

Chairman's Statement



Dear Shareholders:

In 2004, the demand in the PRC civil aviation market sustained the growth trend from the second half of 2003. As a result, the Group recorded a year-on-year growth of more than 37% in total operating revenue, marking a breakthrough achievement in the Group's history. However, due to the persistent high price of aviation fuel and relatively more major overhauls of aircraft having been performed, which increased maintenance costs, the Group still recorded a net loss of RMB48 million for 2004.

Instabilities in the world economy and in global politics continued to drive up the prices of aviation fuel in the international market. As a result, fuel costs rose substantially, accounting for more than 30% of the operating costs of the Group. The Group, without compromising flight safety, adopted various technical measures, including the preparation of precise flight plans and minimisation of turnaround time, so as to reduce fuel consumption. However, as an airline in the PRC, the options available to the Group were limited in this respect. As such, the high aviation fuel price exerted immense pressure on the operating expenses of the Group.

The Group has revamped its marketing management by designating an accountability system to each of its sales managers. These measures have encouraged the operating and marketing team of the Group to be more proactive and vigilant of the difficulties faced by the Group, thereby maximising the total revenue of the Group to the greatest possible extent. In addition, the commencement of operation of the new Guangzhou Baiyun International Airport, the main hub of the Group, provides a wider platform of development for the operations of the Company. Moreover, the Group has successfully secured the exclusive right to use Terminal No. 1 of the Beijing Capital International Airport, marking a substantial step in carrying out the strategy of the Group to improve its flight routes network.

Flight safety is a perennial concern to airlines. In this regard, the Group is committed to flight safety by strengthening internal safety checks, pilot training and aircraft maintenance. As a result, the Group was awarded the Golden Roc Cup, the highest award for flight safety in the PRC civil aviation industry, for the fourth time in 2004.

The acquisition of the airline operations of China Northern Airlines Company and Xinjiang Airlines Company was approved at the general meeting of the Company held on 31 December, 2004. Such acquisition provides a robust platform for the Group to consolidate its market leadership and financial results. It also brought in various benefits to the Group by expanding its flight service network, fleet size and transport capacity, as well as lowering costs and improving overall efficiency. Given the investment incentive policies such as "Go West" and "Revitalising the Old Industrial Bases in the North-eastern Region" promulgated by the PRC government, the economy in the western and north-eastern regions of the PRC is expected to grow at a rapid pace in the coming decades, which in turn provides substantial growth potential for the Group. Ultimately, the acquisition will strengthen the Group's position as the largest airline in the PRC and will create positive value to its investors. At present, the management of the Group focuses on harnessing the expanded business capacity and operation scale of the Group, and on enhancing its overall management standards through an integration of corporate cultures, innovation and development, thereby realising the ultimate goal of the Group's reorganisation.



Chairman's Statement (Cont'd)

2005 is expected to be a year of challenge for the Group. While managing the integrated post-acquisition operations of the Group, the Group will also face increasing competition due to increasing supply in capacity in the PRC aviation market. In anticipation of this, the Group is adopting the following measures to enhance its competitiveness and to maintain its market share and operating results of the expanded business:



1. optimise its service offerings, flight schedules and route networks by improving the integrated management and resources allocation, thereby capitalising on the advantages as a result of the tripartite combination;
2. enhance pilot training and further strengthen flight supervision to ensure flight safety;
3. optimise the performance-oriented marketing incentive system; reinforce the sales by building an integrated route network and improving the revenue sharing scheme; providing e-commerce services; and continue to optimise the existing offerings with a focus on personalised and value-added services and sales services, thereby enhancing the general operating efficiency;
4. strengthen the cargo operation to further penetrate the international and regional markets;
5. exercise stringent cost controls by decentralising budget management and integrating purchasing and maintenance operations, and try all possible means to minimise the impact of fuel costs; and
6. establish a comprehensive internal control system to improve risk resistance.



2005 will be a brand new start for the new China Southern Airlines. On behalf of the board, I would like to express our gratitude to our staff and to the shareholders and friends for their caring and thoughtfulness. We also look forward to the continued support of our staff, shareholders and friends, working hand-in-hand with them for a healthy, sustainable growth at China Southern Airlines.

Liu Shao Yong

Chairman

Guangzhou, the PRC

25 April, 2005