	HK\$10,000,000	Investment holding
Xiamen Air Holidays Limited	Hong Kong 28 April, 1994	-	54	HK\$3,000,000	Travel servicing
Xiamen Macau Holidays Limited	Macau 11 May, 1995	-	27.5	MOP1,000,000	Travel servicing
Shantou Hua Kang Air Catering Company Ltd (a)	PRC 22 June, 1994	-	42	10,000,000	Air catering

Expressed in RMB, unless otherwise stated

(a) These subsidiaries are PRC limited companies.

(b) These subsidiaries are Sino-foreign equity joint venture companies

36 Associated companies and jointly controlled entities

The particulars of the Group's principal associated companies and jointly controlled entities at 31 December, 2002 are as follows:

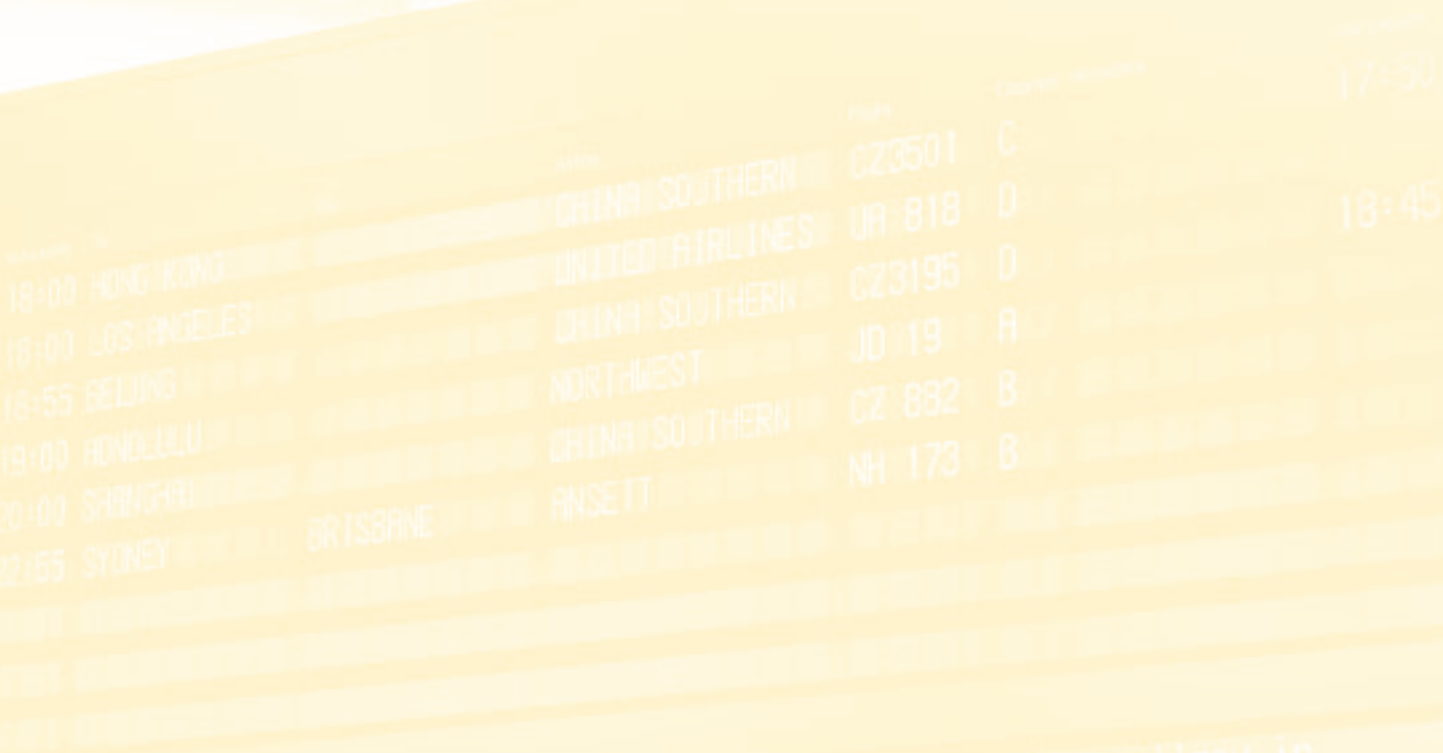
Name of company	Place and date of establishment/ operation	Attributable equity interest		Issued/ registered capital#	Principal activities
		Direct %	Indirect %		
Guangzhou Aircraft Maintenance Engineering Company Limited	PRC 28 October, 1989	50	–	US\$27,500,000	Provision of aircraft repair and maintenance services
Southern Airlines Group Finance Company Limited	PRC 28 June, 1995	30	16.82	300,000,000 and US\$15,000,000	Provision of financial services
Hainan Phoenix Information System Limited	PRC 12 March, 1994	45	–	US\$16,360,000	Provision of ticket reservation system services
Hong Kong Business Aviation Centre Company Limited	Hong Kong 7 January, 1998	20	–	HK\$1,000,000	Provision of private flight logistic services
Sichuan Airlines Corporation Limited	PRC 28 August, 2002	39	–	350,000,000	Airline
MTU Maintenance* Zhuhai Co. Ltd.	PRC 6 April, 2001	50	–	US\$63,100,000	Provision of engine repair and maintenance services

36 Associated companies and jointly controlled entities (cont'd)

Name of company	Place and date of establishment/ operation	Attributable equity interest		Issued/ registered capital#	Principal activities
		Direct %	Indirect %		
China Postal Airlines* Limited	PRC 25 November, 1996	49	-	306,000,000	Airline
Zhuhai Xiang Yi * Aviation Technology Company Limited	PRC 10 July, 2002	51	-	US\$29,800,000	Provision of flight simulation service

Expressed in RMB, unless otherwise stated

* These are jointly controlled entities



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