Notes to the Consolidated Financial Statements

At 31 December 2003

1. CORPORATE INFORMATION

Hainan Meilan International Airport Company Limited (formerly "Hainan Meilan Airport Company Limited" and hereinafter 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 ("Meilan Airport") and certain ancillary commercial businesses.

During 2002, the Company acquired equity interests in Haikou Meilan Airport Duty-Free Shop Limited ("DFG"), Hainan Meilan Airport Travelling Company Limited ("Meilan Travelling") and the carpark operations and cargo handling centre business (collectively referred to as the "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 3,700,000 existing state owned shares (after conversion to H shares) were offered, at a premium, to the public and were subsequently traded on The Stock Exchange of Hong Kong Limited. On 9 December 2002, 25,213,000 additional H Shares were issued.

On 31 July 2003, the Civil Aviation Administration of China (the "CAAC") granted the qualification of international airport to Meilan Airport and it was then eligible to operate international routes. With effect from 25 March 2004, the Company's name was changed from Hainan Meilan Airport Company Limited to Hainan Meilan International Airport Company Limited.

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.

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, which comprise standards and interpretations approved by the International Accounting Standards Board, and International Accounting Standards and Standing Interpretations Committee interpretations approved by the International Accounting Standards Committee 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 and available-for-sale financial assets.

Basis of consolidation

The consolidated financial statements comprise the financial statements of the Company and its subsidiaries for the year ended 31 December 2003 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. On acquisition, DFG and Meilan Travelling were included in the consolidated financial statements using the purchase method of accounting. Accordingly, the consolidated income statement and consolidated cash flow statement for the year ended 31 December 2002 include the results and cash flows of DFG and Meilan Travelling for the seven-month period from their acquisition on 31 May 2002. The purchase consideration was allocated to the assets and liabilities acquired on the basis of their 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.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Subsidiaries

A subsidiary is a company whose financial and operating polices 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 stated at cost initially 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.

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 a 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 of an asset does not differ materially from that which would be determined had the asset been stated at valuation at the balance sheet date. Increases in valuations of property, plant and equipment are credited to the revaluation reserve. Decreases in valuations are first offset in the revaluation reserve against an increase from earlier valuations in respect of the same asset, with any excess being 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 financial statements 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 on disposal.

As part of the 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 relevant PRC 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 share premium account directly as this was in connection with the change in value of the 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

Assets under construction represent buildings and aprons under construction, which are stated at cost less any impairment losses, and are not depreciated. Cost comprises the direct costs of construction and capitalised borrowing costs on related borrowed funds during the period of construction. Assets under construction are reclassified to the appropriate category of property, plant and equipment when completed and ready for use.

Notes to the Consolidated Financial Statements

At 31 December 2003

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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.

Goodwill

Goodwill represents the excess of the cost of the acquisition over the fair value of identifiable net assets of a subsidiary at the date of acquisition. Goodwill is amortised on the straight-line basis over its useful economic life of 10 years. It is reviewed for impairment when events or changes in circumstances indicate that the carrying value may not be recoverable. Goodwill is stated at cost less accumulated amortisation and any impairment in value.

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 the 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 relevant PRC 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 share premium account directly as this was in connection with the change in value of the 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.

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.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Impairment of assets (continued)

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.

A reversal of an impairment loss is credited to the income statement 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.

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 period 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 prices 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;
(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;
(h) interest income, on a time proportion basis taking into account the principal outstanding and the effective interest rate applicable;
(i) from the sale of goods, when the significant risks and rewards of ownership of the goods have passed to the buyer and the amount of revenue can be measured reliably; and
(j) from the provision of tourism services, when the services are rendered.

Notes to the Consolidated Financial Statements

At 31 December 2003

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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, it is deducted in arriving at the amount of the asset, and is therefore recognised as income on the straight line basis over the useful life of the asset in the form of a reduced depreciation charge for the asset.

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 assets 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 receivable 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.

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 applicable exchange rates ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated into RMB at the applicable exchange rates ruling at the balance sheet date. All foreign exchange gains or losses are shown in the income statement.

Cash and cash equivalents

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

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.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Tax (continued)

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.

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent it 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.

Accounts receivable, other receivables and amounts due from related parties

Accounts receivable, which generally have 30-90 day credit 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 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 credit 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.

Notes to the Consolidated Financial Statements

At 31 December 2003

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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.

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 benefit plans managed by the local municipal government in the PRC in the location 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 contributions payable are charged as an expense to the income statement as and when incurred.

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 balance sheet date events that provide additional information about a company's position at the balance sheet date or those that indicate that the going concern assumption is not appropriate (adjusting events), are reflected in the financial statements. Post balance sheet date 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, short term investments, accounts receivable and payable, other receivables and payables, loans, and balances with related parties. The accounting policies on recognition and measurement of these items are disclosed in the respective accounting policies included in this section.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Dividends

Final dividends proposed by the directors are classified as a separate allocation of retained earnings within the capital and reserves section of the balance sheet, until they have been approved by the shareholders in a general meeting. 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 the authority to declare interim dividends. Consequently, interim dividends that are proposed or declared after the balance sheet date but before the financial statements are authorised for issue are classified as a separate allocation of retained earnings within the capital and reserves section in the balance sheet, and as a liability when they are proposed and declared.

Investments

All investments are initially recognised at cost, being the fair value of the consideration given and including acquisition charges associated with the investments.

After initial recognition, investments which are classified as held-for-trading and available-for- sale are measured at fair value. Gains or losses on investments held for trading are recognised in income. Gains or losses on available-for-sale investments are recognised as a separate component of equity until the investment is sold, collected of otherwise disposed of, or until the investment is determined to be impaired, at which time the cumulative gain or loss previously reported in equity is included in income.

Investments that are intended to be held-to-maturity, such as bonds and reverse repurchase agreements, are subsequently measured at amortised cost using the effective interest rate method. Amortised cost is calculated by taking into account any discount or premium on acquisition, over the period to maturity. For investments carried at amortised cost, gains and losses are recognised in income when the investments are derecognised or impaired, as well as through the amortisation process.

For investments that are actively traded in organised financial markets, fair value is determined by reference to stock exchange quoted market bid prices at the close of business on the balance sheet date. For investments where there is no quoted market price, fair value is determined by reference to the current market value of another instrument which is substantially the same or is calculated based on the expected cash flows of the underlying net asset base of the investment.

All regular way purchases or sales of financial assets are recognised on the trade date i.e., the date that the Group commits to purchase or sell the asset. Regular way purchases or sales are purchases or sales of financial assets that require deliveries of assets within the time frame generally established by regulation or convention in the marketplace.

Notes to the Consolidated Financial Statements

At 31 December 2003

3. REVENUES

(a) The total revenues of the year are analysed as follows:

	2003 **RMB'000**	2002 RMB'000
Aeronautical:		
Passenger charges	**84,620**	102,229
Airport fees	**71,668**	66,576
Ground handling service fees	**20,254**	23,348
Aircraft movement fees and related charges	**38,297**	17,391
Total aeronautical revenues	**214,839**	209,544
Non-aeronautical:		
Leasing of commercial areas, counters and offices in the terminal	**15,964**	22,797
Franchise fees	**24,493**	21,451
Sale of goods	**11,450**	4,411
Provision of tourism services	**21,977**	10,605
Provision of advertising services	**6,192**	5,118
Car parking fees	**2,963**	1,466
Management fee income	**2,472**	689
Other revenue	**7,583**	7,371
Total non-aeronautical revenues	**93,094**	73,908
Total revenues	**307,933**	283,452

(i) Pursuant to a bank loan agreement, China Development Bank has floating charges over the Company's revenues (see note 24).

(b) Other income comprises:

	Note	**2003** **RMB'000**	2002 RMB'000
Negative goodwill in excess of the fair value of acquired non-monetary assets	15	**–**	2,528
Amortisation of negative goodwill		**37**	21
Others		**548**	–
		585	2,549

4. PROFIT FROM OPERATING ACTIVITIES

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

	2003	2002
	RMB'000	RMB'000
Crediting:		
Gross and net rental income	**(15,964)**	(22,797)
Charging:		
Cost of goods and services:		
Composite services fee	**10,567**	9,896
Environmental protection expenses	**1,911**	1,378
Cost for provision of tourism services	**7,698**	5,580
Cost of sale of goods	**5,929**	2,209
Others	**3,193**	1,011
	29,298	20,074
Provision for doubtful debts	**1,876**	1,172
Staff costs, including directors' emoluments	**21,316**	14,304
Contributions to the retirement scheme	**3,624**	1,563
Net foreign exchange differences	**39**	–
Depreciation and amortisation	**35,044**	30,306
Minimum lease payments under operating leases:		
Buildings	**509**	509
Auditors' remuneration	**2,603**	1,103

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

Details of the remuneration of the directors and supervisors are as follows:

	2003	2002
	RMB'000	RMB'000
Fees	**644**	177
Other emoluments:		
Basic salaries, housing benefits, other allowances and benefits in kind	**310**	178
Bonuses	**256**	61
Retirement benefit contributions	**70**	48
	1,280	464

No directors or supervisors waived or agreed to waive any emoluments during the year.

Notes to the Consolidated Financial Statements

At 31 December 2003

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

The five highest paid individuals in the Group during the year included five directors (2002: three). The emoluments for these directors are included in the above disclosures.

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

	2003 **RMB'000**	*2002* *RMB'000*
Basic salaries, housing benefits, other allowances and benefits in kind	**278**	273
Bonuses	**235**	89
Retirement benefit contributions	**60**	67
	573	429

The remuneration of each of the executive directors, supervisors and five highest paid employees during each of the years 2003 and 2002 fell within the range of nil to HK$1,000,000 (equivalent to RMB1,061,000).

During each of the years 2003 and 2002, 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

	2003 **RMB'000**	*2002* *RMB'000*
Interest on bank loans		
– wholly repayable within five years	**12,812**	12,803
– not wholly repayable within five years	**484**	6,141
Total interest	**13,296**	18,944
Less: interest capitalised	**(1,576)**	–
	11,720	18,944

7. TAX

Hong Kong profits 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 holidays"), entities in the PRC are subject to corporate income tax ("CIT") at a rate of 33% on the taxable income as reported in their statutory financial statements which are prepared in accordance with accounting principles and financial regulations applicable to PRC enterprises.

In accordance with the regulations of "Tax Benefits on Encouraging Investments" issued by the Hainan Provincial Government on 5 August 1988 and "Clarification of 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 its operation upon which there is a 50% reduction for the five consecutive years commencing from the Company's 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 each of the years 2002 and 2003.

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 of 15%.

Since Meilan Advertising and DFG had no assessable profits for the year ended 31 December 2003 determined in accordance with the PRC accounting regulations, no CIT was provided.

A reconciliation of income tax expenses applicable to the 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 relevant year is as follows:

	2003 **RMB'000**	2002 RMB'000
Profit from operating activities before income tax	**154,563**	161,456
At PRC preferential corporate income tax rate of 15%	**23,184**	24,218
Expenditure not allowed for deduction	**3,149**	2,509
Tax holiday	**(26,173)**	(25,797)
At effective income tax rate of 0.8% (2002: 0.58%)	**160**	930

Except for the tax losses of Meilan Advertising and DFG attributable to the Group as at 31 December 2003 of approximately RMB438,000 (as at 31 December 2002: RMB42,000) and RMB1,103,000 (as at 31 December 2002: RMB814,000), respectively, there are no other material deductible temporary differences for which deferred tax assets were not been recognised.

Except for the unrecognised deferred tax assets in respect of tax losses carried forward disclosed above, the Group did not have any significant unprovided deferred income tax as at 31 December 2003 and 31 December 2002.

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

Aeronautical revenues	3%
Non-aeronautical revenues	5%

Pursuant to a notice promulgated by the State Tax Bureau of the PRC, the Group was entitled to one-off business tax holiday in respect of its aeronautical revenue and its revenue from the provision of tourism services earned during the period from 1 May 2003 to 31 December 2003.

Notes to the Consolidated Financial Statements

At 31 December 2003

8. RELATED PARTY TRANSACTIONS

In addition to such transactions and balances disclosed elsewhere in these 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*	**2003 RMB'000**	2002 RMB'000
Revenues:					
Yangzijiang Air Express Co., Ltd.	Related party	Income from franchise fee for the operation of the cargo centre	*(i)*	**18,000**	10,500
Hainan Airlines Food Co., Ltd. ("Hainan Food")	Related party	Franchise income from catering services	*(ii)*	**4,380**	4,380
Hainan Airlines Co., Ltd. ("Hainan Airlines")	*Shareholder	Income for the provision of customary airport ground services	*(iii)*	**65,539**	57,704
		Rental income for the leasing of office and commercial space	*(iv)*	**5,831**	5,863
Expenses:					
Haikou Meilan Airport Co. Ltd. (the "Parent Company")	Immediate holding company	Airport composite services charged by the Parent Company	*(v)*	**9,900**	9,896
		Rental expense paid for the leasing of office and commercial space	*(vi)*	**509**	509
HNA Group Co., Ltd. ("HNA Group")	*Shareholder	Logistic composite services charged by HNA Group	*(vii)*	**6,500**	5,313
Copenhagen Airport Development International A/S ("CADI")	Related party	Technical services fee expenses	*(viii)*	**4,146**	–
Sharing of customary airport ground services income:					
Parent Company	Immediate holding company	Sharing of customary airport ground services income by the Parent Company	*(ix)*	**41,350**	45,543

* *A shareholder represents an individual or corporate entity holding the shares of the Company directly, other than the Parent Company.*

8. RELATED PARTY TRANSACTIONS (continued)

Continuing transactions (continued)

Notes:

(i) *On 12 August 2002, the Company entered into an 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 with effect from 1 June 2002.*

(ii) *On 31 December 2000, the Company entered into a Catering Service Agreement with Hainan Airlines Food Co., Ltd., a subsidiary of Hainan Airlines, granting the latter the right to provide on-board catering services to airlines for a term of three years whereby the franchise fee is RMB4,380,000 per annum.*

(iii) *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 and other airlines at rates prescribed by the CAAC.*

(iv) *The Company leased office, commercial areas, premises, airport counters and an aircraft hangar to Hainan Airlines. The rental charges were agreed between the Company and Hainan Airlines.*

(v) *According to a Revised Airport Composite Services Agreement dated 25 October 2002, the Parent Company has agreed to provide the following services to the Group:*

(a) *provision of security guard service;*
(b) *cleaning and landscaping;*
(c) *sewage and refuse processing;*
(d) *power and energy supply and equipment maintenance; and*
(e) *passenger and luggage security inspection.*

The charge rates for the above services are as follows:

- *The charges relating to items (a) – (c) above are determined in accordance with the cost to the Parent Company in providing such services plus a 5% mark-up as a management fee. The charges are settled on an annual basis.*
- *The charges relating to item (d) are determined in accordance with the cost to the Parent Company plus a 25% mark-up pursuant to the relevant pricing guideline set by the CAAC. The charges are settled on an annual basis.*
- *The charges relating to item (e) are determined in accordance with the rates prescribed by the CAAC and are charged to the airline customers directly. The Company collects such fees receivable from airline customers on behalf of the Parent Company.*

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

(vi) *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 with effect from 1 January 2002.*

Notes to the Consolidated Financial Statements

At 31 December 2003

8. RELATED PARTY TRANSACTIONS *(continued)*

Continuing transactions *(continued)*

(vii) *Pursuant to a Logistic Composite Service Agreement dated 25 October 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 services; (d) vehicle maintenance; and (e) appliance procurement with effect from 1 January 2002.*

The charges for these services are determined as follows: item (a), at the cost of providing such services are shared between HNA Group, the Company and other relevant companies on a pro rata basis by reference to employee headcount; items (b) and (c) at a fixed price with reference to the relevant cost per employee headcount; and items (d) and (e) at the cost of providing such services plus a 5% and a 1% mark-up as management fees, respectively.

(viii) *Pursuant to the Technical Service Agreement dated 16 September 2002 and amended on 30 October 2002 between the Company and CADI, a wholly-owned subsidiary of the Company's strategic investor-Copenhagen Airport A/S, CADI has agreed to provide certain technical and consultancy services in respect of the long-term management and development of Meilan Airport.*

The Company is required to pay fees to CADI which consist of a fixed fee component and a performance-related component. The fixed fee component is calculated by reference to the number of consultant-days used in providing the technical and consultancy services. The performance-related component is calculated by reference to the Company's actual earnings before interest, tax, depreciation and amortisation.

(ix) *By an agreement between the Company dated 25 October 2002 and the Parent Company, the Company has agreed to share with the Parent Company on such a ratio as the CAAC or any other regulatory authorities may from time to time prescribe, which as at 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 for the runway services provided by Parent Company. The Company will collect such fees on behalf of the Parent Company and assumes no liabilities in respect of a default of payment by the airline customers.*

Discontinued transactions*

Name of related party	Relationship with the Company	Nature of transaction	Notes	2003 RMB'000	2002 RMB'000
Parent Company	Immediate holding company	Acquisition of acquired businesses	(i)	**9,800**	78,131

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

Note:

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

With effect from 15 October 2003, the Company acquired an additional 35% equity interest in Meilan Travelling from the Parent Company for a cash consideration of RMB9,800,000, which was determined based on the valuation report prepared by Hainan Zhong Li Xin Asset Valuation Company Limited dated 31 July 2003.

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

9. DIVIDENDS

	2003	2002
	RMB'000	RMB'000
Interim – RMB 2.7 cents (2002: Nil) per share	12,777	–
Proposed final – RMB 14.3 cents (2002: RMB 18.1 cents) per share	67,669	85,650
	80,446	85,650

The proposed final dividend for the year is subject to the approval of the Company's shareholders at the forthcoming annual general meeting.

10. EARNINGS PER SHARE

The calculation of earnings per share is based on the Group's profit attributable to shareholders for the year of RMB152,608,000 (2002: RMB160,086,000) and the weighted average of 473,213,000 shares (2002: 275,457,258 shares) of the Company in issue during the year.

No diluted earnings per share amount 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 20% and 18% of the employees salaries after and before 1 January 2003, respectively.

The Group's pension cost contributions for the year amounted to approximately RMB3,624,000 (2002: RMB1,563,000).

Notes to the Consolidated Financial Statements

At 31 December 2003

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 valuation:						
At 1 January 2003	10,549	561,901	77,720	37,332	13,342	700,844
Additions	37,293	19,996	151	3,089	3,800	64,329
Transferred to fixed assets	(47,071)	47,071	–	–	–	–
Disposals	–	–	–	(1,057)	–	(1,057)
Government grant	–	(4,000)	–	–	–	(4,000)
At 31 December 2003	771	624,968	77,871	39,364	17,142	760,116
Analysis of cost or valuation:						
At cost	771	63,968	151	2,620	7,786	75,296
At 31 August 2002 valuation	–	561,000	77,720	36,744	9,356	684,820
	771	624,968	77,871	39,364	17,142	760,116
Accumulated depreciation:						
At 1 January 2003	–	4,811	2,439	1,950	2,490	11,690
Charge for the year	–	14,708	7,069	6,293	3,243	31,313
Disposals	–	–	–	(351)	–	(351)
At 31 December 2003	–	19,519	9,508	7,892	5,733	42,652
Net book value:						
At 31 December 2003	771	605,449	68,363	31,472	11,409	717,464
At 1 January 2003	10,549	557,090	75,281	35,382	10,852	689,154

Had the property, plant and equipment of the Group been carried at historical cost less accumulated depreciation, the carrying amounts of each class would have been:

	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	771	663,943	98,547	50,614	21,679	835,554
Accumulated depreciation	–	92,340	33,900	20,799	10,057	157,096
	771	571,603	64,647	29,815	11,622	678,458

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

Company

	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 valuation:						
At 1 January 2003	10,523	561,901	77,720	36,783	10,133	697,060
Additions	37,293	19,996	151	2,963	2,605	63,008
Transferred to fixed assets	(47,071)	47,071	–	–	–	–
Disposals	–	–	–	(897)	–	(897)
Government grant	–	(4,000)	–	–	–	(4,000)
At 31 December 2003	745	624,968	77,871	38,849	12,738	755,171
Accumulated depreciation:						
At 1 January 2003	–	4,811	2,439	1,788	1,082	10,120
Charge for the year	–	14,708	7,069	6,199	2,471	30,447
Disposals	–	–	–	(249)	–	(249)
At 31 December 2003	–	19,519	9,508	7,738	3,553	40,318
Net book value:						
At 31 December 2003	745	605,449	68,363	31,111	9,185	714,853
At 1 January 2003	10,523	557,090	75,281	34,995	9,051	686,940

A valuation of the property, plant and equipment of the Group was performed as at 31 August 2002 by Vigers Hong Kong Ltd., independent professionally 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 of 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 RMB1,813,000 for the year (2002: RMB612,000).

In the opinion of directors, there has been no material change to the values of the property, plant and equipment between 31 August 2002 and 31 December 2003.

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

Prior to their transfer to buildings and leasehold improvements, the carrying amount of assets under construction included capitalised interest of RMB1,576,000 (2002: Nil).

Notes to the Consolidated Financial Statements

At 31 December 2003

13. LAND USE RIGHTS

Group and Company

	RMB'000
Cost:	
At 1 January 2003 and 31 December 2003	175,260
Accumulated amortisation:	
At 1 January 2003	3,228
Charge for the year	3,731
At 31 December 2003	6,959
Net book value:	
At 31 December 2003	168,301
At 1 January 2003	172,032

A valuation of the land use rights of the Group was performed as at 31 August 2002 by Vigers Hong Kong Ltd., independent professionally 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 restated to their valuation amount less accumulated amortisation and impairment losses, then the net carrying amount would have been approximately RMB179,629,000 and would have resulted in additional amortisation charges of approximately RMB166,000 for the year (2002: RMB69,000).

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

As at 31 December 2003, the legal formalities for the transfer of title of certain land use rights acquired from the Parent Company, amounting to RMB94,380,000, were still in progress. The directors are confident that this matter can be resolved without any material effect on the Company's future results of operations and financial position.

14. INTERESTS IN SUBSIDIARIES

	31 December 2003 RMB'000	*31 December 2002 RMB'000*
Unlisted shares, at cost	**18,094**	8,294
Amount due to subsidiaries	**(2,419)**	(15,760)
	15,675	(7,466)

The amounts due to 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 2003, the Company had direct and indirect interests in the following subsidiaries:

Name	***Place and date of incorporation and operations***	***Nominal value of 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	95	Provision of tourism services
DFG* (note (ii))	PRC 11 May 1999	1,000	95	Trading of duty-free items

* *Each of the subsidiaries is registered as a company with limited liability in the PRC.*

Notes:

(i) 95% of the equity interest of Meilan Advertising is directly held by the Company while the remaining 4.75% equity interest of 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.

Notes to the Consolidated Financial Statements

At 31 December 2003

14. INTERESTS IN SUBSIDIARIES (continued)

With effect from 15 October 2003, the Group acquired an additional 35% equity interest in Meilan Travelling from the Parent Company for a cash consideration of RMB9,800,000.

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

	RMB'000
Property, plant and equipment	229
Cash and cash equivalents	2,978
Prepayments, deposits and other receivables	14,788
Accounts receivable	1,217
Inventories	47
	19,259
Accounts payable	(564)
Accrued liabilities and other payables	(2,501)
	16,194
Fair value of net assets acquired by the Company (35% thereof)	5,668
Goodwill arising on acquisition (note 15)	4,132
	9,800
Consideration:	
Settled in cash during 2003	9,800

15. GOODWILL AND NEGATIVE GOODWILL

The amounts of goodwill and negative goodwill, capitalised as an asset and recognised in the consolidated balance sheet, arising from the acquisition of subsidiaries are as follows:

Group

	Goodwill	**Negative goodwill**	**Total**
	RMB'000	*RMB'000*	*RMB'000*
Cost:			
At 1 January 2003	–	(260)	(260)
Addition (note 14)	4,132	–	4,132
At 31 December 2003	4,132	(260)	3,872
Accumulated amortisation:			
At 1 January 2003	–	21	21
Charge for the year	(69)	37	(32)
At 31 December 2003	(69)	58	(11)
Net book value:			
At 31 December 2003	4,063	(202)	3,861
At 1 January 2003	–	(239)	(239)

16. CASH AND CASH EQUIVALENTS

Cash and cash equivalents comprise cash at banks and in hand and short term bank deposits. Cash at banks earns interest at floating rates based on daily bank deposit rates. Short term deposits are made for varying periods of between seven days and three months depending on the immediate cash requirements of the Group, and earn interest at the respective short term deposit rates.

For the purpose of the consolidated cash flow statement, the cash and cash equivalents of the Group comprise the following:

	31 December 2003	*31 December 2002*
	RMB'000	*RMB'000*
Cash at bank and in hand	**213,704**	703,752
Short-term bank deposits	**200,000**	–
	413,704	703,752

Notes to the Consolidated Financial Statements

At 31 December 2003

16. CASH AND CASH EQUIVALENTS (continued)

Cash and cash equivalents of the Company comprise the following:

	31 December 2003 RMB'000	31 December 2002 RMB'000
Cash at bank and in hand	**201,930**	699,928
Short-term bank deposits	**200,000**	–
	401,930	699,928

17. TIME DEPOSITS

As at 31 December 2003, the Group and the Company had two deposits placed with Xiamen International Bank amounting to RMB50,000,000 and RMB30,000,000. The deposits earn interest at 1.98% per annum and have maturity dates of 25 September 2004 and 13 October 2004, respectively.

18. SHORT TERM INVESTMENTS

During 2003, the Company entered into two designated investment agreements with Xiangcai Securities Company Limited, whereby the latter agreed to invest on behalf of the Company a maximum amount of RMB200,000,000 and RMB100,000,000, respectively, in government bond securities traded on recognised securities exchanges in the PRC. Each of the aforesaid agreements was for a period of six months, from 23 May 2003 to 23 November 2003 and from 7 July 2003 to 7 January 2004, respectively. The Company was guaranteed a minimum rate of return of 2.5% per annum.

The outstanding balance of short term investments as at 31 December 2003 of RMB90,000,000 was received by the Company in January 2004.

19. ACCOUNTS RECEIVABLE, NET

Group

	31 December 2003 RMB'000	31 December 2002 RMB'000
Outstanding balances aged:		
Within 90 days	**38,664**	19,019
Between 91 to 180 days	**4,076**	3,645
Between 181 to 365 days	**1,999**	2,777
More than 365 days	**3,191**	1,264
	47,930	26,705
Less: Provision for doubtful debts	**(4,391)**	(2,514)
	43,539	24,191

19. ACCOUNTS RECEIVABLE, NET (continued)

Company

	31 December 2003 RMB'000	31 December 2002 RMB'000
Outstanding balances aged:		
Within 90 days	**38,257**	19,019
Between 91 to 180 days	**3,914**	3,645
Between 181 to 365 days	**1,940**	2,777
More than 365 days	**3,040**	1,161
	47,151	26,602
Less: Provision for doubtful debts	**(4,319)**	(2,514)
	42,832	24,088

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 with the Group. 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.

20. INVENTORIES

Group

	31 December 2003 RMB'000	31 December 2002 RMB'000
Finished goods and low value consumables	**2,853**	2,297

Company

	31 December 2003 RMB'000	31 December 2002 RMB'000
Low value consumables	**28**	2

All the carrying amounts were stated at cost.

Notes to the Consolidated Financial Statements

At 31 December 2003

21. BALANCES WITH RELATED PARTIES

Group

	Notes	**31 December 2003 RMB'000**	31 December 2002 RMB'000
Due from:			
Parent Company		**1,654**	1,757
HNA Group Co., Ltd.		**309**	1,557
Hainan Airlines Co., Ltd.	*(iii)*	**49,752**	20,061
China Southern Airlines Co., Ltd.#		**–**	17,483
Southern Airlines (Group)		**–**	575
Hainan Da Lung Enterprise Co., Ltd.	*(i)*	**13,230**	20,000
Hainan Airlines Construction and Development Co., Ltd.	*(ii)*	**–**	30,000
Hainan Airlines Food Co., Ltd.		**3,493**	4,054
Hainan Airlines Information Systems Co., Ltd.		**–**	24,565
Hainan Lanyu Air Service Co., Ltd.		**–**	1,248
Yangzijiang Air Express Co., Ltd.	*(iii)*	**12,565**	7,517
Others		**311**	793
		81,314	129,610
Due to:			
Parent Company		**7,341**	2,980
Hainan Airlines Co., Ltd.		**–**	–
CADI		**4,146**	–
Others		**203**	173
		11,690	3,153

21. BALANCES WITH RELATED PARTIES (continued)

Company

	Notes	31 December 2003 RMB'000	31 December 2002 RMB'000
Due from:			
HNA Group Co., Ltd.		**309**	1,557
Hainan Airlines Co., Ltd.	*(iii)*	**49,752**	20,061
China Southern Airlines Co., Ltd. #		**–**	17,483
Southern Airlines (Group)		**–**	575
Hainan Da Lung Enterprise Co., Ltd.	*(i)*	**13,230**	20,000
Hainan Airlines Construction and Development Co., Ltd.	*(ii)*	**–**	30,000
Hainan Airlines Food Co., Ltd.		**3,493**	4,054
Hainan Airlines Information Systems Co., Ltd.		**–**	24,565
Hainan Lanyu Air Service Co., Ltd.		**–**	1,248
Yangzijiang Air Express Co., Ltd.	*(iii)*	**12,565**	7,517
Others		**212**	757
		79,561	127,817
Due to:			
Parent Company		**6,463**	2,126
Hainan Airlines Co., Ltd.		**–**	–
CADI		**4,146**	–
Others		**201**	–
		10,810	2,126

China Southern Airlines was a promoter of the Company and owned 925,000 domestic shares of the Company. In November 2002, the aforesaid 925,000 domestic shares were converted to H shares and sold to the public in compliance with the Temporary Administration Measures on the Reduction of State-Owned Shares for the Raising of Social Security Fund promulgated by the State Council on 12 June 2001.

Notes to the Consolidated Financial Statements

At 31 December 2003

21. BALANCES WITH RELATED PARTIES (continued)

The amounts due from/to related parties are unsecured, non-interest bearing and repayable in accordance with the contract terms. The balances primarily arose from the related party transactions disclosed in note 8.

Notes:

(i) *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, under which Hainan Da Lung Enterprise Co., Ltd. would purchase equipment for the apron of 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 the contract terms. The balance is guaranteed by the Parent Company. During the year, Hainan Da Lung Enterprise Co., Ltd. paid an amount of RMB6,770,000 on behalf on the Company.*

(ii) *On 1 December 2002, the Company entered into a construction agency contract of RMB30,000,000 with Hainan Airlines Construction and Development Co., Ltd, a subsidiary of the HNA Group, for the coordination and the progress payments to be paid on behalf of the Company in respect of the construction of the apron of the airport. In December 2002, the Company made full payment to Hainan Airlines Construction and Development Co., Ltd. in accordance with the contract terms. During the year, Hainan Airlines Construction and Development Co., Ltd. settled progress payments to the contractor of the apron amounting to RMB30,000,000.*

(iii) *In February 2004, Hainan Airlines Co., Ltd. and Yangzijiang Air Express Co., Ltd. settled RMB40,000,000 and RMB12,000,000, respectively, of their outstanding balances as at 31 December 2003.*

22. ACCOUNTS PAYABLE

Group

	31 December 2003 RMB'000	31 December 2002 RMB'000
Outstanding balances aged:		
Within 90 days	**1,833**	1,026
Over 90 days	**392**	350
	2,225	1,376

23. AIRPORT FEE PAYABLE

Airport fee payable represents the proportion of the Civil Airport Management and Construction Fee collected by the Company, which is payable to the CAAC.

24. INTEREST BEARING LOANS AND BORROWINGS

Group and Company

	31 December 2003 RMB'000	*31 December 2002 RMB'000*
Within one year	**–**	14,000
Between one and two years	**25,000**	50,000
Between two and five years	**87,000**	150,000
Over five years	**16,000**	50,000
Total long term bank loans	**128,000**	264,000
Less: Amounts due within one year included in current liabilities	**–**	14,000
	128,000	250,000

During the year, the Company repaid, without penalty charges, long term bank loans amounting to RMB264,000,000 and borrowed a new long term bank loan amounting to RMB128,000,000. The Group's and the Company's long term bank loan outstanding at 31 December 2003 is secured by a floating charge over the Company's revenues (see note 3) and bears interest at 5.76% per annum.

25. DEFERRED INCOME TAX LIABILITIES

As at 31 December 2003 and 31 December 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 from 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 has been recorded since 2000, after taking into account the impact of the preferential tax scheme, with a corresponding adjustment to the share premium that was recorded to reflect the cost adjustment in respect of the assets contributed by the Parent Company.

During the second half of 2002, 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 the property, plant and equipment of the Group and the Company. Details of the asset appraisal are disclosed in note 12.

26. SHARE CAPITAL

	31 December 2003 RMB'000	*31 December 2002 RMB'000*
Issued and fully paid:		
– 246,300,000 domestic shares of RMB1 each	**246,300**	246,300
– 226,913,000 H shares of RMB1 each	**226,913**	226,913
	473,213	473,213

Notes to the Consolidated Financial Statements

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27. RESERVES

The movements in the reserves of the Group are set out in the consolidated statement of movements in equity on page 38 of the financial statements.

Company

	Notes	Share premium account RMB'000	Revaluation reserve RMB'000	Statutory reserves RMB'000	Retained earnings RMB'000	Proposed dividend RMB'000	Total RMB'000
At 1 January 2002		69,390	–	11,018	31,499	45,000	156,907
Dividend paid		–	–	–	–	(45,000)	(45,000)
Revaluation of property, plant and equipment – surplus	12	–	41,449	–	–	–	41,449
Related deferred tax liability arising from the revaluation of property, plant and equipment	25	–	(4,968)	–	–	–	(4,968)
Net gains and losses not recognised in the income statement		–	36,481	–	–	–	36,481
Net profit for the year (note i)		–	–	–	157,216	–	157,216
Proposed final dividend	9	–	–	–	(85,650)	85,650	–
Transfer to statutory reserves		–	–	21,446	(21,446)		–
Issue of H Shares		672,169	–	–	–	–	672,169
Expenses for the placing and initial public offering		(114,522)	–	–	–	–	(114,522)
At 31 December 2002		627,037	36,481	32,464	81,619	85,650	863,251
Dividend paid		–	–	–	–	(85,650)	(85,650)
Net profit for the year (note i)		–	–	–	157,503	–	157,503
Interim dividend paid	9	–	–	–	(12,777)	–	(12,777)
Proposed final dividend	9	–	–	–	(67,669)	67,669	–
Transfer to statutory reserves		–	–	20,160	(20,160)	–	–
At 31 December 2003		627,037	36,481	52,624	138,516	67,669	922,327

Note:

(i) The net profit from ordinary activities attributable to shareholders for the year ended 31 December 2003 dealt with in the financial statements of the Company, was RMB157,503,000 (2002: RMB157,216,000).

27. RESERVES (continued)

In accordance with the relevant PRC regulations, the companies now comprising the Group are required to transfer 10% of the year end 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 of that company. 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 employees of that company. 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 2003 amounting to RMB13,440,000 (2002: RMB14,297,000) and RMB6,720,000 (2002: RMB7,149,000) 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 Financial Reporting Standards. As at 31 December 2003, the amount of reserves available for distribution as determined under PRC accounting regulations was approximately RMB134,602,000 (at 31 December 2002: RMB138,964,000).

28. NOTES TO THE CONSOLIDATED CASH FLOW STATEMENT

Major non-cash transactions

(i) As further disclosed in notes 21(i) and (ii) to the financial statements, during the year, Hainan Da Lung Enterprise Co., Ltd. and Hainan Airlines Construction and Development Co., Ltd. settled construction cost payables on behalf of the Company amounting to RMB6,770,000 and RMB30,000,000, respectively.

29. SEGMENT INFORMATION

The Group conducts its business within one business segment, i.e., the business of operating an airport and the 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 statement. No segment consolidated income statement has 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 further geographical segment data is presented.

Notes to the Consolidated Financial Statements

At 31 December 2003

30. COMMITMENTS AND CONTINGENT LIABILITIES

Operating lease arrangements – Group as lessee

The total future minimum lease payments under non-cancellable operating leases in respect of buildings were as follows:

Group and Company

	31 December 2003 RMB'000	31 December 2002 RMB'000
Within one year	**910**	509
In the second to fifth years, inclusive	**1,019**	1,018
	1,929	1,527

Operating lease arrangements – Group as lessor

The total future minimum lease receivables under non-cancellable operating leases with the Group's tenants are as follows:

	31 December 2003		31 December 2002	
	Group RMB'000	Company RMB'000	Group RMB'000	Company RMB'000
Within one year	**9,293**	**6,593**	20,419	19,098
In the second to fifth years, inclusive	**1,494**	**1,397**	4,151	3,042
	10,787	**7,990**	24,570	22,140

Capital commitments

Group and Company

	31 December 2003 RMB'000	31 December 2002 RMB'000
Contracted, but not provided for:		
In respect of buildings and leasehold improvements	**–**	6,300
In respect of motor vehicles	**3,520**	–
	3,520	6,300
Authorised, but not contracted for:		
In respect of buildings and leasehold improvements	**434,015**	–
	437,535	6,300

Contingent liabilities

As at 31 December 2003, the Group and the Company did not have any significant contingent liabilities.

31. FAIR VALUES OF FINANCIAL INSTRUMENTS

As at 31 December 2003, the Group's financial instruments comprise bank loans, cash and bank deposits. The main purpose of these financial instruments is to raise finance for the Group's operations. The Group has various other financial instruments such as accounts receivable, amounts due from and due to related parties, other receivables, accounts payable and other payables which arise directly from its operations. The Group also enters into investment transactions, principally available-for-sale and held-to-maturity investments, with the purpose of generating returns through interest income and holding gains.

The carrying amounts of the Group's financial instruments approximated their fair value as at 31 December 2003 because of the short term maturities of these instruments, except for the long term borrowings.

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

The Company's risk management objectives and policies are summarised in note 32 to the financial statements.

32. FINANCIAL RISK FACTORS

The Group does not have written risk management policies and guidelines. However, the board of directors meets periodically to analyse and formulate measures to manage the Group's exposure to risks, including principally market risks and changes in interest rates and currency exchange rates. Generally, the Group follows conservative strategies in its risk management.

As the Group does not have significant exposure to interest rate and currency exchange rate risk, the Group has not used derivatives or other instruments for hedging purposes. The Group does not hold or issue derivative financial instruments for trading purposes.

The main risks arising from the Group's financial instruments are business risk, interest rate risk, foreign currency risk and credit risk, which are set out as follows:

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, the influence of national authorities over pricing regulations and competition in the industry.

Furthermore, the Group's five largest customers represented in aggregate approximately 68% (2002: 44%) of the aeronautical revenues of the Group for the year.

ii) Interest rate risk

The interest rate and repayment terms of the bank loans of the Group are disclosed in note 24. The interest rate and terms of the short term investments of the Group are disclosed in note 18 to the financial statements.

iii) Foreign currency risk

The Group's businesses are principally conducted in RMB, except for the purchase of certain equipment, goods and materials in United States dollars. As at 31 December 2003, all of the Group's assets and liabilities were denominated in RMB except that cash and cash equivalents of approximately RMB9,627,000 (2002: RMB208,270,000) were denominated in Hong Kong dollars. Fluctuation of the exchange rates of RMB against foreign currencies could affect the Group's results of operations.

Notes to the Consolidated Financial Statements

At 31 December 2003

32. FINANCIAL RISK FACTORS (continued)

iv) Credit risk

The carrying amounts of cash and cash equivalents, time deposits and accounts receivable 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.

33. EVENTS AFTER THE BALANCE SHEET DATE

(i) With effect from 25 March 2004, the registered name of the Company was changed from Hainan Meilan Airport Company Limited to Hainan Meilan International Airport Company Limited.

(ii) On 29 March 2004, the board of directors of the Company proposed a 2003 final dividend of approximately RMB14.3 cents per share, totalling approximately RMB67,669,000. The proposed dividend is subject to shareholders' approval in their next general meeting.

34. APPROVAL OF THE FINANCIAL STATEMENTS

The financial statements were approved and authorised for issue by the board of directors on 29 March 2004.