NOTES TO THE FINANCIAL STATEMENTS

31 December 2002

1. CORPORATE INFORMATION

Hainan Meilan Airport Company Limited (the "Company") is a joint stock company with limited liability incorporated in the People's Republic of China (the "PRC") on 28 December 2000. The Company and its subsidiaries (the "Group") are mainly engaged in the operation of Meilan Airport in Hainan, the PRC (the "Meilan Airport") and certain ancillary commercial businesses.

During the year, the Company acquired the equity interests of Haikou Meilan Airport Duty-Free Shop Limited ("DFG"), Hainan Meilan Airport Travelling Company Limited ("Meilan Travelling") and the carpark operation and cargo handling centre businesses (collectively referred to as "Acquired Businesses") from Haikou Meilan Airport Company Limited (the "Parent Company").

On 18 November 2002, 198,000,000 newly issued H Shares of the Company and existing 3,700,000 State Owned Shares were offered at a premium to the public and traded on The Stock Exchange of Hong Kong Limited. On 9 December 2002, additional 25,213,000 H Shares were issued.

In the opinion of the directors, the ultimate holding company is Haikou Meilan Airport Company Limited, a company incorporated in the PRC with limited liability.

The Group employed approximately 481 (2001: 351) employees as at 31 December 2002.

The consolidated financial statements of the Company for the year ended 31 December 2002 were authorised for issue in accordance with a resolution of the directors on 19 March 2002.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of preparation

The consolidated financial statements of the Company have been prepared in Renminbi and in accordance with International Financial Reporting Standards ("IFRS"), which comprise standards and interpretations approved by the International Accounting Standards Board ("IABS"), and International Accounting Standards and Standing Interpretations Committee interpretations approved by the International Accounting Standards Committee ("IASC") that remain in effect.

The consolidated financial statements have been prepared on a historical cost basis, except for the measurement at fair value of property, plant and equipment.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Basis of consolidation

The consolidated financial statements comprise the financial statements of the Company and its subsidiaries drawn up to 31 December each year after the elimination of all material intercompany transactions. Subsidiaries are consolidated from the date on which control is transferred to the Group and cease to be consolidated from the date on which control is transferred out of the Group. DFG and Meilan Travelling have been included in the consolidated financial statements using the purchase method of accounting. Accordingly, the consolidated income statement and consolidated cash flow statement include the results and cash flows of DFG and Meilan Travelling for the seven-month period from its acquisition on 31 May 2002. The purchase consideration has been allocated to the assets and liabilities on the basis of fair value at the date of acquisition.

Minority interests represent the interests in Hainan Haikou Meilan Airport Advertising Company Limited ("Meilan Advertising"), Meilan Travelling and DFG, not held by the Group.

Subsidiaries

A subsidiary is a company whose financial and operating policies the Company controls directly or indirectly, so as to obtain benefits from its activities.

The Company's investments in subsidiaries are stated at cost less any impairment losses.

Property, plant and equipment

Property, plant and equipment are initially stated at cost less accumulated depreciation and any impairment in value. The cost of an asset comprises its purchase price and any directly attributable costs of bringing the asset to its working condition and location for its intended use. Expenditure incurred after property, plant and equipment have been put into operation, such as repairs and maintenance, is normally charged to the income statement in the period which it is incurred. In situations where it can be clearly demonstrated that the expenditure has resulted in an increase in the future economic benefits expected to be obtained from the use of the property, plant and equipment, the expenditure is capitalised as an additional cost of that asset.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Property, plant and equipment (continued)

Subsequent to the initial recognition, property, plant and equipment are stated at valuation less accumulated depreciation and any impairment in value. Independent valuations, on a market value basis or depreciated replacement cost basis when there is no evidence of market value for such an item, are made with sufficient regularity such that the carrying amount does not differ materially from that which would be determined had the fixed assets been stated at valuation at the balance sheet date. Increases in valuations are credited to the revaluation reserve. Decreases in valuation of property, plant and equipment are first offset against an increase from earlier valuations in respect of the same asset and are thereafter charged to the income statement. Any subsequent increases are credited to the income statement up to the amount previously charged. When property, plant and equipment are sold or retired, their cost or revalued amounts and accumulated depreciation are eliminated from the accounts and any gain or loss resulting from their disposal is included in the consolidated income statement. Any revaluation surplus in the revaluation reserve is transferred to retained earnings as a reserve movement.

As part of group restructuring and as required by the relevant PRC regulations, a valuation of the property, plant and equipment of the Company was performed as at 31 July 2000 by Hainan Asset Valuation Company, a Certified Assets Appraiser registered under the PRC relevant regulations, in order to determine the fair value of such property, plant and equipment for the purpose of establishing the capital contribution from the Parent Company upon the incorporation of the Company. The result of this valuation was considered as an adjustment to the cost of the property, plant and equipment and the surplus/deficit arising thereon was credited/charged to the reserve directly as this is in connection with the change in value of shareholders' contribution.

Depreciation is calculated on the straight-line basis over the estimated useful life of the assets, after taking into consideration the estimated residual value of 3% of cost or revalued amounts, as follows:

Buildings and leasehold improvements	15-40 years
Machinery and equipment	10-15 years
Motor vehicles	10 years
Office furniture, fixtures and other equipment	6 years

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Property, plant and equipment (continued)

The carrying values of property, plant and equipment are reviewed for impairment when events or changes in circumstances indicate the carrying value may not be recoverable. If any such indication exists and where the carrying values exceed the estimated recoverable amount, the assets or cash-generating units are written down to their recoverable amount. The recoverable amount of property, plant and equipment is the greater of net selling price and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. For an asset that does not generate largely independent cash inflows, the recoverable amount is determined for the cash-generating unit to which the asset belongs. Impairment losses are recognised in the income statements unless the assets are carried at a revalued amount, when the impairment loss is accounted for in accordance with the relevant accounting policy for the revalued assets.

Asset under construction represents a building under construction, which is stated at cost less any impairment losses, and is not depreciated. Cost comprises the direct costs of construction and capitalised borrowing costs on related borrowed funds during the period of construction. Construction in progress is reclassified to the appropriate category of property, plant and equipment when completed and ready for use.

Negative Goodwill

Negative goodwill arising on the acquisition of subsidiaries represents the excess of the Group's share of the fair values of the identifiable assets and liabilities acquired as at the date of acquisition, over the cost of the acquisition.

To the extent that negative goodwill relates to expectations of future losses and expenses that are identified in the acquisition plan and that can be measured reliably, but which do not represent identifiable liabilities as at the date of acquisition, that portion of negative goodwill is recognised as income in the consolidated income statement when the future losses and expenses are recognised.

To the extent that negative goodwill does not relate to identifiable expected future losses and expenses as at the date of acquisition, negative goodwill is recognised in the consolidated income statement on a systematic basis over the remaining average useful life of the acquired depreciable/amortisable assets. The amount of any negative goodwill in excess of the fair values of the acquired non-monetary assets is recognised as income immediately.

On disposal of subsidiaries, the gain or loss on disposal is calculated by reference to the net assets at the date of disposal, including the attributable amount of negative goodwill which has not been recognised in the consolidated income statement and any relevant reserves as appropriate.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Land use rights

Land use rights are stated at cost, less accumulated amortisation and any impairment in value, except for the revaluation as noted below in connection with the formation of the Company.

As part of group restructuring and as required by the relevant PRC regulations, a valuation of the land use rights of the Company was performed as at 31 July 2000 by Hainan Assets Valuation Co., a Certified Assets Appraiser registered under the PRC relevant regulations, in order to determine the fair value of such land use rights for the purpose of establishing the capital contribution from the Parent Company upon the incorporation of the Company. The result of this valuation was considered as an adjustment to the cost of the land use rights and the surplus arising thereon was credited to the reserve directly as this is in connection with the change in value of shareholders' contribution.

The land use rights are amortised on the straight-line basis over the unexpired period of the rights. The carrying values of land use rights are reviewed for impairment when events or changes in circumstances indicate that the carrying value may not be recoverable.

Borrowing costs

Borrowing costs directly attributable to the acquisition, construction or production of qualifying assets, i.e., assets that necessarily take a substantial period of time to prepare for their intended use, are capitalised as a part of the cost of those assets. The capitalisation of such borrowing costs ceases when the assets are substantially ready for their intended use. The capitalisation rate for the year is based on the actual cost of the related borrowings.

All other borrowing costs are recognised as expenses in the period in which they are incurred.

Inventories

Inventories are stated at the lower of cost and net realisable value. Cost is determined on a weighted average basis and comprises mainly the purchase cost. Net realisable value is the estimated selling price in the ordinary course of business less the estimated costs necessary to make the sale.

Revenue recognition

Revenue is recognised when it is probable that the economic benefits will flow to the Group and the revenue can be measured reliably, on the following bases:

(a) airport fees, upon receipt from outbound passengers when departing from the airport;

(b) aeronautical revenues other than airport fees, when the related airport services are rendered;

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Revenue recognition (continued)

(c) rental income, on the straight-line basis during the relevant leasing periods;

(d) advertising income, on the straight-line basis during the period of display of the relevant advertisements;

(e) franchise fees, on the straight-line basis during the period of granting the right of operations;

(f) car parking fees, when the parking services are rendered;

(g) management fee income, when the related management services are rendered; and

(h) interest income, on a time proportion basis taking into account the principal outstanding and the effective interest rate applicable.

Government grants

Government grants are recognised at their fair value where there is reasonable assurance that the grant will be received and all attaching conditions will be complied with. When the grant relates to an expense item, it is recognised as income over the periods necessary to match the grant on a systematic basis to the costs that it is intended to compensate. Where the grant relates to an asset, the fair value is credited to a deferred income account and is released to the income statement over the expected useful life of the relevant asset by equal annual instalments.

Related parties

Parties are considered to be related if one party has the ability, directly or indirectly, to control the other party or exercise significant influence over the other party in making financial and operating decisions. Parties are also considered to be related if they are subject to common control or common significant influence. Related parties may be individuals or corporate entities.

Operating leases

Leases where the lessor retains substantially all the risks and benefits of ownership of the asset are classified as operating leases. Where the Group is the lessor, assets leased by the Group under operating leases are included in property, plant and equipment and rentals receivables under operating leases are credited as income to the income statement on the straight-line basis over the lease terms. Where the Group is the lessee, rentals payable under the operating leases are charged as an expense to the income statement on the straight-line basis over the lease terms.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Foreign currency transactions

The companies now comprising the Group maintain their books and records in Renminbi ("RMB"). Transactions in foreign currencies are recorded at the rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated into RMB at the rate of exchange ruling at the balance sheet date. All foreign exchange gains or losses are shown in the income statement.

Tax

PRC corporate income tax is provided at rates applicable to enterprises in the PRC on the Company's income for financial reporting purposes, as adjusted for income and expense items which are not assessable or deductible for income tax purposes.

Deferred income tax is provided, using the liability method, on all temporary differences at the balance sheet date between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes.

Deferred tax liabilities are recognised for all taxable temporary differences:

(i) except where the deferred income tax liability arises from goodwill amortisation or the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and

(ii) in respect of taxable temporary differences associated with investments in subsidiaries, except where the timing of the reversal of the temporary difference can be controlled and it is probable that the temporary difference will not reverse in the foreseeable future.

Deferred tax assets are recognised for all deductible temporary differences, carry-forward of unused tax assets and unused tax losses, to the extent it is probable that taxable profit will be available against which the deductible temporary differences, carry-forward of unused tax assets and unused tax losses can be utilised:

(i) except where the deferred income tax asset relating to the deductible temporary difference arises from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and

(ii) in respect of deductible temporary differences associated with investments in subsidiaries, deferred tax assets are only recognised to the extent that it is probable that the temporary differences will reverse in the foreseeable future and taxable profit will be available against which the temporary difference can be utilised.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Tax (continued)

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred tax assets to be utilised.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply to the period when the asset is realised or the liability is settled, based on tax rates and tax laws that have been enacted or subsequently enacted at the balance sheet date.

Other tax liabilities are provided in accordance with the regulations issued by PRC government authorities.

Cash and cash equivalents

Cash and cash equivalents comprise cash at bank and in hand and short term deposits. For the purpose of the consolidated cash flow statement, cash and cash equivalents consist of cash at bank and in hand and short term deposits with an original maturity of three months or less, net of outstanding bank overdrafts, if any.

Accounts receivable, other receivables and amounts due from related parties

Accounts receivable, which generally have 30-90 day terms, are recognised and carried at the original invoice amount less an allowance for any uncollectible amounts. An estimate for doubtful debts is made when a collection of the full amount is no longer probable. Bad debts are written off when identified.

Other receivables and amounts due from related parties are recognised and carried at cost less provision for any doubtful amount.

Accounts payable and other payables

Accounts payable and other payables which are normally settled on 30-90 day terms, are carried at cost which is the fair value of the consideration to be paid in the future for goods and services received, whether or not billed to the Group.

Interest-bearing loans and borrowings

All loans and borrowings are initially recognised at cost, being the fair value of the consideration received net of issue costs associated with the borrowing. After initial recognition, interest-bearing loans and borrowings are subsequently measured at amortised cost using the effective interest rate method. Amortised cost is calculated by taking into account any issue costs, and any discount or premium on settlement. Gains and losses are recognised in net profit or loss when the liabilities are derecognised or impaired, as well as through the amortisation process.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Provisions

A provision is recognised when the Group has a present legal or constructive obligation as a result of a past event and it is probable that a future outflow of resources embodying economic benefits will be required to settle the obligation provided that a reliable estimate can be made of the amount of the obligation.

Where the Group expects a provision to be reimbursed, the reimbursement is recognised as a separate asset but only when the reimbursement is virtually certain. If the effect of the time value of money 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. Where discounting is used, the increase in the provision due to the passage of time is recognised as an interest expense.

Retirement benefits

The Company and its subsidiaries participate in defined contribution retirement plans managed by the local municipal government in the PRC in which they operate. The relevant authorities of the local municipal government in the PRC undertake the retirement obligations of the Group's employees. The Group has no obligation for payment of retirement benefits beyond the annual contributions. The contribution payable is charged as an expense to the income statement as and when incurred.

Impairment of assets

An assessment is made at each balance sheet date of whether there is any indication of impairment of any asset, or whether there is any indication that an impairment loss previously recognised for an asset in prior years may no longer exist or may have decreased. If any such indication exists, the asset's recoverable amount is estimated. An asset's recoverable amount is calculated as the higher of the asset's value in use or its net selling price.

An impairment loss is recognised only if the carrying amount of an asset exceeds its recoverable amount. An impairment loss is charged to the income statement in the period in which it arises, unless the asset is carried at a revalued amount, when the impairment loss is accounted for in accordance with the relevant accounting policy for that revalued asset.

A previously recognised impairment loss is reversed only if there has been a change in the estimates used to determine the recoverable amount of an asset, however not to an amount higher than the carrying amount that would have been determined (net of any depreciation/amortisation), had no impairment loss been recognised for the asset in prior years.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Impairment of assets (continued)

A reversal of an impairment loss is credited to the profit and loss account in the period in which it arises, unless the asset is carried at a revalued amount, when the reversal of the impairment loss is accounted for in accordance with the relevant accounting policy for that revalued asset.

Contingencies

Contingent liabilities are not recognised in the financial statements. They are disclosed unless the possibility of an outflow of resources embodying economic benefits is remote.

A contingent asset is not recognised in the financial statements but disclosed when an inflow of economic benefits is probable.

Subsequent events

Post year end events that provide additional information about a company's position at the balance sheet date or those that indicate the going concern assumption is not appropriate (adjusting events), are reflected in the financial statements. Post year end events that are not adjusting events are disclosed in the notes when material.

Financial instruments

Financial assets and financial liabilities carried in the balance sheet include cash and cash equivalents, accounts receivable and payable, other receivable and payable, loans, and balances with related parties. The accounting policies on recognition and measurement of these items are disclosed in the respective accounting policies found in this section.

Financial instruments are classified as liabilities or equity in accordance with the substance of the contractual arrangement. Interest, dividends, gains, and losses relating to a financial instrument classified as a liability are reported as expenses or income. Distributions to holders of financial instruments classified as equity are charged directly to equity. Financial instruments are offset when the Group has a legally enforceable right to offset and intends to settle either on a net basis or to realise the asset and settle the liability simultaneously.

Dividends

Final dividends proposed by the directors are classified as a separate allocation of retained earnings within capital and reserve in the balance sheets, until they have been approved by the shareholders at general meetings. When these dividends are approved by the shareholders and declared, they are recognised as a liability. Interim dividends are simultaneously proposed and declared, because the Company's memorandum and articles grant the directors authority to declare interim dividends. Consequently, interim dividends are recognised directly as a liability when they are proposed and declared.

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3. REVENUE

(a) The total revenue of the year is analysed as follows:

	2002 *RMB'000*	*2001* *RMB'000*
Aeronautical:		
Passenger charges	**102,229**	102,283
Airport fee	**66,576**	—
Ground handling service fees	**23,348**	20,556
Aircraft movement fees and related charges	**17,391**	10,198
Total aeronautical revenues	**209,544**	133,037
Non-aeronautical:		
Leasing of commercial areas, counters and office in the terminal	**22,797**	26,261
Franchise fees	**21,451**	15,490
Sale of merchandise	**4,411**	—
Provision of tourism services	**10,605**	—
Provision of advertising services	**5,118**	4,018
Car parking fees	**1,466**	—
Management fee income	**689**	—
Other revenue	**7,371**	6,195
Total non-aeronautical revenues	**73,908**	51,964
Total revenues	**283,452**	185,001

3. REVENUE (continued)

(b) Other income comprises:

	Note	*2002* *RMB'000*	*2001* *RMB'000*
Negative goodwill in excess of the fair value of acquired non monetary assets	14	**2,528**	—
Amortisation of negative goodwill		**21**	—
		2,549	—

4. PROFIT FROM OPERATING ACTIVITIES

The Group's profit from operating activities is arrived at after charging/(crediting):

	2002 *RMB'000*	*2001* *RMB'000*
Cost of services		
— Composite services fee	**9,896**	11,777
— Environmental protection expenses	**1,378**	1,283
— Cost for the provision of tourism services	**5,580**	—
— Cost of sale of merchandise	**2,209**	—
— Others	**1,011**	335
	20,074	13,395
Provision for doubtful debts	**1,172**	1,342
Staff costs, including directors' emoluments	**14,304**	11,232
Contributions to retirement scheme	**1,563**	728
Depreciation and amortisation	**30,306**	28,404
Minimum lease payments under operating leases:		
— Buildings	**509**	905
Gross and net rental income	**(22,797)**	(26,261)
Auditors' remuneration	**1,103**	262

5. DIRECTORS', SENIOR EXECUTIVES' AND SUPERVISORS' EMOLUMENTS

The details of the remuneration of the directors and supervisors are as follows:

	2002	2001
	RMB'000	RMB'000
Fees for executive directors	**70**	—
Fees for non-executive directors	**87**	—
Fees for supervisors	**20**	—
Other emoluments for executive directors:		
— Basic salaries, housing benefits, other allowances and benefits in kind	**148**	158
— Bonuses	**61**	68
— Retirement benefit contributions	**48**	22
Other emoluments for non-executive directors	**—**	—
Other emoluments for supervisors	**30**	—

No directors or supervisors waived or agreed to waive any emolument for the year.

The five highest paid individuals in the Group during the year ended 31 December 2002 included three director (2001: 1). The emoluments for this director are included in the above disclosures.

The emoluments and designated band of the five highest paid individuals (including directors, supervisors and employees) during the year are as follows:

	2002	2001
	RMB'000	RMB'000
Basic salaries, housing benefits, other allowances and benefits in kind	**273**	197
Bonuses	**89**	84
Retirement benefit contributions	**67**	38
	429	319

5. DIRECTORS', SENIOR EXECUTIVES' AND SUPERVISORS' EMOLUMENTS (continued)

The remuneration of all executive directors, supervisors and five highest paid employees for each of the years ended 31 December 2002 and 2001 each fell within the range of nil to HK$1,000,000 (equivalent to RMB1,061,000).

During each of the years ended 31 December 2002 and 2001, no emoluments were paid by the Group to the directors, supervisors or any of the five highest paid individuals as an inducement to join or upon joining the Group or as compensation for loss of office.

6. FINANCE EXPENSES, NET

	2002 RMB'000	2001 RMB'000
Interest on bank loans		
— wholly repayable within five years	**12,803**	11,358
— not wholly repayable within five years	**6,141**	6,397
	18,944	17,755
Interest income	**(128)**	(96)
Interest expenses, net	**18,816**	17,659

7. TAX

Hong Kong profit tax has not been provided as the Group had no assessable profits arising in Hong Kong during the year.

Under PRC income tax law, except for certain preferential treatment available to the Company and its subsidiaries ("tax holiday"), the entities within the Group are subjective to corporate income tax ("CIT") at a rate of 33% on the taxable income as reported in their statutory accounts which are prepared in accordance with the accounting principles and financial regulations applicable to PRC enterprises.

In accordance with the regulations "Tax Benefits on Encouraging Investments" issued by the Hainan Province on 5 August 1988 and "Clarification on Corporate Income Tax Benefit Policy" issued on 15 August 2002, the Company is exempt from CIT for a period of five years commencing from its first profitable year and is entitled to a preferential income tax rate of 15% for the remaining years of the operation of the Meilan Airport with a 50% reduction for five consecutive years commencing from its sixth profitable year. The first profitable year of the Company was the year ended 31 December 2000. The Company therefore was exempt from CIT for 2001 and 2002.

7. TAX (continued)

In accordance with "Clarification on Corporate Income Tax Benefit Policy", each of the subsidiaries of the Company is subject to a preferential income tax rate at 15%.

Since Meilan Advertising has accumulated losses for the year ended 31 December 2002 determined in accordance with the PRC accounting regulation, no CIT was provided for.

A reconciliation of income tax expenses applicable to profit from operating activities before income tax at the statutory income tax rate to income tax expenses at the Group's effective income tax rate for the year was as follows:

	2002	*2001*
	RMB'000	*RMB'000*
Profit from operating activities before income tax	**161,456**	87,405
At PRC corporate income tax rate of 15%	**24,218**	13,111
Expenditure not allowed for deduction	**2,509**	1,019
Tax holiday	**(25,797)**	(14,130)
At effective income tax rate of 0.58% (2001: Nil)	**930**	—

Except for unutilised tax losses of Meilan Advertising attributable to the Group as at 31 December 2002 of approximately RMB42,000 (2001: RMB301,000), there are no other material deductible temporary differences for which no deferred tax assets are recognised.

Except for as disclosed above and in note 23, the Group did not have any significant unprovided deferred tax as at 31 December 2002 and 2001.

The Group is also subject to business taxes on its service revenues at the following rates:

Aeronautical revenues	3% of services revenue
Non-aeronautical revenues	5% of rental income, advertising income and car parking fee income

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8. RELATED PARTY TRANSACTIONS

In addition to such transactions and balances disclosed elsewhere in financial statements, the Group had the following material transactions with the following related parties:

Continuing transactions

Name of related party	*Relationship with the Company*	*Nature of transaction*	*Notes*	*2002 RMB'000*	*2001 RMB'000*
Haikou Meilan Airport Co., Ltd. (the "Parent Company")	Immediate holding company	Airport composite services charged by the Parent Company	(i)	**9,896**	11,777
		Rental expense paid for the leasing of office and commercial space	(ii)	**509**	905
		Sharing of customary airport ground services income	(ix)	**45,543**	37,540
		Income from franchise fee for the operation of the cargo centre	(vii)	**3,542**	8,500
Yangzijiang Air Express Co., Ltd.	Related party	Income from franchise fee for the operation of the cargo center	(vii)	**10,500**	—
Hainan Lanyu Air Services Co., Ltd. ("Hainan Lanyu")	*Fellow subsidiary	Income from subcontracting arrangement for the sale of air tickets	(iii)	**800**	639
DFG	*Fellow subsidiary	Rental income for the leasing of office and commercial space	(ii)	**367****	846

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8. RELATED PARTY TRANSACTIONS (continued)

Name of related party	*Relationship with the Company*	*Nature of transaction*	*Notes*	*2002 RMB'000*	*2001 RMB'000*
Meilan Travelling	*Fellow subsidiary	Rental income for the leasing of Office and commercial space	(ii)	**295****	83
Hainan Airlines Food Co., Ltd. ("Hainan Food")	Related party	Franchise income from catering services	(iv)	**4,380**	4,380
		Rental income for the leasing of storage space	(iv)	**25**	25
China Southern Airlines Co., Ltd. ("China Southern Airlines")	*Shareholder	Income for the provision of customary airport ground services	(v)	**38,223**	39,349
		Rental income for the leasing of office and commercial space	(ii)	**5,638**	5,483
		Income for the provision of advertising services	(vi)	**257**	241
Xia Men Airlines Co., Ltd.	Related party	Income for the provision of customary airport ground services	(v)	**776**	722
HNA Group Co., Ltd. ("HNA Group")	*Shareholder	Logistic composite services charged by HNA Group	(viii)	**5,313**	—
Hainan Airlines Co., Ltd. ("Hainan Airlines")	*Shareholder	Income for the provision of customary airport ground services	(v)	**57,704**	53,821

8. RELATED PARTY TRANSACTIONS (continued)

Name of related party	*Relationship with the Company*	*Nature of transaction*	*Notes*	*2002 RMB'000*	*2001 RMB'000*
		Rental income for the leasing of office and commercial space	(ii)	**5,863**	5,899
		Income for the provision of advertising services	(vi)	**354**	1,008
China Xinhua Airlines Co., Ltd.	Related party	Income for the provision of customary airport ground services	(v)	**68**	—
Shan Xi Airlines Co., Ltd.	Related party	Income for the provision of customary airport ground services	(v)	**532**	—

* *A fellow subsidiary represents a subsidiary controlled by the Parent Company and a shareholder represents an individual or corporate entity holding the shares of the Company directly.*

** *Balances represented rental income received from DFG and Meilan Travelling for the period prior to the acquisition of the equity interests of DFG and Meilan Travelling.*

Notes:

(i) Airport Composite Services

The Company and the Parent Company entered into an Airport Composite Services Agreement on 31 December 2000. According to the agreement, the Parent Company would continue to provide the services on security guard service, cleaning and landscaping, and power and energy supply and equipment maintenance to the Company for a fee at 7% of the total revenue, as determined under PRC accounting regulations, of the Company for a period of three years.

The Company and the Parent Company entered into a new Airport Composite Services Agreement on 25 October 2002 ("Revised Airport Composite Services Agreement") to replace the agreement dated 31 December 2000. According to the Revised Airport Composite Services Agreement, the Parent Company has agreed to provide to the Group the following services:

(a) security guard service;

(b) cleaning and landscaping;

(c) sewage and refuse processing;

8. RELATED PARTY TRANSACTIONS (continued)

(d) power and energy supply and equipment maintenance; and

(e) passengers and luggage security inspection.

The charge rates for the above various services are as follows:

- *The charges relating to the services of items (a)–(d) above will be determined in accordance with the cost to the Parent Company in providing such services plus a 5% mark-up as management fee, except for item (d), the mark-up of which is 25% pursuant to the relevant pricing guideline set by the Civil Aviation Administration of China (the "CAAC"). The charges are settled on an annual basis.*

- *The charges relating to the service of item (e) will be determined in accordance with the rate prescribed by the CAAC and charged to the airline customers directly. The Company will collect on behalf of the Parent Company such fees receivable from airline customers.*

The term of the Revised Airport Composite Services Agreement is for three years commencing from 1 January 2002 and is renewable upon mutual agreement of the parties thereto.

(ii) Office Lease Agreement

The Company and the Parent Company entered into an Office Lease Agreement dated 31 December 2000, pursuant to which the Company agreed to lease office premises from the Parent Company for a term of two years at an annual rental of RMB905,000. Pursuant to an Office Lease Agreement dated 25 October 2002 which replaced the previous agreement, the Company agreed to rent from the Parent Company office premises for a term of five years at an annual rental of RMB509,000 effective as of at 1 January 2002.

The Company also leased office and commercial areas and premises and airport counters to DFG, Meilan Travelling, Hainan Airlines and China Southern Airlines; and an aircraft storage warehouse to Hainan Airlines. The relevant lease agreements were made on different dates and the rental charge was agreed between the Company, DFG, Meilan Travelling, Hainan Airlines and China Southern Airlines.

(iii) Air Ticket Sales Agency

By way of an Operations Agreement dated 24 April 2001 between the Company and Hainan Lanyu Air Services Co., Ltd. ("Hainan Lanyu"), a company in which the Parent Company holds a 95% equity interest, the Company contracted its air ticket sales agency business at the Meilan Airport to Hainan Lanyu in consideration of a fixed fee in the sum of RMB1,000,000 payable by the latter on an annual basis for a term of two years. On 30 August 2002, the Company and Hainan Lanyu renewed the agreement to reduce the consideration to a fixed fee of RMB800,000 per annum effective as of at 1 January 2002.

(iv) Catering Service

On 31 December 2000, the Company entered into a Catering Service Agreement with Hainan Airlines Food Co., Ltd. for a term of three years whereby the franchise fee was increased to RMB4,380,000 per annum.

(v) Customary Airport Ground Services

The Company provided customary airport ground services including landing facilities, basic ground handling services, cargo storage and handling, passenger and baggage security check services and other related services to Hainan Airlines, China Xinhua Airlines Co., Ltd., a 51%-owned subsidiary of Hainan Airlines, Shan Xi Airlines Co., Ltd., a 89%-owned subsidiary of Hainan Airlines, China Southern Airlines and Xia Men Airlines Co., Ltd., a 60%-owned subsidiary of China Southern Airlines, at rates prescribed by the CAAC throughout the years ended 31 December 2002 and 2001.

8. RELATED PARTY TRANSACTIONS (continued)

(vi) *Advertising Services*

Meilan Advertising, a subsidiary of the Company, provided advertising services to HNA Group and China Southern Airlines at normal rates charged to other clients.

(vii) *Franchise fee income*

The Company entered into a contract with the Parent Company for the operation of the cargo centre in the Meilan Airport for a fixed annual franchise fee of RMB8,500,000 effective from 1 January 2001 and terminated on 31 May 2002. The Company entered into a new agreement with Yangzijiang Air Express Co., Ltd., a subsidiary of HNA Group Co., Ltd., pursuant to which Yangzijiang Air Express Co., Ltd. pays a RMB18,000,000 annual franchise fee to the Company for the operation of the cargo centre with the rights to utilise the facilities of the cargo centre effective from 1 June 2002.

(viii) *Logistic Composite Services*

Pursuant to a Logistic Composite Service Agreement effective from 1 January 2002, HNA Group agreed to provide and procure its subsidiaries to provide to the Company logistic services including (a) staff training; (b) staff shuttle bus services; (c) staff cafeteria service; (d) vehicle maintenance; and (e) appliance procurement. Charges as to the services are as follows: item (a) at the cost for providing such services shared between HNA Group, the Company and other relevant companies on a pro rata basis by reference to employee headcounts; as to items (b) and (c) at a fixed price with reference to relevant cost per employee headcount; and items (d) and (e) at the cost for providing such services plus a 5% and a 1% mark-up as management fees, respectively.

(ix) *Sharing of Customary Airport Ground Services Income*

The runway at the Meilan Airport is owned and operated by the Parent Company. By an agreement between the Company and the Parent Company, the Company has agreed to share with the Parent Company on such ratio as the CAAC or any other regulatory authorities may from time to time prescribe, which as the date of the agreement is in the ratio of 75% to the Company and 25% to the Parent Company, the aircraft movement fees for all airlines, passenger charges for domestic airlines and the basic ground handling fees for Hong Kong, Macau and foreign airlines. The Company will collect such fees on behalf of the Parent Company and assume no liabilities in respect of default of payment by the airline customers.

**Discontinued transactions*

Name of related party	Relationship with the Company	Nature of transaction	Notes	2002 RMB'000	2001 RMB'000
Chang An Airlines Co., Ltd.	Related party	Provision of customary airport ground services	(i)	—	604
The Parent Company	Immediate holding company	Acquisition of Acquired Businesses	(ii)	78,131	—
		Disposal of excessive assets	(ii)	28,399	—
		Purchase of land use rights	(iii)	97,078	—

8. RELATED PARTY TRANSACTIONS (continued)

**Discontinued transactions (continued)*

Name of related party	***Relationship with the Company***	***Nature of transaction***	***Notes***	***2002 RMB'000***	*2001 RMB'000*
Hainan Da Long Enterprise Co., Ltd.	Fellow subsidiary	Advance	(iv)	**—**	20,000
		Deposits for the purchase of equipment	(vi)	**20,000**	—
HNA Group	Shareholder	Income from leasing of office	(v)	**372**	844
Hainan Airlines Construction and Development Co., Ltd.	Related party	Deposits for the provision of construction services	(vii)	**30,000**	—
Hainan Airlines Information Systems Co., Ltd.	Related party	Deposits for the provision of construction services	(viii)	**25,000**	—

* *Discontinued transactions represent one-off transactions not expected to recur.*

Notes:

(i) The Company received RMB604,000 from Chang An Airlines Co., Ltd. for the provision of customary airport ground services in 2001.

(ii) The Company acquired a 95% equity interest in DFG, a 60% equity interest in Meilan Travelling and the businesses of carpark operations and cargo handling centre (the ''Acquired Businesses'') from the Parent Company on 31 May 2002 for an aggregate consideration of RMB78,131,000 which was based on the valuation report prepared by Hainan Zhong Li Xin Asset Valuation Company Limited dated 18 April 2002 and was satisfied by an exchange of excessive assets owned by the Company in the amount of RMB28,399,000 and by cash consideration of RMB49,732,000.

(iii) The Company acquired land use rights approximately of RMB2,698,000 and RMB94,380,000 from the Parent Company for cash in June and December 2002, respectively.

(iv) An advance of RMB20,000,000 was granted to Hainan Da Long Enterprise Co., Ltd., a related party, in 2001. The advance was interest free, unsecured with no fixed terms of repayment and was repaid in 2002.

8. RELATED PARTY TRANSACTIONS (continued)

**Discontinued transactions (continued)*

(v) The Company received RMB844,000 and RMB372,000 from HNA Group, for the leasing of a commercial area in 2001 and for the year ended 31 December 2002, respectively. The rental of the commercial area was agreed between the Company and HNA Group.

(vi) On 10 December 2002, the Company entered into a procurement agreement of RMB20,000,000 with Hainan Da Lung Enterprise Co., Ltd., a subsidiary of the Parent Company, that Hainan Da Lung Enterprise Co., Ltd. would purchase equipment for the apron of the Meilan Airport on behalf of the Company. The Company made full payment to Hainan Da Lung Enterprise Co., Ltd. in December 2002 in accordance with contract terms. The balance is guaranteed by the Parent Company.

(vii) On 1 December 2002, the Company entered into a construction contract of RMB30,000,000 with Hainan Airlines Construction and Development Co., Ltd., a subsidiary of HNA Group, for the construction of the apron of the Meilan Airport. The Company made full payment to Hainan Airlines Construction and Development Co., Ltd. in December 2002 in accordance with the contract terms. The balance is guaranteed by the Parent Company.

(viii) On 12 December 2002, the Company entered into a construction contract of RMB30,000,000 for the improvement of information system in the terminal building with Hainan Airlines Information Systems Co., Ltd., a subsidiary of HNA Group, and the Company paid RMB25,000,000 as down payment. The balance was repaid in February 2003 due to the termination of this project.

In the opinion of the directors, the above transactions were conducted in the ordinary course of business.

9. PROPOSED FINAL DIVIDEND

	2002	*2001*
	RMB'000	*RMB'000*
Proposed final : RMB18 cents (2001: RMB 18 cents)	**85,650**	45,000

A final dividend of RMB85,650,000 (2001: RMB45,000,000) was declared for the year ended 31 December 2002 by the board of directors of the Company on 19 March 2003.

10. EARNINGS PER SHARE

The calculation of earnings per share is based on the Group's profit attributable to shareholders of RMB160,086,000 (2001: RMB87,411,000) and the weighted average of 275,457,258 shares (2001: 250,000,000 shares) of the Company in issue during the year.

No diluted earnings per share is presented as the Company did not have any dilutive potential ordinary shares.

11. PENSION SCHEME

The Company and its subsidiaries are required to participate in employee pension schemes operated by the relevant local government authorities in the PRC. The PRC government is responsible for the pension liability to these retired employees. The Group is required to make contributions for employees who are registered as permanent residents in the PRC at a rate of 18% and 16% of the employees salaries after and before 1 July 2002, respectively.

The Group's contribution to pension costs for the year amounted to approximately RMB1,563,000 (2001: RMB728,000).

12. PROPERTY, PLANT AND EQUIPMENT, NET

Group

	Assets under construction	*Buildings and leasehold improvements*	*Machinery and equipment*	*Motor vehicles*	*Office furniture, fixtures and other equipment*	*Total*
	RMB'000	*RMB'000*	*RMB'000*	*RMB'000*	*RMB'000*	*RMB'000*
Cost or revaluation:						
At beginning of year	—	579,126	110,311	42,388	15,676	747,501
Additions	10,549	39,096	71	6,035	2,102	57,853
Acquisition of subsidiaries	—	—	—	159	101	260
Disposals	—	(17,346)	(11,986)	—	—	(29,332)
Revaluation	—	(38,975)	(20,676)	(11,250)	(4,537)	(75,438)
At end of year	10,549	561,901	77,720	37,332	13,342	700,844
Accumulated depreciation:						
At beginning of year	—	65,778	23,805	11,574	4,956	106,113
Charge for the year	—	14,367	7,348	4,807	2,372	28,894
Disposals	—	(2,433)	(3,997)	—	—	(6,430)
Revaluation	—	(72,901)	(24,717)	(14,431)	(4,838)	(116,887)
At end of year	—	4,811	2,439	1,950	2,490	11,690
Net book value:						
At end of year	10,549	557,090	75,281	35,382	10,852	689,154
At beginning of year	—	513,348	86,506	30,814	10,720	641,388

12. PROPERTY, PLANT AND EQUIPMENT, NET (continued)

Company

	Assets under construction RMB'000	Buildings and leasehold improvements RMB'000	Machinery and equipment RMB'000	Motor vehicles RMB'000	Office furniture, fixtures and other equipment RMB'000	Total RMB'000
Cost or Valuation						
At beginning of year	—	579,126	110,311	41,998	12,758	744,193
Additions	10,523	39,096	71	6,035	1,912	57,637
Disposals	—	(17,346)	(11,986)	—	—	(29,332)
Revaluation	—	(38,975)	(20,676)	(11,250)	(4,537)	(75,438)
At end of year	10,523	561,901	77,720	36,783	10,133	697,060
Accumulated depreciation:						
At beginning of year	—	65,778	23,805	11,515	3,914	105,012
Charge for the year	—	14,367	7,348	4,704	2,006	28,425
Disposals	—	(2,433)	(3,997)	—	—	(6,430)
Revaluation	—	(72,901)	(24,717)	(14,431)	(4,838)	(116,887)
At end of year	—	4,811	2,439	1,788	1,082	10,120
Net book value:						
At end of year	10,523	557,090	75,281	34,995	9,051	686,940
At beginning of year	—	513,348	86,506	30,483	8,844	639,181

Except for assets under construction which are stated at cost, all property, plant and equipment are stated at valuation.

12. PROPERTY, PLANT AND EQUIPMENT, NET (continued)

Company (continued)

A valuation of the property, plant and equipment of the Group was performed as at 31 August 2002 by Vigers Hong Kong Ltd., independent professional qualified surveyors, for the purpose of the listing of the H Shares of the Company on The Stock Exchange of Hong Kong Limited. Except for the valuation of property which was based on a combination of the open market value and depreciated replacement cost, the valuation for the remaining plant and equipment was based on the open market method. The depreciated replacement cost approach considers the cost to reproduce or replace in new condition the property appraised, in accordance with current construction costs for similar property in the locality, less depreciation whether arising from physical, functional or economic causes. The valuer assumed that the buildings and assets under construction will be used for the purposes for which they are presently used and did not consider alternative uses. A net valuation surplus of approximately RMB41,449,000 resulted from the revaluation and was recorded in the Group's financial statements. Additional depreciation on the revaluation surplus was approximately RMB612,000 in 2002 (2001: Nil).

In the opinion of directors, there was no material change to the valuation between 31 August 2002 and 31 December 2002.

Had these property, plant and equipment of the Group been carried at historical cost less accumulated depreciation and impairment losses, their carrying amounts would have been approximately RMB533,733,000 and RMB114,584,000, respectively.

All buildings of the Group are held outside Hong Kong with lease terms of 50 years.

13. LAND USE RIGHTS

Group and the Company

	RMB'000
Cost:	
At beginning of year	57,730
Additions	123,268
Disposals	(5,738)
At end of year	175,260
Accumulated amortisation:	
At beginning of year	2,057
Charge for the year	1,412
Disposals	(241)
At end of year	3,228
Net book value:	
At end of year	172,032
At beginning of year	55,673

A valuation of the land use rights of the Group was performed as at 31 August 2002 by Vigers Hong Kong Ltd., independent professional qualified surveyors, for the purpose of the listing of the H Shares of the Company on The Stock Exchange of Hong Kong Limited. The valuation was based on open market value. A valuation surplus of approximately RMB7,832,000 arose from the revaluation which was not recorded in the Group's financial statements.

Had the land use rights been stated at valuation amount less accumulated amortisation and impairment losses, then the net carrying amount would have been approximately RMB179,795,000 and would have resulted in an additional amortisation change of approximately RMB69,000 in 2002 (2001: Nil).

The land use rights are amortised on the straight-line basis over the term of 50 years.

As at 31 December 2002, the legal formalities for the transferring of the title of the land use rights acquired from the Parent Company amounting to RMB94,380,000 were still in progress.

31 December 2002

13. LAND USE RIGHTS (continued)

Land use rights with a net book value of RMB50,000,000 (2001: RMB50,000,000) as at 31 December 2002 have been pledged for a long term loan granted by the China Development Bank as described in note 22.

14. INTERESTS IN SUBSIDIARIES

	2002 RMB'000	2001 RMB'000
Unlisted shares, at cost	8,294	950
Amount due (to)/from subsidiaries	(15,760)	246
	(7,466)	1,196

Amounts due (to)/from subsidiaries are unsecured, non-interest bearing and payable on demand.

The consolidated financial statements include the financial statements of the Company and its subsidiaries listed in the following table.

As at 31 December 2002, the Company had direct and indirect interests in the following subsidiaries:

Name	*Place and date of incorporation*	*Paid-up share/ registered capital* RMB'000	*Percentage of equity interest attributable to the Group*	*Principal activities*
Meilan Advertising (note (i))	PRC 8 June 1999	1,000	99.75	Provision of advertising services
Meilan Travelling (note (ii))	PRC 13 November 2001	11,000	60	Provision of tourism services
DFG (note (ii))	PRC 11 May 1999	1,000	95	Trading of duty-free items

14. INTERESTS IN SUBSIDIARIES (continued)

Note:

(i) 95% of the equity interest in Meilan Advertising is directly held by the Company while the remaining 4.75% equity interest in Meilan Advertising attributable to the Group is indirectly held by the Company via DFG.

(ii) The equity interests in Meilan Travelling and DFG are directly held by the Company.

Effective 31 May 2002, the Group acquired a 95% equity interest and a 60% equity interest of DFG and Meilan Travelling, respectively. The purchase consideration for the acquisition was in the form of cash, of approximately RMB7,344,000 which was paid during the year.

The fair values of the identifiable assets and liabilities acquired of DFG and Meilan Travelling were:

	RMB'000
Property, plant and equipment	260
Cash and cash equivalents	6,534
Prepayments, deposits and other receivables	9,997
Accounts receivable	82
Inventories	2,618
Investment cost*	151
	19,642
Accounts payable	(1,260)
Accrued liabilities and other payables	(6,363)
Minority interests	(1,887)
Fair value of net assets	10,132
Negative goodwill arising on acquisition	(2,788)
	7,344
Consideration:	
Settled in cash during the year	7,344

14. INTERESTS IN SUBSIDIARIES (continued)

	RMB'000
Cash outflow on acquisition is as follows:	
Cash paid for acquisition	7,344
Net cash acquired (before settlement of purchase cost)	6,534
Net cash outflow	810

* *The balance represents the 5% equity interests of Meilan Advertising held by DFG. The investment cost is eliminated upon the consolidation of the financial statements of the Group.*

Negative goodwill represents the excess of the fair values of the acquired non-monetary assets over the cost of acquisition. The amount of negative goodwill not exceeding the fair values of acquired identifiable non-monetary assets, amounting to approximately RMB260,000 is amortised as income on a systematic basis over the remaining weighted average useful life of approximately seven years of the identifiable acquired depreciable assets while the amount of negative goodwill in excess of the fair values of acquired identifiable non-monetary assets amounting to approximately RMB2,528,000 is recognised as income immediately.

14. INTERESTS IN SUBSIDIARIES (continued)

Movement of negative goodwill is as follows:

Group

	RMB'000
Cost:	
At beginning of year	—
Additions	(260)
At end of year	(260)
Accumulated recognition as income:	
At beginning of year	—
Recognised as income during the year	21
At end of year	21
Net book value:	
At end of year	(239)
At beginning of year	—

From the date of acquisition, DFG and Meilan Travelling in aggregate contributed RMB246,000 to the net profit of the Group during the year.

15. CASH AND CASH EQUIVALENTS

Cash and cash equivalents comprise cash at banks and in hand. Cash at banks earns interest at floating rates based on daily bank deposit rates.

16. ACCOUNTS RECEIVABLE, NET

Group

	2002 RMB'000	2001 RMB'000
Outstanding balances aged:		
Within 90 days	**19,019**	18,042
Between 91 to 180 days	**3,645**	1,157
Between 181 to 365 days	**2,777**	1,336
More than 365 days	**1,264**	—
	26,705	20,535
Less: Provision for doubtful debts	**(2,514)**	(1,342)
	24,191	19,193

The Group normally allows a credit period of not more than 90 days to its customers, although an extension of the credit period is not uncommon for customers with a long term relationship. The Group closely monitors overdue balances. A special provision for doubtful debts is made when it is considered that amounts due may not be recovered.

17. INVENTORIES

Group

	2002 RMB'000	2001 RMB'000
Finished goods and low value consumables	**2,297**	13

Company

	2002 RMB'000	2001 RMB'000
Low value consumables	**2**	13

All the carrying amounts were stated at cost.

31 December 2002

18. BALANCES WITH RELATED PARTIES

Group

Due from:

	2002 **RMB'000**	*2001* *RMB'000*
The Parent Company	**1,757**	—
HNA Group Co., Ltd.	**1,557**	955
Hainan Airlines Co., Ltd.	**20,061**	—
China Southern Airlines Co., Ltd.	**17,483**	19,903
Southern Airlines (Group)	**575**	611
Hainan Da Lung Enterprise Co., Ltd.	**20,000**	20,000
Hainan Airlines Construction and Development Co., Ltd.	**30,000**	—
Hainan Airlines Food Co., Ltd.	**4,054**	4,086
Hainan Airlines Information Systems Co., Ltd.	**24,565**	155
Hainan Lanyu Air Service Co., Ltd.	**1,248**	—
Yangzijiang Air Express Co., Ltd.	**7,517**	—
Others	**793**	612
	129,610	46,322

Due to:

	2002 **RMB'000**	*2001* *RMB'000*
The Parent Company	**2,980**	74,813
Others	**173**	—
	3,153	74,813

18. BALANCES WITH RELATED PARTIES (continued)

Company

Due from:

	2002 *RMB'000*	*2001* *RMB'000*
HNA Group Co., Ltd.	**1,557**	645
Hainan Airlines Co., Ltd.	**20,061**	—
China Southern Airlines Co., Ltd.	**17,483**	19,903
Southern Airlines (Group)	**575**	611
Hainan Da Lung Enterprise Co., Ltd.	**20,000**	20,000
Hainan Airlines Construction and Development Co., Ltd.	**30,000**	—
Hainan Airlines Food Co., Ltd.	**4,054**	4,086
Hainan Airlines Information Systems Co., Ltd.	**24,565**	155
Hainan Lanyu Air Service Co., Ltd.	**1,248**	639
China Xinhua Airlines Co., Ltd.	**—**	618
Yangzijiang Air Express Co., Ltd.	**7,517**	—
Others	**757**	671
	127,817	47,328
Due to:		
The Parent Company	**2,126**	75,379

Amounts due from/to related parties are unsecured, non-interest bearing and payable on demand. The balances primarily arose from related party transactions as shown in note 8, above.

19. SHORT TERM BANK LOAN

As at 31 December 2002, the Group and the Company had a short term bank loan granted by China Development Bank amounting to RMB50,000,000 (2001: RMB20,000,000). The loan bears interest at 5.31% (2001: 5.85%) per annum and is unsecured. The loan has a maturity date of 9 September 2003.

20. ACCOUNTS PAYABLE

Group

	2002 *RMB'000*	*2001* *RMB'000*
Outstanding balances aged:		
Within 90 days	**1,026**	—
Over 90 days	**350**	—
	1,376	—

21. AIRPORT FEE PAYABLE

In accordance with the notice issued by the CAAC, from 1 January 2002, the Company is required to collect on behalf of the CAAC a civil airport management and construction fee (the "Airport fee"), subject to certain exemptions, from each outbound passenger (RMB50 per domestic passenger and RMB70 per international passenger) and the Company is also entitled to 50% of the Airport fee collected as Airport fee income ("Airport fee income"). In addition, the Tourism Development Fund (RMB20 per passenger) is also collected together with the Airport fee from each outbound international passenger on behalf of and payable to the PRC government after deducting certain handling charges.

Approval from the CAAC was obtained on 11 September 2002 that effective from 1 January 2002, the Airport fee income received by the company could be offset against the Airport fee payable.

31 December 2002

22. INTEREST BEARING LOANS AND BORROWINGS

Group and the Company

	2002 **RMB'000**	2001 RMB'000
Within one year	**14,000**	12,000
Between one and two years	**50,000**	14,000
Between two and five years	**150,000**	150,000
Over five years	**50,000**	100,000
Total long term bank loan	**264,000**	276,000
Less: Amounts due within one year included in current liabilities	**14,000**	12,000
	250,000	264,000

The loan is pledged by the land use rights of the Company amounting to approximately RMB50,000,000. The weighted average interest rate of the loan was 6.21% (2001: 6.25%).

23. DEFERRED INCOME TAX LIABILITIES

As at 31 December 2000, 2001 and 2002, the Group and the Company recognised a deferred tax liability arising from the cost adjustment in 2000 relating to the appraised value of the land use rights of the Group and the Company which was in excess of the net carrying value. The valuation of the land use rights on which the appraised value was determined was performed by Hainan Asset Valuation Co., and resulted in a non-tax deductible surplus of approximately RMB48,869,000. The Company has a five-year exemption of CIT from 2000 to 2004 and a preferential income tax rate of 7.5% from 2005 to 2009. The deferred tax liability of RMB6,535,000 relating to this temporary difference was recorded in 2000, after taking into account the impact of the tax preferential scheme, with a corresponding adjustment to the share premium that had been recorded to reflect the cost adjustment in respect of assets contributed by the Parent Company.

During the year, the Group and the Company also recognised a deferred tax liability of approximately RMB4,968,000 arising from a non-tax deductible valuation surplus of approximately RMB41,449,000 on property, plant and equipment of the Group and the Company. Details of the assets appraisal is disclosed in Note 12 above.

24. GOVERNMENT GRANT

The balance represented the grant from Hainan Province government for the construction of a custom and inspection complex building. The grant will be recognised as income on a systematic and rational basis over the useful life of the building. As at 31 December 2002, the building was still under construction, no income has been amortised from the grant for the year ended 31 December 2002.

25. SHARE CAPITAL

	2002 RMB'000	2001 RMB'000
Issued and fully paid:		
246,300,000 (2001: 250,000,000) domestic shares of RMB1 each	246,300	250,000
226,913,000 (2001: Nil) H Shares of RMB1 each	226,913	—
	473,213	250,000

On 18 November 2002 and 9 December 2002, 198,000,000 newly issued H Shares of the Company and existing State Owned Shares of 3,700,000 shares and an additional 25,213,000 H Shares of RMB1 each, respectively, were offered at a price of HK$3.78 (equivalent to RMB4.01) per share to the public and traded on The Stock Exchange of Hong Kong Limited. The aggregate net proceeds was approximately HK$749,814,000 (equivalent to RMB795,702,000) after deducting related expenses for the placing and initial public offering of approximately HK$107,917,000 (equivalent to RMB114,522,000).

The H Shares ranked pari passu, in all material respects, with the Domestic Shares of the Company.

The proceeds for the issuance of H Shares are to be mainly used for the acquisition of the facilities for the development of the Meilan Airport, further details are included in the prospectus issued for the Public Offer and International Placing for the H Shares of the Company on 6 November 2002.

As at 31 December 2002, the registered capital of the Company was RMB250,000,000. An increment of the registered capital of the Company from RMB250,000,000 to RMB473,213,000 was approved in the extraordinary general meeting on 24 February 2003.

26. RESERVES

	Issued Share capital	*Share premium account*	*Revaluation reserve*	*Statutory reserves*	*Retained earnings*	*Total*
	RMB'000	*RMB'000*	*RMB'000*	*RMB'000*	*RMB'000*	*RMB'000*
	(Note 25)					
At 1 January 2001	250,000	69,390	—	—	—	319,390
Net profit	—	—	—	—	87,517	87,517
Proposed final dividend — note 9	—	—	—	—	(45,000)	(45,000)
Transfer to statutory reserves	—	—	—	11,018	(11,018)	—
At 31 December 2001	250,000	69,390	—	11,018	31,499	361,907
Revaluation of property, plant and equipment — Surplus — note 12	—	—	41,449	—	—	41,449
Net gains and losses not recognized in the income statement	—	—	41,449	—	—	41,449
Related deferred tax liability arising from the revaluation surplus — note 23	—	—	(4,968)	—	—	(4,968)
Net profit	—	—	—	—	157,216	157,216
Proposed final dividend — note 9	—	—	—	—	(85,650)	(85,650)
Transfer to statuary reserves	—	—	—	21,446	(21,446)	—
Issue of H Shares — note 25	223,213	672,169	—	—	—	895,382
Expenses for the placing and initial public offering — note 25	—	(114,522)	—	—	—	(114,522)
At 31 December 2002	473,213	627,037	36,481	32,464	81,619	1,250,814

26. RESERVES (continued)

In accordance with the relevant PRC regulations, the companies now comprising the Group are required to transfer 10% of profit after tax, as determined under the PRC accounting regulations, to the statutory common reserve, until the balance of the fund reaches 50% of the registered capital. Subject to certain restrictions as set out in the relevant PRC regulations, the statutory common reserve may be used to offset against the accumulated losses, if any. Pursuant to the PRC regulations, the companies are required to transfer 5% to 10% of net profit, as determined under the PRC accounting regulations, to the statutory common welfare fund. This fund can only be used to provide staff welfare facilities and other collective benefits to the Company's employees. This fund is non-distributable other than in liquidation. The directors of the Company have proposed to transfer 10% and 5% of the net profit, as determined under the PRC accounting regulations, for the year ended 31 December 2002 amounting to RMB14,297,000 (2001: RMB7,345,000) and RMB7,149,000 (2001: RMB3,673,000) to the statutory common reserve and the statutory common welfare fund, respectively.

According to the Articles of Association of the Company, the amount of reserves available for distribution is the lower of the amount determined under PRC accounting regulations and the amount determined under International Accounting Standards. As at 31 December 2002, the amount of reserves available for distribution was approximately RMB138,964,000 (2001: RMB62,438,000).

27. OPERATING LEASE ARRANGEMENTS

As lessee

At 31 December 2002, the total future minimum lease payments under non-cancellable operating leases in respect of buildings were as follows:

Group and the Company

	RMB'000
Within one year	509
In the second to fifth years, inclusive	1,018
After five years	—
	1,527

27. OPERATING LEASE ARRANGEMENTS (continued)

As lessor

At 31 December 2002, the total future minimum lease receivables under non-cancellable operating leases with its tenants falling due were as follows:

	Group	***Company***
	RMB'000	*RMB'000*
Within one year	20,419	19,098
In the second to fifth years, inclusive	4,151	3,042
After five years	—	—
	24,570	22,140

28. SEGMENT INFORMATION

The Group conducts its business within one business segment i.e., the business of operating an airport and provision of related services in the PRC. The Group's chief decision maker for operations is considered to be the Group's general manager. The information reviewed by the general manager is prepared on a similar basis to the information presented in the consolidated income statements. No segment consolidated income statements have been prepared by the Group during the year. The Group also operates within one geographical segment because its revenues are primarily generated in the PRC and its assets are located in the PRC. Accordingly, no geographical segment data is presented.

29. CONTINGENT LIABILITIES

As at 31 December 2002, the Group and the Company did not have any significant contingent liabilities.

31 December 2002

30. COMMITMENTS

As at 31 December 2002, the capital commitments of the Group and the Company contracted but not accounted for were as follows:

Group and the Company

	RMB'000
Construction for the improvement of the information system in the passenger terminal	5,000
Construction for a customs and immigration Building for international passengers	1,300
	6,300

31. FAIR VALUES OF FINANCIAL INSTRUMENTS

As at 31 December 2002, the Group's financial instruments mainly consisted of cash and bank balances, accounts receivable, due from and due to related parties, other current assets, accounts payable, other payables, short term borrowing and long term borrowing.

The carrying amounts of the Group's financial instruments approximated their fair value as at 31 December 2002 because of the short term maturities of these instruments except for long term borrowings.

The carrying amount of long term borrowings approximated its fair value based on borrowing rates currently for loans with similar terms and maturities.

32. CONCENTRATION OF RISK

(i) Business risk

The Group conducts its operations in the PRC and accordingly is subject to special considerations and significant risk. These include risks associated with, among others, the political, economic and legal environment, influence of national authorities over pricing regulations and competition in the industry.

Further, the five largest customers represented in aggregate approximately 44% (2001: 64%) of the aeronautical revenues of the Group for the year.

32. CONCENTRATION OF RISK (continued)

(ii) Interest rate risk

The interest rate terms of repayment of the bank loans of the Group are disclosed in Note 19 and Note 22.

(iii) Foreign currency risk

The Group's businesses are principally conducted in RMB, except for the purchase of certain equipment, goods and materials in US dollars. As at 31 December 2002, all of the Group's assets and liabilities were denominated in RMB except that other receivable and cash and cash equivalents of approximately RMB19,886,000 (2001: Nil) and RMB208,270,000 (2001: Nil), respectively, were denominated in HK dollars. Fluctuation of the exchange rates of RMB against foreign currencies could affect the Group's results of operations.

(iv) Credit risk

The Group's cash and cash equivalents are mainly deposited with major PRC banks.

The carrying amounts of trade debtors included in the consolidated financial statements represent the Group's maximum exposure to credit risk in relation to its financial assets. No other financial assets carry a significant exposure to credit risk. The Group has no significant concentration of credit risk.

33. SUBSEQUENT EVENTS

On 19 March 2003, the board of directors of the Company proposed a final dividend of RMB18 cents per share for the year ended 31 December 2002, totalling approximately RMB85,650,000. The proposed dividend is subject to shareholders' approval in their next general meeting.