People's United Financial, Inc.
Form PRE 14A
February 22, 2013

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

SCHEDULE 14A

Proxy Statement Pursuant to Section 14(a) of the

Securities Exchange Act of 1934

(Amendment No.)

Filed by the Registrant x Filed by a Party other than the Registrant ¨

Check the appropriate box:

x Preliminary Proxy Statement

¨ **Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))**

¨ Definitive Proxy Statement

¨ Definitive Additional Materials

¨ Soliciting Material Pursuant to §240.14a-12

People s United Financial, Inc.

(Name of Registrant as Specified In Its Charter)

(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

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x No fee required.

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(1) Amount previously paid:

(2) Form, Schedule or Registration Statement No.:

(3) Filing Party:

(4) Date Filed:

March 8, 2013

Dear Shareholder:

On behalf of the Board of Directors of People s United Financial, Inc., I cordially invite you to attend our 2013 annual meeting of shareholders at 850 Main Street, Bridgeport, Connecticut on Thursday, April 18, 2013 at 10:00 a.m. The accompanying proxy statement details the actions on which you are asked to vote at the annual meeting. Please read it carefully.

Whether or not you choose to join us at the annual meeting, I urge you to complete, sign and date the proxy card and return it promptly in the postage-paid envelope to ensure that your shares are represented. You may also cast your vote by telephone or electronically, instead of by mail. If you have any questions about your proxy card, voting procedures or other matters set forth in the proxy statement, please feel free to call our Investor Relations department at 203-338-7228.

On behalf of our Board of Directors, our management team and all of our employees, I want to thank you for your investment in People s United Financial and the continued opportunity to work for you.

Sincerely,

John P. Barnes

President and Chief Executive Officer

People s United Financial, Inc. 850 Main Street, P.O. Box 1580 Bridgeport, Connecticut 06601-1580 203-338-7171

NOTICE OF ANNUAL MEETING OF SHAREHOLDERS

TO BE HELD ON APRIL 18, 2013

NOTICE IS HEREBY GIVEN that the annual meeting of shareholders of People s United Financial, Inc. (People s United) will be held on Thursday, April 18, 2013, at 10:00 a.m. local time at 850 Main Street, Bridgeport, Connecticut, for the following purposes:

1. To elect four directors who, with the six directors whose terms of office do not expire at the annual meeting, will constitute the full Board of Directors of People s United;

2. To cast a non-binding advisory vote to approve the compensation of our named executive officers as disclosed in this proxy statement;

3. To consider and vote upon a proposal to amend and restate the Certificate of Incorporation of People s United to provide for the annual election of directors;

4. To ratify the appointment of KPMG LLP as our independent registered public accounting firm for the year ending December 31, 2013; and

5. To act on any other proposal that may properly come before the annual meeting or any adjournment or postponement thereof.

We have fixed the close of business on February 20, 2013 as the record date for determination of shareholders entitled to notice of and to vote at the 2013 annual meeting or at any adjournment or postponement thereof. Record holders of People s United common stock as of the record date are entitled to vote at the annual meeting.

A list of the holders of People s United common stock entitled to vote at the annual meeting will be available for inspection on request by any People s United shareholder for any purpose germane to the annual meeting at our headquarters, located at 850 Main Street, Bridgeport, Connecticut 06604, during normal business hours beginning no later than ten days prior to the date of the annual meeting and continuing through the date of the annual meeting.

WE URGE YOU TO COMPLETE AND RETURN PROMPTLY THE ACCOMPANYING PROXY, WHETHER OR NOT YOU PLAN TO ATTEND THE ANNUAL MEETING. YOU MAY CAST YOUR VOTE BY TELEPHONE OR ELECTRONICALLY INSTEAD IF YOU SO CHOOSE. IF YOU WERE A SHAREHOLDER OF RECORD ON THE RECORD DATE AND ATTEND THE MEETING, YOU MAY REVOKE YOUR PROXY OR TELEPHONE OR ELECTRONIC VOTE AND VOTE IN PERSON.

By Order of the Board of Directors

Robert E. Trautmann, Secretary

Bridgeport, Connecticut

March 8, 2013

People s United Financial, Inc. 850 Main Street, P.O. Box 1580 Bridgeport, Connecticut 06601-1580 203-338-7171

PROXY STATEMENT

General

We are furnishing this proxy statement to the shareholders of People s United Financial, Inc., which we refer to as People s United or the Company, in connection with the solicitation of proxies by our Board of Directors for use at the 2013 annual meeting of shareholders to be held on Thursday, April 18, 2013 at 10:00 a.m. local time at 850 Main Street, Bridgeport, Connecticut. At the 2013 annual meeting, holders of the common stock, $0.01 par value per share, of People s United will be asked to elect four directors; to cast a non-binding advisory vote to approve the compensation of our named executive officers as disclosed in this proxy statement; to consider and vote upon a proposal to amend and restate the Certificate of Incorporation of People s United to provide for the annual election of directors; to ratify the appointment of KPMG LLP as our independent registered public accounting firm for the year ending December 31, 2013; and to act on any other proposal that may properly come before the annual meeting or any adjournment or postponement thereof.

We are furnishing this proxy statement and the enclosed form of proxy to our shareholders beginning on or about March 8, 2013.

Proxies

The accompanying form of proxy is for use at the 2013 annual meeting if you will be unable to attend in person or wish to have your shares voted by proxy even if you do attend the meeting. Instead of completing the accompanying form of proxy, you may cast a proxy vote by telephone or electronically, by following the telephone or Internet voting instructions printed on the proxy card. You can revoke a vote cast by written proxy or by proxy authorized by telephone or electronically, at any time before the proxy is exercised, by submitting to the Company s Corporate Secretary a written notice of revocation or a properly executed proxy bearing a later date, by casting a subsequent vote by telephone or electronically, or by attending the meeting and voting in person. However, attendance at the annual meeting will not in and of itself constitute revocation of a proxy or other previously cast vote. You should address any written notices of revocation and other communications with respect to the revocation of proxies to: People s United Financial, Inc., 850 Main Street, Bridgeport, Connecticut 06604, Attention: Corporate Secretary. In addition, if your shares of common stock are not registered in your name, you will need additional documentation from the record holder(s) of such shares to vote in person at the annual meeting.

All shares of common stock represented by properly executed or telephonically or electronically authorized proxies received pursuant to this solicitation, and not subsequently revoked, will be voted at the annual meeting in the manner specified by the shareholder submitting the proxy. If no specification is made, the proxies will be voted **for** the election of each of the nominees for director identified in this proxy statement; **for** the advisory vote to approve the compensation of our named executive officers as disclosed in this proxy statement; **for** the proposal to amend and restate the Certificate of Incorporation; **for** ratification of the appointment of KPMG LLP as our independent registered public accounting firm for the year ending December 31, 2013; and in the discretion of the proxy holders, as to any other matter that may properly come before the annual meeting.

People s United will bear the entire cost of soliciting proxies. In addition to the solicitation of proxies by mail, we will request banks, brokers and other record holders to send proxies and proxy material to the beneficial owners of our stock and secure their voting instructions, if necessary. We will reimburse those record holders for their reasonable expenses in doing so. We may also use our regular employees, who will not be specially compensated, to solicit proxies from shareholders, either personally or by telephone, facsimile, other electronic means, or special or express delivery letter.

Record Date and Voting Rights

The Board of Directors has fixed February 20, 2013 as the record date for determining People s United shareholders entitled to notice of and to vote at the 2013 annual meeting. Only holders of record of shares of common stock at the close of business on that date are entitled to notice of and to vote at the annual meeting. On the record date, there were approximately holders of record of our common stock and shares of our common stock outstanding.

Shares representing a majority of the votes entitled to be cast at the annual meeting must be present in person or by proxy at the annual meeting in order for a quorum to be present. Shares of common stock present but not voting, and shares for which proxies have been received but with respect to which holders of such shares have abstained, will be counted as present for purposes of determining the presence or absence of a quorum for the transaction of business at the annual meeting. Shares represented by proxies returned by a broker holding such shares in nominee or street name will be counted for purposes of determining whether a quorum exists, even if those shares are not voted on matters where discretionary voting by the broker is not allowed (known as broker non-votes).

Each share of common stock entitles a holder of record on the record date to one vote on each matter to be presented at the annual meeting, and all such shares vote together as a single class. The voting requirements for each matter presented are as follows:

For a nominee to be elected as a director, more votes must be cast for that nominee than are cast against (withheld from) that nominee.

The affirmative vote of a majority of the shares present or represented by proxy and entitled to vote at the annual meeting is necessary for advisory approval of the compensation of our named executive officers as disclosed in this proxy statement. Your vote on this item is advisory, and it will not be binding on the Company or the Board of Directors. However, the Compensation, Nominating and Governance Committee expects to take the outcome of the vote into account in connection with future executive compensation decisions.

The affirmative vote of a majority of the shares entitled to vote at the annual meeting is necessary for approval of the amendment and restatement of our Certificate of Incorporation.

The affirmative vote of a majority of the shares present or represented by proxy and entitled to vote at the annual meeting is necessary to ratify the appointment of KPMG LLP as our independent registered public accounting firm for the year ending December 31, 2013.

Abstentions from voting and broker non-votes will not be deemed to have been cast either for or against approval of the matters to be considered and voted upon at the annual meeting. Abstentions and broker non-votes will have no effect on the outcome of voting for the election of directors, and will have the effect of a vote against the advisory vote regarding approval of the compensation of our named executive officers disclosed in this proxy statement, against approval of the amendment and restatement of our Certificate of Incorporation, and against ratification of the appointment of KPMG LLP as our independent registered public accounting firm.

Security Ownership of Certain Beneficial Owners

The following table sets forth information as of February 20, 2013 with respect to beneficial ownership of the Company s common stock by any person or group as defined in Section 13(d)(3) of the Securities Exchange Act of 1934 who is known by the Company to be the beneficial owner of more than five percent of the common stock.

Name and Address of Beneficial Owners	Number of Shares; Nature of Beneficial Ownership[1]	Percent of Common Stock Owned[2]
BlackRock, Inc. 40 East 52nd Street New York, NY 10022	22,925,875[3]	%
State Street Corporation State Street Financial Center One Lincoln Street Boston, MA 02111	18,792,862[4]	%
The Vanguard Group, Inc. 100 Vanguard Boulevard Malvern, PA 19355	20,514,534[5]	%

(1) Based on information in the most recent Schedule 13D or 13G filed with the Securities and Exchange Commission pursuant to the Securities Exchange Act of 1934, unless otherwise indicated.
(2) Shares reported as owned as of date indicated on the Schedule as filed, expressed as a percentage of shares outstanding as of February 20, 2013.
(3) BlackRock, Inc. reports having sole voting and dispositive power with respect to all of these shares.
(4) State Street Corporation reports having shared voting and dispositive power with respect to all of these shares.
(5) The Vanguard Group, Inc. reports having sole voting power with respect to 612,249 such shares, sole dispositive power with respect to 19,929,348 such shares, and shared dispositive power with respect to 585,186 such shares.

We do not know of any other person who is the beneficial owner of more than 5% of the Company s common stock as of the specified date.

Security Ownership of Management

The following table sets forth, as of February 20, 2013, the beneficial ownership of common stock by each director, each nominee for election as a director, each named executive officer (as defined below) who is not also a director, and by all directors and executive officers as a group. Except as indicated in the notes following the table, each person has sole voting and investment power with respect to the shares listed as being beneficially owned by such person.

	Common Stock	
	Amount and Nature of Beneficial Ownership	Percent of Class
Directors and Nominees		
John P. Barnes	811,530	*
Collin P. Baron	401,455	*
Kevin T. Bottomley	151,686	*
George P. Carter	447,774	*
John K. Dwight[(a)]	218,007	*
Jerry Franklin[(b)]	287,152	*
Janet M. Hansen	330,869	*
Richard M. Hoyt	381,494	*
Mark W. Richards[(a)]	274,489	*
Kirk W. Walters	536,807	*
Named Executive Officers[(c)]		
Robert R. D Amore	1,257,655	*
Lee C. Powlus	132,884	*
Jeffrey J. Tengel	180,368	*
All Directors, Nominees and Executive Officers as a Group (17 persons)	6,398,166	%

* Denotes beneficial ownership of less than one-half of one percent of the outstanding shares of common stock.

(a) Does not include additional shares owned by a non-qualified benefit trust for the benefit of Messrs. Dwight (94,235 shares) and Richards (147,497 shares) with respect to which the named directors have neither investment nor voting authority.

(b) Mr. Franklin has pledged 12,500 of the shares owned by him as security for a loan from Synovus Bank.

(c) The named executive officers consist of (1) the Chief Executive Officer (Mr. Barnes), the Chief Financial Officer (Mr. Walters), and (2) the three most highly compensated executive officers of the Company other than the Chief Executive Officer and Chief Financial Officer who were serving as executive officers at year-end.

Stock ownership totals include shares of common stock that are: vested but remain subject to transfer restrictions (Column A); subject to forfeiture if certain conditions are not satisfied (Column B); held indirectly through benefit plans (Column C); or subject to acquisition whether upon the exercise of stock options or otherwise within 60 days from February 20, 2013 (Column D), as follows:

	A	B	C	D
Directors:				
John P. Barnes		152,187	5,447	475,137
Collin P. Baron	13,714	7,419		194,415
Kevin T. Bottomley		7,419	19,982	
George P. Carter	13,714	16,419		236,679
John K. Dwight	13,714	7,419		106,928
Jerry Franklin	13,714	7,419		194,415
Janet M. Hansen	13,714	7,419		194,415
Richard M. Hoyt	13,714	7,419		194,415
Mark W. Richards	13,714	7,419		106,928
Kirk W. Walters		124,240	4,098	275,988
Named Executive Officers:				
Robert R. D Amore		44,745	56,572	774,970
Lee C. Powlus		38,008	2,461	79,520
Jeffrey J. Tengel		67,230	657	100,651
All Directors, Nominees and Executive Officers as a Group (17 persons)	95,998	677,313	111,445	3,546,461

A small number of shares are held indirectly in benefit plans but remain subject to forfeiture if certain conditions are not satisfied. These shares are included in Column C but not in Column B. The number of shares reported in this manner is 316 shares for Mr. Tengel and 1,146 shares for all directors, nominees and executive officers as a group.

ITEM I. ELECTION OF DIRECTORS

Our Certificate of Incorporation currently provides for the election of directors by the shareholders and for the division of the Board of Directors into three classes of directors as nearly equal in number as reasonably possible. The terms of office of the members of one class expire and a successor class is elected for a three-year term at each annual meeting of shareholders. If Item III (proposed amendment and restatement of our Certificate of Incorporation to provide for the annual election of directors) is approved by the requisite vote, the terms of all directors will expire at the annual meeting of shareholders each year and the directors successors will be elected for one-year terms that will expire at the next annual meeting. If Item III is approved, the nominees for election at the Annual Meeting, if elected, will have terms expiring at the 2014 Annual Meeting. The current terms of the directors who were elected at the 2011 and 2012 Annual Meetings will not be affected and those directors will continue to hold their offices until their terms expire in 2014 and 2015, respectively.

Our Certificate of Incorporation provides that there will be between five and fifteen members of the Board of Directors, as fixed by resolution of the Board of Directors. The Board of Directors has resolved that there will be ten members of the Board following the 2013 Annual Meeting. Therefore, at the Annual Meeting, four directors will be elected to serve for one-year terms or, if Item III is not approved, for three-year terms. The terms of Kevin T. Bottomley, John K. Dwight, Janet M. Hansen and Mark W. Richards expire at the 2013 Annual Meeting, and each has been nominated for re-election. Each nominee has consented to being named in this proxy statement and to serve as a director of People s United if elected. Directors elected at the annual meeting will serve until their respective successors have been elected and qualified. The persons named in the proxy intend to vote shares under the authority granted by the proxy for the election of all nominees named below. If any of the nominees should be unable to serve, the persons named in the proxy will use their discretion in voting the shares represented by such proxies.

Certain information concerning the nominees and the directors continuing in office, including ages as of March 1, 2013 and the business experience of each during the past five years, is set forth below. Information regarding each director s length of service as a director of the Company includes such person s term of service as a director of People s United Bank (which we refer to as the Bank), if he or she was elected prior to 2007.

The Board of Directors recommends that shareholders vote for the election of each of the nominees listed below.

NOMINEES TO THE BOARD OF DIRECTORS

Kevin T. Bottomley, age 60, served as President and Chief Executive Officer of Danvers Bancorp, Inc. and its principal subsidiary, Danversbank, from 1996 until the merger of Danvers with the Company in July 2011. Mr. Bottomley became a member of the Company s Board on July 1, 2011 when the merger became effective. He is a member of the Treasury and Finance Committee and of the Bank s Loan Review and Trust Committees. Mr. Bottomley also serves as chairman of the board of directors of The Danversbank Charitable Foundation, Inc.

Mr. Bottomley has extensive experience in the financial services industry. In addition to his executive positions with Danvers, Mr. Bottomley had served as Chairman of the Danvers Board of Directors since 2003. Prior to joining Danvers, he was the Chief Lending Officer and Executive Vice President at Boston Private Bank & Trust Company. Mr. Bottomley began his career at Bankers Trust in 1976 in the Asia Pacific Division in the Reverse Multinational Group and in its London Branch. Mr. Bottomley earned his undergraduate degree from Harvard College in 1974 and his MBA from the University of Virginia in 1976.

Mr. Bottomley s qualifications to serve on the Board include his demonstrated experience in executive leadership, strategic planning and governance of a public company. As a resident of northeastern Massachusetts, Mr. Bottomley adds geographic diversity to the board, and is a valuable source of insight and knowledge regarding the banking market in this portion of the Bank s market area, including the greater Boston region.

John K. Dwight, age 68, became a member of the Board of Directors on January 1, 2008 following completion of the merger of Chittenden Corporation into People s United. Mr. Dwight had served as a director of Chittenden since 1999. He is the founder and Chairman of Dwight Asset Management Company, a registered investment advisor managing over $60 billion in fixed income assets for insurance companies, stable value funds, and other institutional clients. Mr. Dwight is a former director of Old Mutual Asset Management US Holdings, Inc., a founding member of the Stable Value Investment Association and the Vermont Security Analysts Chapter. In addition, Mr. Dwight is a Trustee of St. Lawrence University and the Shelburne Museum.

Mr. Dwight has more than 20 years experience as a director of a publicly-held bank holding company, having served as a director and member of the audit committee of Eastern Bancorp, Inc. (parent of Vermont Federal Bank), a director of Vermont Financial Services Corporation (parent of Vermont National Bank), and a director of Chittenden (parent of multiple banks).

In evaluating Mr. Dwight s qualifications as a director, the Board considered the contribution that his extensive expertise in the area of asset management and his considerable financial acumen has made to his board service. The Board determined that he brings to his role as director a strong proficiency in the area of analyzing and evaluating both company financial statements and complex financial instruments, which enhances his service not only as a member of the Board but also as a member of its Enterprise Risk and its Treasury and Finance Committees and as chair of the Bank s Trust Committee.

The Board also determined that the diversity of perspective of the Board as a whole benefits from Mr. Dwight s status as a resident of Vermont and a very active member of the greater Burlington, Vermont community. The Company has extensive operations in Vermont by virtue of its 2008 acquisition of Chittenden.

Janet M. Hansen, age 70, was employed as Executive Vice President of Aquarion Company, a diversified water management company, from 1995 until her retirement in March 2005. Mrs. Hansen served as Aquarion s Treasurer and Chief Financial Officer from 1992 through 1999. Aquarion was, until its acquisition by Kelda Group, plc in 2000, a publicly-held company listed on the New York Stock Exchange. Mrs. Hansen was President and Chief Executive Officer of Aquarion s principal operating subsidiary, Aquarion Water Company, from 2000 to 2003. She served in a variety of other financial positions during her 29 year tenure with Aquarion in addition to the positions specifically noted above.

Mrs. Hansen became a member of the Board of Directors in February 2004. She is Chairwoman of the Enterprise Risk Committee and a member of the Audit and Treasury and Finance Committees. She also serves on the Board of Directors of Bridgeport Hospital, and the University of Connecticut Foundation. Ms. Hansen served on the Board of Directors of Pennichuck Corporation (a publicly-owned holding company for a group of water utilities and related businesses) until the sale of that company in late January 2012. Mrs. Hansen is a graduate of Salem State College and has an MBA in Finance from the University of Connecticut. She is also a graduate of the Advanced Management Program and the International Senior Management Program at Harvard University.

In determining Mrs. Hansen s qualifications for the position of director, and her contributions to the Board s overall mix of skills and attributes, the Board noted that Mrs. Hansen s financial background and her past experience as Treasurer and Chief Financial Officer of a publicly-held company and as director and member of the Audit Committee of Pennichuck Corporation enhance her contribution to the Company s Audit and Treasury and Finance Committees.

In her various roles at Aquarion, Mrs. Hansen had extensive experience with the preparation and evaluation of financial statements. She has a detailed understanding of generally accepted accounting principles, internal controls, and financial reporting procedures. She is also intimately familiar with the role of a public company audit committee, having not only worked closely with Aquarion s audit committee, but also having served on the audit committees of Pennichuck Corporation, Gateway Bank (acquired in 1994 by a subsidiary of a predecessor to Bank of America Corporation), the Bank and the Company. For these reasons, the Board has identified Mrs. Hansen as an audit committee financial expert. Mrs. Hansen is also active in the Greater Bridgeport community, serving as a member of the audit committees of the University of Connecticut Foundation and Bridgeport Hospital.

Mark W. Richards, age 67, became a member of the Board of Directors effective January 1, 2008 immediately following completion of the merger of Chittenden into People s United. Mr. Richards had served as a director of Chittenden from 1999 until its merger with the Company. He is President of The Richards Group in Brattleboro, Vermont, an independent, full-service insurance and financial services firm specializing in providing risk management, employee benefits and investment advisory services to individuals, families, and businesses in southern and central Vermont and New Hampshire. Until 2008, Mr. Richards was also vice president and the majority owner of Lyon Travel Agency, a privately-owned provider of travel management services to more than 35,000 individuals annually. Mr. Richards is a member of the Audit and the Compensation, Nominating and Governance Committees. He also serves as a member of the Bank s Trust Committee.

Mr. Richards is a graduate of Williams College, and served as an officer in the U.S. Navy for three years.

The Board has determined that by virtue of his background in insurance-related financial services, Mr. Richards provides the Board with an important perspective, especially with respect to the Bank s wealth management division, which includes an insurance brokerage subsidiary. The Board also considered that Mr. Richards has more than 20 years experience as a director of a public company and director of a financial services organization, having formerly served as a director of Vermont Financial Services Corporation (parent of Vermont National Bank) from 1988 to 1999, and Chittenden (parent of multiple banks) from 1999 until Chittenden s merger into the Company effective January 1, 2008. In addition, the Board considered Mr. Richards more recent experience as a member of the Enterprise Risk Committee.

Mr. Richards is a resident of southern Vermont and an active member of the greater Vermont/New Hampshire community. Mr. Richards brings an element of geographic diversity to his service on the board and is able to provide insight and counsel to the entire Board with respect to this portion of the Bank s market area.

INFORMATION CONCERNING DIRECTORS CONTINUING IN OFFICE

Terms Expiring at the 2014 Annual Meeting

John P. Barnes, age 57, was named President and Chief Executive Officer of People s United on July 22, 2010. Mr. Barnes had been serving as interim President and Chief Executive Officer since April 25, 2010. Prior to that date, Mr. Barnes had served as Senior Executive Vice President and Chief Administrative Officer for People s United following the acquisition of Chittenden Corporation in early 2008. Mr. Barnes served as an Executive Vice President of Chittenden since 1997. He became a member of the Board in 2010 and is a member of the Enterprise Risk and the Treasury and Finance Committees and a member of the Bank s Loan Review and Trust Committees.

Mr. Barnes has worked in the financial services industry since 1983, when he joined Chittenden Bank after five years with the FDIC in Boston. He became Senior Vice President and Chief Credit Policy Officer in 1988. In 1990 he was named to head the Credit Policy and Administration division. In 2002, he was appointed Executive Vice President in charge of the newly formed Chittenden Services Group, which included Information Technology, Operations and other centralized services for the corporation. Mr. Barnes is a graduate of Northeastern University and received his MBA from the University of Vermont.

The Board believes that Mr. Barnes, as the Company s chief executive officer, has a critical role to play as a representative of management on the Board. For this reason, the Board expects that for as long as Mr. Barnes serves as the Company s chief executive officer, the Board will recommend him for election to the Company s Board of Directors. Mr. Barnes also serves as the Chairman of The People s United Community Foundation.

Collin P. Baron, age 65, is a member of the law firm of Pullman & Comley, LLC, a full-service law firm with offices in major Connecticut cities and in White Plains, N.Y. He has been affiliated with the firm since 1973. Mr. Baron became a director in 2001. He serves as a member of the Enterprise Risk Committee and chairs the Treasury and Finance Committee. He also serves as a member of the Bank s Loan Review Committee.

A graduate of the University of Virginia and the George Washington University National Law Center, Mr. Baron has more than 35 years of experience in corporate, health care and banking law. He is a member of the Connecticut Health Lawyers Association and National Health Lawyers Association. He is a member of the Banking Law Committee of the American Bar Association. He has also been an active member of the greater Bridgeport business, legal and philanthropic community.

In evaluating Mr. Baron s qualifications for board service, the Board determined that Mr. Baron s expertise in corporate and banking law, coupled with his past experience as a member of the Bank s and the Company s Board of Directors and thus his familiarity with both the Bank s and the Company s operations, qualify him to serve on the Company s Board and enhance the overall mix of skills among Board members.

The Board also considered the fact that Mr. Baron is a principal at a law firm that does business with the Bank and determined that this relationship does not compromise Mr. Baron s ability to serve effectively as a director of the Company. In February of this year, the Board determined that Mr. Baron met the criteria for independence under applicable NASDAQ listing standards.

Richard M. Hoyt, age 70, is affiliated with two privately held Connecticut-based companies. He is President and Chief Executive Officer of Chapin & Bangs Co., a steel service and processing center based in Bridgeport, Connecticut, and is Chairman and Chief Executive Officer of Lindquist Steels, Inc., a distributor of tool steel based in Stratford, Connecticut with operations in Columbia, South Carolina and Knoxville, Tennessee. He has occupied each of these positions for more than five years. In his role as chief executive officer of these companies, Mr. Hoyt has overall responsibility for all aspects of their business, including their financial condition and performance. Mr. Hoyt also serves as a director of Bridgeport Hospital and previously served as a director of the Yale New Haven Health System. Mr. Hoyt, a graduate of Yale University, was first elected as a director in 2002. Mr. Hoyt is a member of the Audit and Enterprise Risk Committees, and serves as chair of the Compensation, Nominating and Governance Committee.

In assessing Mr. Hoyt s qualifications for board service and the contributions he brings to the Board s total mix of skills and attributes, the Board gave favorable weight to Mr. Hoyt s perspective as a small business owner and his extensive involvement in the greater Bridgeport community, noting that Mr. Hoyt serves on the audit committee of Bridgeport Hospital. In addition, the Board gave positive consideration to Mr. Hoyt s past experience as a director of Connecticut Energy Corporation (former parent of the Southern Connecticut Gas Company) from 1992 until its acquisition by Energy East Corporation in 2002 and to his past service as a director of both the Bank and the Company, including his service on the Company s Board and its Audit and Compensation, Nominating and Governance Committees.

Terms Expiring at the 2015 Annual Meeting

George P. Carter, age 76, is the President of Connecticut Foods, Inc. Mr. Carter was first elected to the Board in 1976. He serves as the Company s non-executive Chairman, and also serves as Chairman of the Audit Committee and as a member of the Compensation, Nominating and Governance and the Enterprise Risk Committees, and the Bank s Loan Review Committee.

Mr. Carter has significant experience as a member of both the Board of Directors and the Audit Committee of a financial services company, having served as a member of the Bank s Board of Directors since 1976 and as a member of its Audit Committee since 1981. He became Chairman of the Bank s Audit Committee in 1987 and Chairman of the Audit Committee of the Company at the time of its formation in 2007. Mr. Carter is a graduate of Michigan State University, with a B.S. in business and has been a business owner since 1969. He is active in community and philanthropic affairs and serves as a member of the Board of Directors of The People s United Community Foundation and of Bridgeport Hospital.

In considering Mr. Carter s contributions to the Board and his skills and qualifications for board service, the Board noted that over his more than 30 years of board service Mr. Carter has developed a level of expertise in banking matters and an in-depth familiarity with the Company and its various businesses that enhance his contributions to the Board. The Board also cited the benefit to the Board s deliberative process provided by Mr. Carter s long-term perspective, noting that Mr. Carter has been a member of the Board throughout a number of business cycles.

Jerry Franklin, age 65, is the President and Chief Executive Officer of Connecticut Public Broadcasting Inc., a position he has held since 1985. Mr. Franklin was elected to the Board of Directors in 1997 and is a member of the Audit and Enterprise Risk Committees. Mr. Franklin also serves as chairman of the Bank s Loan Review Committee.

Mr. Franklin has spent his entire professional career in the communications field. Following his honorable discharge from the U.S. Air Force in 1970, Mr. Franklin received a bachelor of science in political science and journalism from Georgia Southern University and a master of arts in telecommunications management from Indiana University. Mr. Franklin s position with Connecticut Public Broadcasting involves overall responsibility for all aspects of that corporation s business, including its financial condition and performance. Specifically, Mr. Franklin has responsibility for oversight of that company s financial management, investment policies, and budget.

The Board has concluded that the Board as a whole benefits from the perspective provided by Mr. Franklin by virtue of his professional background and his experience as chief executive officer of a non-profit organization. In addition, the Board considered the contributions Mr. Franklin has made to the Board by virtue of his experience as a director of the Bank (and a current member of its Loan Review Committee) and later the Company, a member of its Audit Committee and a former member of its Compensation, Nominating and Governance Committee.

Kirk W. Walters, age 57, joined People s United on March 16, 2011 as a Senior Executive Vice President and Chief Financial Officer. He was also appointed as a member of the Board of Directors of the Company on that date. Mr. Walters had most recently served as Senior Executive Vice President and a member of the board of directors of Santander Holdings USA, Inc., the parent company of Sovereign Bank. He joined Sovereign in February 2008 as Executive Vice President and Chief Financial Officer and served as interim President and Chief Executive Officer from October 2008 until Banco Santander acquired the bank in February 2009. Prior to joining Sovereign, Mr. Walters was Executive Vice President and Chief Financial Officer of Chittenden Corporation from 1996 to 2008. Mr. Walters is a member of the Company s Enterprise Risk Committee and the Bank s Loan Review and Trust Committees.

Mr. Walters, who holds an undergraduate degree in accounting from the University of Southern California, has worked in the banking industry for more than 25 years, much of it in the Northeast. This experience and his position as the Company s chief financial officer are significant factors in the Board s evaluation of Mr. Walters qualifications for service as a director of the Company.

Except as set forth above, during the past five years no director or nominee has had a principal occupation or employment with People s United or any of its subsidiaries or other affiliates. No director or nominee is related by blood, marriage or adoption to an executive officer of People s United or any of its subsidiaries or other affiliates.

With the exception of Messrs. Barnes, Bottomley and Walters, each person nominated for reelection as a director at the 2013 annual meeting and each of the directors continuing in office is independent for purposes of the applicable listing standards of The Nasdaq Stock Market.

Meetings of the Board of Directors and its Committees

During 2012, our Board of Directors held 15 meetings. No director attended fewer than 75% of the aggregate of (a) the total number of meetings of the Board of Directors held while he or she was a director and (b) the total number of meetings held by all committees of the Board on which he or she served.

The Board of Directors of People s United encourages all directors to attend the annual meeting of shareholders. All ten of the individuals serving as directors of People s United at the time of the 2012 annual meeting of shareholders attended that meeting.

Board of Directors Committees

Our Board of Directors has four standing committees: the Audit Committee; the Compensation, Nominating and Governance Committee; the Enterprise Risk Committee; and the Treasury and Finance Committee. The charters of each of these committees are posted on our website (www.peoples.com) under the heading Investor Relations Corporate Governance Board and Committee Structure.

***Audit Committee*.** The Audit Committee met 11 times during 2012. The Audit Committee was established in accordance with Section 3(a)(58)(A) of the Securities Exchange Act of 1934. Each member of the Audit Committee is independent, as that term is defined in Rule 5605(a)(2) of the listing standards of The Nasdaq Stock Market. Each member of the Audit Committee also satisfies the more stringent definition of independence required for members of audit committees generally, as set forth in Rule 5605(c)(2)(A) of the listing standards of The Nasdaq Stock Market. The members of the Audit Committee are George P. Carter (Chairman), Jerry Franklin, Janet M. Hansen, Richard M. Hoyt and Mark W. Richards. The Audit Committee is responsible for monitoring the Company s accounting practices and internal controls, including the supervision of an annual audit of our financial statements by independent registered public accountants.

Our Board of Directors has adopted a written charter for the Audit Committee, including provisions recognizing the specific audit committee responsibilities imposed by the Sarbanes-Oxley Act of 2002, Securities and Exchange Commission rules implementing that Act, and the listing standards of The Nasdaq Stock Market. A copy of the charter is available on the Bank s website at www.peoples.com.

The Board of Directors has determined that Janet M. Hansen, a member of the Audit Committee, qualifies as an audit committee financial expert within the meaning of applicable Securities and Exchange Commission regulations.

Compensation, Nominating and Governance Committee. The Compensation, Nominating and Governance Committee of People s United, which is comprised of Richard M. Hoyt (Chairman), George P. Carter, and Mark W. Richards, met 10 times during 2012. Each member of this committee is independent, as that term is defined in Rule 5605(a)(2) of the listing standards of The Nasdaq Stock Market. Each member of the Compensation, Nominating and Governance Committee also satisfies the more stringent standards for members of compensation committees generally, as set forth in Rule 5605(d)(2)(A)(ii) of the listing standards of The Nasdaq Stock Market. The Compensation, Nominating and Governance Committee is responsible for making policy decisions concerning the Company s compensation and benefit programs, and conducts periodic performance reviews of the senior and executive officers of the Company. The Compensation, Nominating and Governance Committee also recommends nominees for election as directors to the full Board of Directors of the Company. A current copy of the Compensation, Nominating and Governance Committee charter is available on the Bank s website at www.peoples.com. This charter will be updated prior to July 1, 2013 to reflect the provisions of Rule 5605(d)(3) of the listing standards of The Nasdaq Stock Market.

The Compensation, Nominating and Governance Committee engages an independent compensation consultant to assist it in the annual compensation process. The consultant is retained by and reports to the Compensation, Nominating and Governance Committee. The consultant provides expertise and information about competitive trends in the employment marketplace, including established and emerging compensation practices at other companies. The consultant also provides survey data, and assists in assembling relevant comparison groups for various purposes and establishing benchmarks for particular components of core compensation from the survey and comparison group data. The Committee engaged the firm of Towers Watson to serve as its independent compensation consultant during 2012.

Management may engage one or more consultants to provide additional information, advice, and professional services related to other aspects of the compensation and benefits function. These consultants work primarily with management but may also communicate directly with the Compensation, Nominating and Governance Committee. The consultant engaged to assist the Compensation, Nominating and Governance Committee in the annual compensation process may also be engaged to perform some of these additional services.

The total amount of fees paid to Towers Watson for services rendered in 2012 was $186,847. Of this amount, $177,729 was for services relating to executive and director compensation, and $9,118 was for other services.

The Compensation, Nominating and Governance Committee has adopted a policy requiring that the terms of engagement of the compensation consultant be set forth in an annual engagement agreement, with such agreement to set forth the scope of work to be undertaken in connection with matters relating to executive compensation. The engagement agreement also requires the compensation consultant to provide periodic reports to the Committee of any work performed by the consultant for People s United or any of our affiliates, other than work relating to executive compensation. The purpose of this policy is to ensure that the Committee maintains an appropriate level of control over the compensation consultant and its activities on behalf of the Company and our affiliates. Towers Watson s work on behalf of the Committee and the Company has not raised any conflicts of interest.

Enterprise Risk Committee. The Enterprise Risk Committee met 11 times during 2012. The Committee is comprised of Janet M. Hansen (Chairwoman), John P. Barnes, Collin P. Baron, George P. Carter, John K. Dwight, Jerry Franklin, Richard M. Hoyt and Kirk W. Walters. The Enterprise Risk Committee assists the Board of Directors in its oversight of management s implementation of the Company s enterprise-wide risk management process, makes recommendations to the Board concerning the Company s risk tolerance, and assesses the Company s corporate strategy in light of its risk tolerance.

Treasury and Finance Committee. The Treasury and Finance Committee met six times during 2012. The Committee is comprised of Collin P. Baron (Chairman), John P. Barnes, Kevin T. Bottomley, John K. Dwight, and Janet M. Hansen. The Treasury and Finance Committee assists the Board of Directors in its oversight of the Company s asset-liability management goals and strategy.

Board Leadership Structure; Board s Role in Risk Oversight

Leadership Structure. In November 2008, the Board elected George P. Carter, who at that time was serving as the Company s Lead Director, as its independent, non-executive Chairman of the Board. Prior to this time, the President and Chief Executive Officer also served as Chairman of the Board of Directors. The non-executive Chairman must be an independent director of the Company, as that term is defined pursuant to the listing requirements established by The Nasdaq Stock Market, Section 10A of the Securities Exchange Act of 1934, and, because Mr. Carter occupies the same position on the Board of Directors of the Bank, the rules and regulations of the Federal Deposit Insurance Corporation relating to the independence of directors.

In his role as non-executive Chairman of the Board, Mr. Carter s responsibilities include chairing meetings of the Company s board of directors; approving Board agendas and meeting schedules and ensuring appropriate information flow; acting as liaison between the non-management members of the Board and management; meeting periodically with the Chief Executive Officer for informal discussion concerning major issues involving the Company; and providing input to the Compensation, Nominating and Governance Committee concerning the performance of the Chief Executive Officer.

The Board adopted this structure during a time of unexpected leadership transition at the Company. It believed that separating the position of Chief Executive Officer and Chairman and assigning the Chairman s responsibility to an independent director with long tenure as a member of the Board of Directors would benefit the Company by providing leadership continuity to the Board and management during this transition period and would provide support to the Company s incoming Chief Executive Officer as he assumed his new duties. The Board believes that good corporate governance requires having an independent director assume a formal board leadership role, and the Company s Bylaws were amended in 2010 to require that the Chairman of the Board be an independent director. In view of this requirement, the Bylaws were also amended to eliminate the position of Lead Director at that time.

Board s Role in Risk Oversight. Given the importance of the Bank s operations to the Company and the possible impact of risks associated with Bank activities on the Company, the Company and the Bank have adopted an integrated risk management oversight structure designed to ensure that all significant risks are actively monitored by the Board or a board-level committee of either the Company or the Bank. All members of the Company s board of directors are also members of the Board of Directors of the Bank.

Role of the Enterprise Risk Committee. The Enterprise Risk Committee of the Board has been established to assist the Board in fulfilling its responsibility to oversee the Company s enterprise risk management (ERM) framework and associated policies and practices. The Enterprise Risk Committee has been assigned authority to oversee management s implementation of the Company s risk management process; to make recommendations to the full Board concerning the Company s risk appetite; and to assess the Company s corporate strategy in light of its risk appetite. The Enterprise Risk Committee s role is to oversee and monitor management s implementation of the Company s risk-management process; management is responsible for establishing and maintaining an effective risk management framework.

The Enterprise Risk Committee coordinates its oversight of enterprise risk with the Bank s Loan Review Committee (which oversees certain aspects of credit and concentration risk); the Treasury and Finance Committee (which oversees aspects of liquidity and interest rate risk); the Bank s Trust Committee (which oversees fiduciary risk); and the Compensation, Nominating and Governance Committee (which oversees incentive compensation risk). Additional information regarding the involvement of Board committees other than the Enterprise Risk Committee is provided below. Ultimate responsibility for oversight of risk throughout the entire enterprise rests with the Enterprise Risk Committee.

The primary responsibilities of the Enterprise Risk Committee include: (i) approving and overseeing the Company s ERM policy; (ii) ongoing monitoring of information demonstrating the Company s administration of its established ERM policy; (iii) evaluating the adequacy and effectiveness of the Company s ERM framework; (iv) monitoring the activities of the Chief Risk Officer and the Executive Risk Oversight Committee (EROC), a management-level committee comprised of senior executives including the Chief Executive Officer and Chief Financial Officer; and (v) reviewing information provided by management and the Compensation, Nominating and Governance Committee concerning the integration of risk management and control objectives into management goals and the Company s compensation structure.

The Enterprise Risk Committee also has responsibility to review management s assessments concerning specific risks, including: credit risk; market/interest rate risk; liquidity risk; incentive compensation risk; reputation risk; strategic risk; operational risk; compliance and regulatory risk; risk related to mergers and acquisitions, including risks associated with the due diligence process and integration risk; fiduciary risk and technology risk . The Enterprise Risk Committee will also receive additional updates and progress reports concerning the management of risks that contain elements that, in the opinion of management and/or the Committee, warrant an additional level of management reporting and oversight. The Enterprise Risk Committee has responsibility for oversight of the Company s operational risks. These include risks arising from fraud, error, or the inability to deliver products or services and manage information. It also monitors risk mitigation processes related to information and physical security, business continuity and compliance.

The Company s Chief Risk Officer is the head of the Company s Risk Management Division and is the individual designated by the Board to administer the Company s ERM program. Primary responsibilities of the Chief Risk Officer include: (i) formulation of the Company s risk appetite statement and framework; (ii) establishment of appropriate processes to ensure that deviations from risk appetite triggers and limits are identified, reported to executive management and the Enterprise Risk Committee, and corrective action is taken in a timely manner; (iii) development and implementation of the Company s ERM program framework; (iv) establishment, implementation and administration of certain risk management policies for the Company; and (v) ensuring appropriate communication of and training with respect to risk management-related topics. The Chief Risk Officer monitors compliance with the triggers and limits established in the risk appetite statement on an ongoing basis, reporting quarterly to EROC and the Enterprise Risk Committee concerning the Company s compliance with such parameters. In the event that a risk appetite trigger or limit is breached (even if the breach is subsequently corrected), or it is apparent that the trigger or limit level is being approached, the Chief Risk Officer reports the matter to EROC and the Enterprise Risk Committee at the next scheduled meeting of each group (or sooner, if deemed appropriate by the Chief Risk Officer) and, working with the applicable business unit, develops an action plan to address the matter. The action plan is presented for approval by EROC and the Enterprise Risk Committee at the next scheduled meeting of the applicable committee.

The Company maintains policies and procedures for the reporting by employees of risk-related issues, violations or breaches to a senior member of the Risk Management Division, and for the escalation of such matters to the Chief Risk Officer. Under the Company s Code of Conduct, any employee who in good faith reports an issue is entitled to protection against retaliation for reporting the issue.

In addition to the Enterprise Risk Committee s general risk oversight role, responsibility for detailed oversight of specific types of risks has been delegated to various Company and Bank board committees, as follows:

Internal Control Risk. In addition to its oversight of all aspects of the Company s annual independent audit and the preparation of the Company s financial statements, the Company s Audit Committee has been assigned responsibility for oversight of risks associated with the Company s internal controls, legal risks, compliance with applicable laws and regulations, ensuring the establishment and implementation of codes of conduct and overseeing response to reports of examination. The Bank s Audit Committee has a similar role with respect to oversight of risks associated with the Bank s internal controls, legal risks, compliance with applicable law and oversight of response to Bank reports of examination.

Market/Interest Rate/Liquidity Risks. The Treasury and Finance Committee has been charged with overseeing management of the Company s interest rate, liquidity, currency and similar market risks. In fulfilling its responsibilities the Committee oversees the implementation of the Company s asset liability management policies and activities undertaken in connection with such policies. The Treasury and Finance Committee monitors the Company s liquidity positions and liquidity risk management activities, interest rate risk management process and overall interest rate risk profile, the sensitivity of the Company s earnings under varying interest rate scenarios and considers the risks to the Company associated with potential changes in market interest rates. The Treasury and Finance Committee also monitors economic and interest rate trends with a view toward limiting any potential adverse impact on the Company s earnings.

The Treasury and Finance Committee oversees Company investment activities to ensure compliance with both regulatory requirements and applicable policy. It reviews significant financial risk exposures in its investment and derivatives portfolios, and the steps management is taking to monitor and control such exposures. It also monitors management of the Company s treasury functions by the Treasury group, including: management of the Company s securities portfolio; short-term investments and securities purchased under agreements to resell; wholesale borrowings; and in general the Company s overall funds management processes. The Treasury group acts as the Company s centralized funding center for all business segments, which includes managing interest rate risk through the use of derivative financial instruments.

Credit Risk. The Bank s Loan Review Committee oversees and monitors risk related to the Bank s lending activities. Among other things, it reviews and approves lending strategies and policies; approves asset quality standards with respect to all lending areas, including standards for loan concentrations and liquidity; and monitors concentrations of credit by product, industry and geographic area. The Committee approves appropriate general underwriting policies with respect to all lending areas and monitors adherence to such policies; and approves credit policies. The Committee also monitors asset quality trends, reviews classified loans, charge-offs and delinquencies and approves strategies and policies regarding the acquisition, management and disposition of foreclosed property.

Risks Associated with Compensation Programs. The Company s Compensation, Nominating and Governance Committee has been delegated responsibility for oversight of the Company s and the Bank s various compensation programs. As part of its duties, the Compensation, Nominating and Governance Committee is responsible for evaluating whether any of these programs contain features that promote excessive risk-taking by employees, either individually or as a group. In addition, the Enterprise Risk Committee will review management s assessment of risks posed by incentive compensation programs.

Communications with the Board

Shareholders who wish to communicate with the Board of Directors of People s United or with individual members of the Board may address correspondence to the Board or to a director, c/o Corporate Secretary, People s United Financial, Inc., 850 Main Street, Bridgeport, CT 06604. The Corporate Secretary will review all correspondence addressed to the Board or to a director, and will handle each item in accordance with procedures that have been approved by the independent directors.

The policies described in this section do not apply to shareholder proposals made pursuant to Securities and Exchange Commission Rule 14a-8, or to communications relating to those shareholder proposals.

Section 16(a) Beneficial Ownership Reporting Compliance

Section 16(a) of the Securities Exchange Act of 1934 requires our directors and executive officers, and persons who own more than 10% of our common stock, to file initial reports of ownership and reports of changes in ownership of the common stock with the Securities and Exchange Commission. Based solely on a review of the reporting forms received by People s United, and written representations that no other reports were required, we believe that during 2012, all reports that were required to be filed under Section 16(a) were filed on a timely basis.

Compensation Committee Interlocks and Insider Participation

The Compensation, Nominating and Governance Committee of our Board of Directors is composed solely of individuals who are neither officers nor employees of People s United, or any of our direct or indirect subsidiaries. The current members of the Compensation, Nominating and Governance Committee are Richard M. Hoyt (Chairman), George P. Carter, and Mark W. Richards. During the fiscal year ended December 31, 2012, there were no interlocks, as defined under the rules and regulations of the Securities and Exchange Commission, between members of the Compensation, Nominating and Governance Committee or executive officers of People s United and corporations with which such persons are affiliated.

Director Nominations

The Company s certificate of incorporation and bylaws provide that nominations of candidates for election as directors may be made only by the Board of Directors or by a registered shareholder.

Shareholders of record may nominate candidates by following the nomination provisions specified in the Company s certificate of incorporation. Shareholders may submit nominations in writing to People s United Financial, Inc., 850 Main Street, Bridgeport, Connecticut 06604, Attention: Corporate Secretary, no later than 120 days in advance of the next annual meeting at which directors will be elected or, if directors are to be elected at a special meeting of shareholders held for that purpose, no later than the close of business on the seventh day following the earlier of (i) the date on which notice of the special meeting was first given to shareholders, or (ii) the date on which a public announcement of that meeting was first made. Each shareholder nomination must include: the name and address of the shareholder(s) of record who intends to appear in person or by proxy to make the nomination; the name and address of each person being nominated; a description of all arrangements or understandings between the shareholder(s) submitting the nomination and the nominee(s) and any other person(s) (including the name of such person(s)) concerning the nomination(s) to be made by the shareholder(s); such other information regarding each nominee proposed by such shareholder as would have been required to be included in a proxy statement filed pursuant to the proxy rules of the Securities and Exchange Commission; and the consent of each prospective nominee to serve as a director of the Company if elected.

Role of Compensation, Nominating and Governance Committee. The Compensation, Nominating and Governance Committee identifies possible candidates for Board service and is charged with responsibility for evaluating proposed nominations, including those proposed by shareholders. The Committee selects those nominees who will be presented for election by the shareholders, or appointed by the Board of Directors in the case of vacancies arising between annual meetings.

Identification of Proposed Nominees. Prospective candidates for election to the Board of Directors can be identified in several ways. First, any current member of the Board whose term is expiring, who is not disqualified from serving an additional term by reason of age pursuant to the Company s bylaws, and who has indicated his or her willingness to stand for re-election is automatically considered to have been proposed as a possible candidate.

Second, prospective candidates for Board service may be identified by members of the Committee through informal recommendations from other members of the Board or other parties. Although the Committee has not previously done so, it may in the future decide to retain the services of a search firm to assist it in identifying appropriate candidates for Board service.

Finally, the Company has announced its intention to grow through acquisitions of other financial services companies. The Company has in the past and may in the future appoint one or more members of the board of an acquired institution to the Company s Board.

Evaluation of Proposed Nominees. In evaluating the qualifications of proposed candidates for nomination for election to the Board, including candidates recommended by shareholders, the Compensation, Nominating and Governance Committee will consider the following factors:

With respect to nominations made by a shareholder, the Committee will consider whether the nomination complies with the requirements of Section 5.06 of the Company s certificate of incorporation.

The Committee has also established minimum qualifications for board service, which are applied to all potential candidates, including current Board members proposed for re-election. The Compensation, Nominating and Governance Committee will not nominate any person for election to the Board of Directors if, in the opinion of the Committee:

actual or apparent conflicts of interest exist that would substantially interfere with the ability of such person to fulfill his or her duties as a director;

the person would not, or could not, effectively represent the best interests of People s United and all of its shareholders;

board service would be prohibited under any applicable law or regulation, including, but not limited to, federal banking regulations prohibiting interlocking directorships; or

the nomination did not comply with the requirements of Section 5.06 of our certificate of incorporation.

In addition to the minimum qualifications outlined above, in evaluating proposed nominees, the Committee will consider the following factors:

whether, in the opinion of the Committee, the nominee exhibits personal qualities, including personal and professional integrity, judgment and collegiality, that will ensure that the nominee will work effectively with the rest of the Board in serving the long-term best interests of People s United and its shareholders;

the skills, personal attributes and professional qualifications of the nominee, in light of the total mix of skills, personal attributes and professional qualifications found within the Board as a whole;

- the extent to which the nominee would enhance the diversity of perspective and life experience among members of the Board;

- whether, in the opinion of the Committee, the nominee has demonstrated a commitment to the betterment of the communities that the Company serves; and

- whether the nominee would be considered independent for purpose of service on the Board or any of its committees. Lack of independence will not, by itself, render a candidate unqualified for Board service; however, it is the Board s intention that a substantial majority of Board members shall at all times qualify as independent under the listing standards of The Nasdaq Stock Market and any other applicable laws or regulations.

Within this general framework, the weight given by the Committee and by each Committee member to any particular factor may differ, depending on whether the proposed nominee is a current member of the Board who is being considered for re-election, has been identified as a possible candidate through informal recommendations from other Board members or other parties or is being appointed to the Board in the context of an acquisition. For example, the evaluation process for a current Board member being considered for re-election will focus on the individual s personal qualities and skills, as reflected in his or her actual performance as a director of the Company. The Committee s evaluation of a candidate proposed to be newly-elected to the Board might give greater weight to the individual s professional qualifications in light of the mix of professional qualifications found within the Board as a whole.

The Committee would expect to follow a somewhat different process for evaluating the qualifications of candidates, depending on the source of the recommendation. The process for evaluating current Board members proposed for re-election is simpler than the process for evaluating newly-elected directors. A more in-depth evaluation would have been performed at the time the individual was first proposed for election. Additionally, the Committee has personal knowledge of the individual s strengths and weaknesses as a Board member, and does not need to solicit information from third parties or conduct interviews.

The evaluation process for directors appointed to the Board in the context of an acquisition would also be simpler than the process for evaluating candidates recommended by other Board members or shareholders, because the Company may be contractually obligated to select a candidate from among the members of the board of the entity being acquired. In this instance, the evaluation process consists of reviewing information about the professional and business experience of board members who have expressed an interest in the position. Potential candidates will also meet with the Chairman of the Board (who is also a member of the Compensation, Nominating and Governance Committee) and the Chief Executive Officer. The Committee then makes its selection based on feedback provided by the Chairman and Chief Executive Officer, and its evaluation of the candidates qualifications and personal qualities, based on the factors outlined above.

The Company has only been in existence since April 2007. Therefore, some aspects of the Committee s evaluation process have not yet been put into actual practice. The Company has never received any proposed nominations from shareholders and has therefore not had the occasion to evaluate the qualifications of any such nominee. Since the Company s creation, in addition to the re-election of current Board members to new terms, the Company has filled board positions resulting from one vacancy and five newly-created positions, as follows:

- The Company s agreement to merge with Chittenden contained a provision that two members of the Chittenden board would join the Company s Board following the completion of the merger. As a result, Messrs. Dwight and Richards, both former directors of Chittenden, were appointed to newly-created positions on the Board effective January 1, 2008, contemporaneously with the Company s acquisition of Chittenden.

- On February 6, 2008, Philip R. Sherringham was appointed to serve as the Company s President and Chief Executive Officer, following the death of the Company s previous President and Chief Executive

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Officer, John A. Klein. Also on this date, the Board appointed Mr. Sherringham to the Board of Directors, to fill the vacancy resulting from Mr. Klein s death.

On July 22, 2010, Mr. Barnes was appointed to a newly-created position on the Board, concurrent with his appointment as President and Chief Executive Officer of the Company.

On March 17, 2011, Mr. Walters was appointed to a newly-created position on the Board, in connection with his appointment as Senior Executive Vice President and Chief Financial Officer of the Company.

The Company s agreement to merge with Danvers Bancorp, Inc. contained a provision that one member of the Danvers board would join the Company s Board following the completion of the merger. As a result, Mr. Bottomley, formerly a director and the President and Chief Executive Officer of Danvers, was appointed to a newly-created position on the Board effective July 1, 2011, contemporaneously with the Company s acquisition of Danvers.

The Committee seeks candidates who will bring a diversity of perspective and life experience to their board service, and it does not restrict its definition of diversity to any particular personal attribute, such as race or gender. The Committee has taken this approach because it recognizes that there are a myriad of personal characteristics, including not only race and gender but also attributes such as physical disability, national origin, geographic location, socio-economic background, professional experience, religious affiliation and prior military service, that may contribute to an individual s diversity of perspective. Because the Committee s definition of diversity is broadly defined, it does not have a policy requiring consideration of any particular personal attribute or attributes in evaluating the qualifications of potential candidates.

Audit Committee Report

The Audit Committee of People s United has: (1) reviewed and discussed the Company s audited consolidated financial statements for the year ended December 31, 2012 with management of People s United; (2) discussed with KPMG LLP, the independent registered public accounting firm for People s United, the matters required to be discussed by Statement on Auditing Standards No. 61 (Communication with Audit Committees); (3) received the written disclosures and the letter from KPMG LLP required by applicable professional standards concerning auditor independence; and (4) discussed with KPMG LLP its independence.

Based on the review and discussions referred to in the preceding paragraph, the Audit Committee recommended to the Board of Directors of People s United that the audited consolidated financial statements of People s United as of and for the fiscal year ended December 31, 2012 be included in the Company s Annual Report on Form 10-K for filing with the Securities and Exchange Commission.

Audit Committee

George P. Carter, Chairman

Jerry Franklin

Janet M. Hansen

Richard M. Hoyt

Mark W. Richards

Compensation Committee Report

The Compensation, Nominating and Governance Committee has reviewed and discussed the Compensation Discussion and Analysis required by Item 402(b) of Securities and Exchange Commission Regulation S-K with management of People s United. Based upon such review and discussion, the Compensation, Nominating and Governance Committee recommended to the Board of Directors that the Compensation Discussion and Analysis be included in this proxy statement.

Compensation, Nominating and Governance Committee

Richard M. Hoyt, Chairman

George P. Carter

Mark W. Richards

Compensation Discussion and Analysis

This section includes information about the executive compensation practices of People s United, and includes information about compensation paid to our executives by subsidiaries and affiliates of the Company. This discussion is focused specifically on the compensation of the executive officers named in the Summary Compensation Table which appears later in this section. These executives are referred to in this discussion as the named executive officers.

Executive Summary. In 2012, People s United continued to make progress on the execution of our primary objectives optimizing existing businesses and efficiently deploying capital. Financial highlights for 2012 included:

Increase in net income to $245.3 million ($0.72 per share) from $192.4 million ($0.55 per share) for 2011.

Increase in operating earnings to $253.9 million ($0.75 per share) from $230.7 million ($0.66 per share) for 2011.

Continued strong loan and deposit growth within our legacy franchise and as a result of strategic revenue initiatives. For example, mortgage warehouse lending, asset-based lending, New York commercial real estate and equipment finance contributed to total loan growth of $1.4 billion, or 7%, in 2012. In addition, our total deposits increased by $935 million, or 4%, year-over-year.

Continued improvements in asset quality.

- For the originated loan portfolio, non-performing loans as a percentage of total originated loans improved to 1.30% at December 31, 2012 from 1.75% at December 31, 2011.
- Non-performing assets (excluding non-performing acquired loans) as a percentage of originated loans, other real estate owned and repossessed assets improved to 1.48% at December 31, 2012 from 2.00% at December 31, 2011.
- Non-performing loans in the acquired portfolio declined to $181.6 million at December 31, 2012 from $249.0 million at December 31, 2011.

Our efficiency ratio, which represents an approximate measure of the cost required to generate a dollar of revenue, improved to 62.4% for 2012 compared to 64.0% for 2011.

Returned more than $437 million to our shareholders in the form of dividends and share repurchases during 2012.

Please see our January 17, 2013 earnings release which was furnished as an exhibit to our Form 8-K filed on January 18, 2013 for an explanation of how operating earnings differs from net income and how we calculate our efficiency ratio, and for more information on the distinction between our originated and acquired loan portfolios.

The compensation program is based on pay for performance principles and designed to reward the named executive officers based on their level of management responsibility, the ability to direct employees toward the achievement of corporate goals and individual contribution and performance.

Despite the tough economic environment and continued historically low interest rates, the Company performed solidly against challenging goals during 2012. Both Company and individual performance impact compensation for the executives. The majority of our executives compensation mix is variable or at risk. The variable components of compensation are linked to the Company s performance against pre-established metrics and share price movement. Our variable compensation plans encourage executives to consider the impact their decisions have on both the short and long-range time horizons. Our executives compensation is closely aligned with the Company s performance and our incentive compensation payouts for 2012 reflected our performance over the past year (for annual cash incentives) and the past three years (for long-term cash-based incentives):

For the annual incentive, the Company established a goal based on operating earnings per share to determine the level of funding available for the payout of awards made pursuant to the plan. After the overall funding was determined, each individual executive s payout was finalized to reflect performance against his or her individual goals. Due to our solid financial performance in 2012, the payouts were near or at target levels. For the Chief Executive Officer and the other named executive officers, annual incentive payouts ranged from 90 100% of target within a total opportunity range of 0 200%.

For the 2010-2012 performance period, the long term cash based incentive was based on our total shareholder return relative to that of a designated peer group. As performance on that measure was below the threshold, no long term cash-based incentive payouts were made for the performance period that ended on December 31, 2012.

Overview. The Compensation, Nominating and Governance Committee of the Company s Board of Directors is responsible for overseeing and making recommendations to the independent members of the Board of Directors with respect to the compensation of the named executive officers, including the Chief Executive Officer. As part of these duties, the Committee conducts an annual performance review of the Chief Executive Officer and, in consultation with the Chief Executive Officer, reviews the performance of each other named executive officer. The independent members of the Board of Directors have ultimate authority to approve the compensation of all named executive officers, including the Chief Executive Officer.

The Compensation, Nominating and Governance Committee also reviews, oversees and approves the management and implementation of the Company s human resources policies and its principal employee benefit plans. The Committee may undertake other duties that are related to the Company s human resources function. The Committee has a formal charter which describes the Committee s scope of authority and its duties. The Committee s charter is available on the Bank s website at www.peoples.com.

The Compensation, Nominating and Governance Committee consists of three directors, all of whom are independent within the meaning of Rule 5605(a)(2) of The Nasdaq Stock Market and also satisfy the standards prescribed by Rule 5605(d)(2)(A)(ii) of The Nasdaq Stock Market. The Board of Directors evaluates the independence of Compensation, Nominating and Governance Committee members annually. This evaluation, and the determination that each member of the Committee is independent and satisfies the standards prescribed by Rule 5605(d)(2)(A)(ii) of The Nasdaq Stock Market, was most recently made in February 2013.

Executive Participation in Committee Discussions. The executive officers who participate in the Compensation, Nominating and Governance Committee s compensation-setting process are the Chief Executive Officer and the Chief Human Resources Officer. The Chief Financial Officer may participate to a limited extent in connection with the establishment of financially-driven performance goals. The Chief Risk Officer participates in at least one meeting annually to discuss the assessment of risk in the design and execution of the compensation programs. Executive participation is meant to provide the Compensation, Nominating and Governance

Committee with input regarding the Company s compensation philosophy, process and decisions. In addition to providing factual information such as company-wide performance on relevant measures, these executives articulate management s views on current compensation programs and processes, recommend relevant performance measures to be used for future awards, and otherwise supply information to assist the Compensation, Nominating and Governance Committee. The Chief Executive Officer also provides information about individual performance assessments for the other named executive officers, and expresses to the Compensation, Nominating and Governance Committee his view on the appropriate levels of compensation for the other named executive officers for the ensuing year.

Executives participate in Committee discussions purely in an informational and advisory capacity, but have no vote in the Committee s decision-making process. The Chief Executive Officer does not attend those portions of Compensation, Nominating and Governance Committee meetings during which his performance is evaluated (except to present his self-evaluation to the Committee) or his compensation is being determined. No executive officer other than the Chief Executive Officer and, on occasion, the Chief Human Resources Officer attends those portions of Compensation, Nominating and Governance Committee meetings during which the performance of the other named executive officers is evaluated or during which their compensation is being determined.

Compensation Objectives. The goals of the Company s executive compensation programs are to attract, motivate, retain, and pay key executives (including the named executive officers) for performance. The methods used to achieve these goals are strongly influenced by the compensation and employment practices of our competitors within the financial services industry, and elsewhere in the marketplace, for executive talent. Other considerations include each named executive officer s individual performance as well as the encouragement of behaviors directed towards attainment of corporate goals, not all of which are financial in nature or capable of being quantified.

The compensation program is designed to reward the named executive officers based on their level of assigned management responsibilities, individual performance levels, and individual value in the job marketplace. At-risk components of compensation reward the named executive officers, including the Chief Executive Officer, based primarily on company-wide performance while also considering their performance against individually-set performance objectives. The Chief Executive Officer s individual performance objectives are set by the Committee. For the other named executive officers, individual performance objectives are set by the Chief Executive Officer and are reviewed and approved by the Compensation, Nominating and Governance Committee. Equity-based components of compensation provide an incentive for executive behaviors that are aligned with the interests of shareholders. The retirement component of the compensation program rewards the named executive officers for their long-term contributions to the organization.

Components of Compensation. We use many different building blocks as part of our overall executive compensation program. Some are paid in cash, while others are based on our common stock. The principal components of executive compensation packages consist of:

- Base salary
- Annual cash bonus (also referred to as the Short-Term Incentive Plan (STIP) Bonus)
- Long-term incentives

Long-term incentives are awarded under the People s United Financial 2008 Long-Term Incentive Plan, or LTIP; the People s United Financial 2007 Recognition and Retention Plan, or RRP; and the People s United Financial 2007 Stock Option Plan, or SOP.

Awards under the LTIP are made in one of three forms:

- Long-term cash bonus (also referred to as the LTIP Bonus)
- Stock options
- Restricted stock grants

Beginning in 2013, long-term incentive awards under the LTIP will no longer include the LTIP Bonus as a component. This will not affect LTIP Bonus awards made in prior years.

Awards under the RRP are made in the form of restricted stock grants, and awards under the SOP are made in the form of stock options.

LTIP Bonuses are paid out at the end of a three-year performance cycle. Equity-based awards (stock options and restricted stock grants) under the LTIP, RRP and SOP vest incrementally over time, and in the case of stock options have value only if the market price of our common stock increases after the awards are made.

Named executive officers receive a variety of fringe benefits as compensation. Some of these are available to a broad range of employees. Others are limited to senior and executive officers. Fringe benefits for the named executive officers are:

Broad-based fringe benefits:

- Medical, dental and vision coverage (employee shares cost)
- Pre-tax health and dependent care spending accounts
- Adoption assistance
- Employee referral services
- Group life insurance coverage
- Short-term disability insurance coverage
- Long-term disability insurance coverage equal to 60% of base salary

Senior and executive officers only:

- Tax preparation services
- Financial planning services
- Annual $500 reimbursement for health club membership (discontinued after June 30, 2012)
- Automobile allowance and reimbursement of operating expenses
- Home security services (management committee members only) (discontinued after June 30, 2012)

People s United bears the expense of other club memberships for named executive officers, if the membership is used primarily for business-related purposes. Certain executives who do not reside permanently in the Bridgeport, Connecticut area are provided with local housing at our expense.

Retirement benefits represent an important source of compensation to the named executive officers. As with fringe benefits, some forms of retirement benefits are available to a broad range of employees, while others are limited to senior and executive officers who meet specified eligibility criteria. Retirement benefits are provided through these programs (tax-qualified plans are marked with an asterisk):

Broad-based retirement programs:

People s United Bank 401(k) Employee Savings Plan*

People s United Financial Employee Stock Ownership Plan*, or ESOP

Senior and executive officers only:

People s United Bank Non-Qualified Savings and Retirement Plan

Certain executive officers only:

Split-Dollar Cash Value Restoration Plan

Additional information about the LTIP can be found later in this section under the heading *Long-Term Incentive Plan* ; for the RRP under the heading *2007 Recognition and Retention Plan* ; for the SOP under the heading *2007 Stock Option Plan* ; for the Split-Dollar Cash Value Restoration Plan under the heading *Split-Dollar Cash Value Restoration Plan* , and for the 401(k) Employee Savings Plan, the ESOP, and the Non-Qualified Savings and Retirement Plan, in the discussion following the table headed Pension Benefits.

Mr. D Amore is entitled to benefits under the People s United Bank Employees Retirement Plan, the People s United Bank Cap Excess Plan, and the People s United Bank Enhanced Senior Pension Plan. Benefits under these plans were frozen as of December 31, 2011. Mr. Barnes and Mr. Powlus are entitled to benefits under the Chittenden Corporation Pension Account Plan. Benefits under this plan were frozen as of December 31, 2005. Additional information about these plans can be found in the discussion following the table headed Pension Benefits.

Say on Pay. At the 2012 annual meeting, our shareholders approved the compensation of our executive officers as presented in the proxy statement for that meeting, with approximately 95% of the votes cast in favor of approval. The Board of Directors elected to make no changes to the Company s executive pay practices based on the outcome of that vote. Other changes to our executive compensation programs, which are described below, were made for unrelated reasons.

Assembling the Components. The Compensation, Nominating and Governance Committee analyzes the level and relative mix of each of the principal components of the compensation packages for named executive officers on an annual basis. The Chief Executive Officer also makes recommendations to the Committee relating to compensation to be paid to the named executive officers other than himself. Based on this analysis and (where appropriate) the Chief Executive Officer s recommendations, the Compensation, Nominating and Governance Committee makes annual recommendations to the independent members of the Board of Directors about each named executive officer s compensation package to the extent derived from base salary, STIP Bonus and long-term incentives provided pursuant to the LTIP. This portion of executive compensation is also called core compensation.

Decisions about core compensation are made without reference to other elements of compensation (i.e., fringe benefits, retirement benefits, and non-core incentive awards under the RRP and SOP). With one exception, fringe benefits and retirement benefits are not specifically tailored for the named executive officers, and are provided under programs that provide similar benefits to non-executive employees of the Company. The Split-Dollar Cash Value Restoration Plan is an exception to this general rule. As noted in the section entitled *Split-Dollar Cash Value Restoration Plan*, this plan was created after enactment of the Sarbanes-Oxley Act of 2002 and the resulting termination of executive officers participation in the split-dollar life insurance program.

The RRP and the SOP have historically not been used to replace or supplement the LTIP as the source of incentive grants used in assembling the annual core compensation package for the named executive officers. Instead, grants under the RRP and the SOP have been approved by the Compensation, Nominating and Governance Committee to acknowledge and recognize significant contributions made to the organization by the proposed recipient, or if deemed necessary or appropriate in order to help attract or retain the services of the proposed recipient. For a discussion of grants made pursuant to these plans to named executive officers in 2012, see *Other Committee Actions*.

As noted above, beginning in 2013, long-term incentive awards under the LTIP will no longer include the LTIP Bonus as a component. This change is expected to result in an increase in the number of options and/or restricted shares awarded as part of the annual core compensation packages for named executive officers. The

Compensation, Nominating and Governance Committee may consider using the RRP and the SOP as a source of equity grants for core compensation purposes during the 2013 annual compensation cycle or in future years if the number of shares reserved for issuance pursuant to the LTIP becomes insufficient for this purpose.

The Compensation, Nominating and Governance Committee reviews the other components of executive compensation (fringe benefits and retirement benefits), but does not necessarily consider changes to those components on an annual basis. Changes to the level or types of benefits within these categories, including considerations relating to the addition or elimination of benefits and plan design changes, are made by the Compensation, Nominating and Governance Committee on an aggregate basis with respect to the group of employees entitled to those benefits, and not with reference to a particular named executive officer s compensation package. Decisions about these components of compensation are made without reference to the named executive officers core compensation packages, as they involve issues of more general application and often include consideration of trends in the industry or in the employment marketplace.

The Compensation, Nominating and Governance Committee seeks to create what it believes is the best mix of the principal components of core compensation in delivering the named executive officers core compensation. These components are evaluated in relation to benchmark data derived from information reported in publicly-available proxy statements or from market survey data. The companies which are the source of the benchmark data may be different for the Chief Executive Officer and for the other named executive officers, due to differences in the availability of reliable data for comparable executive positions below the Chief Executive Officer level. As discussed below under the heading *Committee Actions Affecting 2012 Compensation*, the Committee uses the benchmark data as a primary reference point when setting the Chief Executive Officer s compensation, and as a reference point when setting the compensation for the other named executive officers. Except in unusual circumstances, executive officer compensation is expected to fall within the parameters established by the benchmark data.

For each named executive officer, a significant percentage of core compensation is at-risk, meaning it will generally be earned or increase in value when the Company or the named executive officer is successful in ways that are aligned with and support shareholder interests. At-risk elements of compensation may have no value or may be worth less than the target value if applicable performance goals are not fully attained or the price of the common stock declines or remains flat after the date the at-risk compensation is awarded. At-risk compensation includes all components of core compensation other than base salary.

Assembly of the core compensation package for each named executive officer begins with the establishment of target ranges for the separate elements making up each named executive officer s core compensation package. The Compensation, Nominating and Governance Committee establishes these target ranges in consultation with the Chief Executive Officer and the independent compensation consultant. The target range for each element of core compensation for each named executive officer is generally between the 50^{th} and 75^{th} percentile of the benchmark data. Deviations from the target ranges may be made to account for a particular executive s experience, complexity of responsibility, value to the organization, and expertise in his or her field of responsibility. A number of these factors are subjective in nature.

Once the ranges have been established, the Compensation, Nominating and Governance Committee determines the base salary component for each named executive officer, including the Chief Executive Officer. In doing so, the Compensation, Nominating and Governance Committee reviews base salary information compiled by the compensation consultant from the sources described above, then formulates a recommendation for the base salary component of each named executive officer s compensation in relation to that information. The target base salary for the Chief Executive Officer is determined using the percentile target range established for the elements of his core compensation. The target base salary for each other named executive officer is based on target ranges for each element of core compensation. The target base salary for each named executive officer may then be adjusted on an individual basis to reflect one or more of the factors noted in the preceding paragraph.

The Compensation, Nominating and Governance Committee follows a similar process for each other element of core compensation using the target ranges established for the elements of core compensation.

The target amount of the STIP Bonus award and the target amount of the LTIP Bonus award are each expressed as a percentage of the executive s base salary for the ensuing year. The assumed value of stock options for purposes of assembling the compensation package is determined using the Black-Scholes option pricing model, and the assumed value of restricted stock grants is the fair value of the common stock, in each case determined as of a date reasonably close to the date the grants are made. The relative weighting of stock options, restricted stock grants and targeted LTIP Bonus awards is determined with reference to the competitive data made available to the Compensation, Nominating and Governance Committee. In each case, the Committee may decide to depart from the target levels so established, for the same reasons as discussed with respect to base salary.

The annual process of assembling target compensation packages for the named executive officers is forward-looking in nature. Actual performance over the applicable measurement period may exceed or fall short of the targets, and the common stock may be worth more or less in the future compared to valuations used in formulating equity-based awards. This means that when at-risk compensation is actually received by a named executive officer, it may be worth more or less to the executive than was expected at the time the award was initially made. This applies to forms of at-risk compensation paid out in cash (STIP Bonus and LTIP Bonus) or realized in the stock market from the exercise of stock options or sale of shares of restricted stock after vesting.

The value (or lack of value) realized by named executive officers from at-risk awards granted in prior years is not taken into account by the Compensation, Nominating and Governance Committee in the process of setting compensation for the current year. The Committee believes that doing so would be inconsistent with the underlying reasons for the use of at-risk compensation. If current year awards were increased to make up for below-target performance in prior years or decreased to account for above-target performance in prior years, the link between performance and reward would be diluted or eliminated. Named executive officers would have little incentive to improve performance if it meant decreased target awards in the future, or if the negative consequences for poor performance would be cushioned by increases in the target value of future awards. In addition, the value realized by a named executive officer from equity-based awards granted in prior periods depends in large measure on when the executive decides to realize that value by exercising options or by selling vested shares of restricted stock. The Committee does not believe it would be appropriate to adjust future grants in light of these types of individual decisions.

The objective of the annual compensation-setting process is to establish the appropriate level and mix of compensation for each named executive officer, in reference to the factors discussed above. Therefore, the Compensation, Nominating and Governance Committee believes that the accounting treatment of any given element of core compensation, while relevant, is not a fundamental consideration in the compensation-setting process.

For the same reasons, the Compensation, Nominating and Governance Committee considers, but does not give undue weight to, the tax treatment of each component of compensation. Under Section 162(m) of the Internal Revenue Code, annual compensation paid to a named executive officer is not deductible if it exceeds $1 million unless it qualifies as performance-based compensation as defined in the tax code and related tax regulations. Base salary and compensation derived from restricted stock awards are not forms of performance-based compensation. Many fringe benefits also do not qualify as performance-based compensation. Stock options are treated as a form of performance-based compensation because their value is entirely dependent on the performance of the common stock in the market after the date the option is granted. Short-term bonus and long-term cash bonus awards may qualify as forms of performance-based compensation under the income tax regulations.

The Compensation, Nominating and Governance Committee understands that People s United will not be able to deduct a certain portion of the compensation paid to the named executive officers if it does not qualify as performance-based compensation for tax purposes and exceeds the Section 162(m) limit. The Committee further understands that the absence of this deduction will increase the effective cost of such compensation. The Committee believes this represents an additional cost of doing business that should be borne by the organization as a result of non-tax decisions regarding the appropriate level and mix of compensation for each named executive officer.

The Committee will continue to monitor and review the Company s compensation policies in light of evolving corporate governance standards and the results of periodic say on pay votes by shareholders. It will consider revisions to compensation policies when, in the Committee s judgment, doing so would be consistent with the achievement of long-term success and the enhancement of shareholder value.

Linking Company Performance to Incentive Plan Funding. Each year, the Compensation, Nominating and Governance Committee establishes one or more prospective company-wide performance targets for use in making funding determinations that affect payment of STIP Bonuses and LTIP Bonuses. Actual performance is evaluated against the target performance measures after the close of the performance period to which the measures apply. The results of that comparison are used to calculate the level of funding available to pay STIP Bonuses and to determine payouts for LTIP Bonuses awarded for the applicable performance period.

For purposes of the STIP Bonus, each named executive officer is also evaluated on several performance objectives that are set at the beginning of the year and which are reviewed and revised as appropriate on a quarterly basis. These performance measures relate to the strategic business objectives of the organization for the year. Each named executive officer has a unique set of individual performance measures. The degree to which a named executive officer satisfies these individualized measures as well as competencies and overall performance rating is taken into account in determining the amount to be paid out to that executive as a STIP Bonus.

The target performance measures for the STIP are objective measures that reflect the Company s operating results for the year for which the target is established. The Committee has historically sought to ensure that attainment of the target performance measure is challenging yet achievable. When establishing a performance target in relation to results of operations, the Committee seeks to establish a target based on operating results derived from sources that are reasonably predictable and stable. Therefore, the Committee often specifies a target operating measure (such as earnings per share, or EPS) that is based on results from continuing operations. After the conclusion of the fiscal year, the Chief Executive Officer may suggest that the Committee consider additional adjustments to the target operational measures which are designed to eliminate the effects of extraordinary or unusual events. Some events for which these kinds of adjustments are made do recur from time to time, but are nevertheless considered to be extraneous to the conduct of normal day-to-day banking business. The Committee is not required to adopt the Chief Executive Officer s recommendations. For any given year, the Compensation, Nominating and Governance Committee may decide to establish performance measures in addition to or in place of operationally-based measures. For 2012, the Committee established a STIP performance target based on EPS. The EPS performance measure established by the Committee differs from EPS as reported under U.S. generally accepted accounting principles because it excludes the effects of certain non-routine items. For 2012, this measure was identical to non-operating EPS as reported by the Company from time to time during 2012 and in January 2013.

For purposes of determining the level of funding available to pay STIP Bonuses, actual performance for the relevant year is compared to the target performance measure(s) without reference to any external factors. If actual performance falls below the targeted level but at or above a minimum threshold level set by the Committee, funding for payment of STIP Bonuses on a reduced basis may be available.

The process is different for the LTIP Bonus. The actual amount paid out pursuant to an LTIP Bonus award is determined over a three-year performance cycle. A new performance cycle begins at the start of each calendar year. The Company s performance relative to the designated performance measure (total shareholder return, or TSR, as discussed below) over the entire three-year period will determine the amount to be paid out, without regard to the Company s performance during any one year within that period.

The amount actually payable to each named executive officer based on his or her LTIP Bonus award will be determined by People s United s total shareholder return, or TSR, for the full three-year performance period relative to the TSR for a peer group of financial institutions over the same period. TSR measures the change in value realized by shareholders over a specified time based on changes in stock price and total dividends paid. The peer group is designated by the Compensation, Nominating and Governance Committee at the beginning of the three-year performance period for which the target performance measure is set. The composition of the peer group is determined by the Committee with input from executive management and the Committee s independent compensation consultant, and may be updated from time to time as necessary to reflect changes (such as mergers) affecting the companies included in the group at the time the group was identified. LTIP Bonuses will be paid out at target if the Company s TSR for the designated period falls at the 50th percentile of the TSR for the peer group. If the Company s TSR relative to the TSR of the peer group falls below the 25th percentile of the peer companies, no payout will occur. LTIP Bonuses will be paid on a reduced basis if the Company s relative TSR is between the 25th and 50th percentile of peer group TSR. Likewise, LTIP Bonuses will be paid at levels greater than target if the Company s TSR is above the 50th percentile of the peer group TSR, and will be paid at a maximum of 150% of target if the Company s TSR is at or above the 75th percentile of the peer group TSR.

The Company has decided to discontinue using the LTIP Bonus as a component of long-term incentive compensation beginning in 2013 to be more in line with the practices of many companies in our peer group. This will have no effect on LTIP Bonus awards made in prior years.

Timing of Equity Grants. Stock option grants and restricted stock grants are effective as of the grant date, and options are priced at fair market value on the date of grant. The grant date is the date the equity awards are approved for issuance by the independent members of the Board of Directors, acting on recommendations made to them by the Compensation, Nominating and Governance Committee. The LTIP and the SOP each define fair market value as the average of the high and low price of the common stock on the grant date or, if the grant date is not a day when the stock market is open, on the most recent day for which trading data is reported by the market. Equity grants are only made to named executive officers during the normal annual compensation-setting cycle except under circumstances discussed under the heading *Exceptions to Usual Procedures*.

Stock Ownership Guidelines. People s United has adopted guidelines establishing expected levels of stock ownership by the named executive officers. In general, the Chief Executive Officer is expected to own shares valued at five times his base salary, while the other named executive officers are expected to own shares valued at three times base salary. These guidelines were adopted in September 2008 and updated in October 2010, with compliance to be achieved within a five-year phase-in period from the later of the date the guidelines were first adopted or the date of an executive s promotion or hire.

Exceptions to Usual Procedures. The Compensation, Nominating and Governance Committee may from time to time recommend to the independent members of the Board of Directors that they approve the payment of special cash compensation or the grant of special equity-based awards to one or more named executive officers in addition to payments and grants approved during the normal annual compensation-setting cycle. The Committee might make such a recommendation if it believes it would be appropriate to reward one or more named executive officers in recognition of contributions to a particular project, or in response to competitive and other factors that were not addressed during the normal annual compensation-setting cycle. On occasion, special payments are contingent on some period of future service by the named executive officer. All equity grants are subject to future vesting contingencies, which may be different than the vesting periods that apply to grants made during the normal annual compensation-setting cycle.

The Committee will generally make off-cycle compensation decisions and recommendations whenever a current employee is promoted to executive officer status, or an executive officer is hired. The Committee may depart from the compensation guidelines it would normally follow for executives in the case of outside hires.

Equity-based grants were made to the Chief Executive Officer pursuant to the RRP in 2012 outside the normal annual compensation-setting process. See *Other Committee Actions* for a more detailed discussion of this grant.

Rating Past Performance; Payout Decisions. The Committee is responsible for reviewing the actual performance of People s United against performance targets established in prior periods. The evaluation of performance in relation to those targets is essential to determining the extent to which cash bonuses are paid to or amounts are accrued for the benefit of named executive officers. For more information about these performance targets and how they are used, see *Linking Company Performance to Incentive Plan Funding* above.

The amount actually paid out to each named executive officer (including the Chief Executive Officer) pursuant to a STIP Bonus award depends on two factors: the extent to which the overall STIP Bonus pool is funded for the year; and the named executive officer s overall performance rating with respect to his or her individual performance measures and leadership competencies. The Chief Executive Officer evaluates the performance and leadership behaviors of all named executive officers other than himself, and makes recommendations to the Compensation, Nominating and Governance Committee based on those evaluations. The Compensation, Nominating and Governance Committee evaluates the performance and leadership behaviors of the Chief Executive Officer.

As discussed earlier, the Committee often specifies one or more target performance measures intended to fairly represent the results of continuing operations during the ensuing year. Events may occur during the course of the year which cause management to conclude that one or more of these measures as initially established does not in fact achieve its intended goal. In that case, the Chief Executive Officer may ask the Compensation, Nominating and Governance Committee to exercise discretion in deciding whether or to what degree the applicable performance measure has been attained or exceeded. The Committee may, but is not required to, exercise that discretion.

The extent to which the overall STIP Bonus pool for all eligible employees (including named executive officers) is funded is determined by the performance of the Company measured against the target performance metrics specified by the Compensation, Nominating and Governance Committee. The bonus pool is not funded unless at least a designated minimum percentage (as determined by the Committee) of the target performance measures are attained for the year. Maximum funding of the bonus pool will occur if actual performance equals or exceeds a designated percentage (as determined by the Committee) of the target performance measures.

Once the funding level has been determined, the Committee then decides whether to apply an overall funding adjustment factor. Application of this factor, which may be positive or negative, may result in an adjustment to the overall funding pool. The Compensation, Nominating and Governance Committee will consider applying an overall funding adjustment factor when the actual financial performance for the preceding year was extraordinarily different from expected performance, and when the Committee believes that actual performance was not primarily attributable to any particular operating unit or units within the organization.

Each named executive officer is also evaluated on several performance objectives that were set at the beginning of the previous year and which are reviewed and revised as appropriate on a quarterly basis. These performance measures relate to the strategic business objectives of the organization for the year. Each named executive officer has a unique set of individual performance measures. The degree to which a named executive officer satisfies these individualized measures is taken into account in determining the amount to be paid out to that executive as a STIP Bonus. No named executive officer can receive a STIP Bonus payout in excess of 200% of the target short-term cash bonus amount.

As discussed above under the heading *Linking Company Performance to Incentive Plan Funding*, the actual payout for the LTIP Bonus award is determined over a three-year period. Target LTIP Bonus awards are made to each named executive officer on an annual basis. As a result, in any given year there are three overlapping LTIP Bonus cycles in effect. At the end of the applicable three year performance period a decision regarding the actual payout is made based on the Company s relative TSR compared to a group of established peer companies. The composition of the peer group may change from year to year. See the discussion under the heading *Linking Company Performance to Incentive Plan Funding.* The maximum amount that may be paid out pursuant to an LTIP Bonus award upon expiration of a three-year bonus cycle is 150% of the individual participant s target LTIP Bonus established at the beginning of the three-year cycle.

Committee Actions Affecting 2012 Compensation. The Compensation, Nominating and Governance Committee took a variety of actions during 2012 that affected executive compensation for the year. These actions are described in greater detail below under the headings *Annual Compensation-Setting Process Chief Executive Officer*; *Annual Compensation-Setting Process Other Named Executive Officers*; *Establishing Performance Targets*; *Rating Past Performance*; and *Other Board and Committee Actions*. Early in 2013, the Compensation, Nominating and Governance Committee evaluated the performance of People s United against the target performance measures established in early 2012 and took other actions relating to calculation of actual payments and accruals for the STIP Bonus and LTIP Bonus based on 2012 performance. Actions taken by the Committee in 2012 with reference to performance measures established for 2011 are not included in the following discussion.

Annual Compensation-Setting Process Chief Executive Officer

In February 2012, the Committee recommended, and the independent members of the Board of Directors approved, the various components of the Chief Executive Officer s annual compensation package. Details regarding base salary, stock options, and restricted stock grants are included in the detailed compensation tables elsewhere in this proxy statement. Information about the STIP Bonus and LTIP Bonus target amounts established by the Committee for the Chief Executive Officer are included in this discussion. For 2012, the Committee selected the following companies for use in benchmarking the Chief Executive Officer s compensation package:

Associated Banc-Corp.	BancorpSouth, Inc.
City National Corp.	Comerica Inc.
Commerce Bancshares Inc.	Cullen/Frost Bankers, Inc.
East West Bancorp	FirstMerit Corporation
First Niagara Financial Group, Inc.	Fulton Financial Corp.
Huntington Bancshares Inc.	M&T Bank Corp.
New York Community Bancorp, Inc.	Susquehanna Bancshares, Inc.
Signature Bank	Synovus Financial Corp.
Valley National Bancorp	Wintrust Financial Corp.
Webster Financial Corp.	Zions Bancorporation

The companies in this group are all in the financial services industry. All companies listed in the peer group had a market capitalization between $1 billion and $11 billion at the time the companies were selected. Other factors used in selecting these companies were asset size and loan portfolio size. Compensation information for companies included in the peer group was obtained by reviewing publicly available proxy statements and other relevant filings made with securities regulatory authorities.

For 2012, the Committee established the target value of Mr. Barnes core compensation package at approximately $3.1 million. This placed Mr. Barnes in the 63rd percentile for core compensation paid to chief executive officers of the companies included in the peer group. This target was established based on the recent financial performance of People s United, Mr. Barnes estimated value in the marketplace, and the Committee s view of the Chief Executive Officer s critical role in the future success of the Company.

After establishing the target value for Mr. Barnes overall core compensation package, the Committee made detailed determinations for each element of that package in order to arrive at the desired overall result:

Base Salary: The Committee set Mr. Barnes base salary at $950,000 representing a 5.6% increase from his base salary in 2011. Mr. Barnes base salary represented approximately 31% of the target value of his core compensation package, consistent with the Committee s philosophy of emphasizing the at-risk components of core compensation for executive officers.

STIP Bonus: Mr. Barnes STIP Bonus target for 2012 was established at 100% of his base salary for 2012. The actual amount to be paid out to Mr. Barnes will be determined based on the financial performance of People s United for the year. The amount paid out will not exceed 200% of the target amount. See *Rating Past Performance* below for a discussion of the amount paid out to Mr. Barnes pursuant to this award.

The Committee established Mr. Barnes STIP Bonus target at this level in part based on market practice and trends, and in part to achieve the desired mix between base compensation and at-risk compensation.

Long-Term Incentives: To arrive at the desired total target value of Mr. Barnes core compensation package for 2012, and in light of the levels of base salary and STIP Bonus award already determined, the Committee established the target value of the long-term incentive portion of Mr. Barnes compensation package for 2012 at approximately $1.2 million. The target value of the long-term incentive portion of Mr. Barnes compensation package is made up of the target value of the LTIP Bonus award, the value of stock options using the Black-Scholes option pricing model, and the assumed value of restricted stock grants. Option values and assumed restricted stock grant values were based on the stock price as of a date reasonably close to the actual grant date.

The relative mix of the three components of Mr. Barnes long-term incentive compensation package was designed so that approximately three-quarters of the target value would be attributable to equity-based forms of compensation. The Committee considered this weighting to be an appropriate means of aligning Mr. Barnes compensation with the long-term interests of People s United s shareholders.

Mr. Barnes LTIP Bonus target for the three-year performance cycle beginning with 2012 was established at approximately 31% of his base salary for 2012. The actual amount to be paid out to Mr. Barnes will be determined based on the Company s TSR compared to the TSR of the designated peer group during the three year period of 2012-2014. The amount paid out will not exceed 150% of the target amount.

The Committee recommended the award to Mr. Barnes of options to purchase 136,809 shares of People s United common stock. Additional information about these options is contained in the Summary Compensation Table and the table headed *Grants of Plan-Based Awards* and accompanying discussion, all of which appear below. The actual value realized upon the exercise of these options will depend on the market value of our stock at the time of exercise. The target value of these stock options represented approximately 25% of Mr. Barnes long-term compensation for 2012**,** reflecting the Committee s decision to weight equity-based awards towards stock grants rather than towards options.

The Compensation, Nominating and Governance Committee also recommended the award to Mr. Barnes of 47,557 shares of People s United common stock, subject to vesting restrictions. Additional information about these restricted shares is contained in the Summary Compensation Table and the table headed *Grants of Plan-Based Awards* and accompanying discussion, all of which appear below. The target value of these shares represented approximately 50% of Mr. Barnes long-term compensation for 2012.

All Compensation, Nominating and Governance Committee actions taken with respect to the compensation packages for Mr. Barnes were presented as recommendations for approval by the independent members of the Board of Directors. All of the Committee s recommendations regarding the compensation packages for Mr. Barnes were approved by the independent members of the Board of Directors.

See *Other Committee Actions* for a more detailed discussion of additional restricted stock grants made to Mr. Barnes in 2012.

Annual Compensation-Setting Process Other Named Executive Officers. In February 2012, the Compensation, Nominating and Governance Committee recommended, and the independent members of the Board of Directors approved, the various components of the annual compensation packages for Messrs. D Amore, Powlus, Tengel and Walters. Details regarding base salary, stock options, and restricted stock grants made to all of the named executive officers are included in the detailed compensation tables elsewhere in this proxy statement. Information about the STIP Bonus and LTIP Bonus target amounts established by the Committee for Messrs. D Amore, Powlus, Tengel and Walters is included in this discussion.

The Committee began the compensation-setting process for the four named executive officers by referring to internally developed broad guidelines which specify target dollar ranges for executive compensation. These guidelines are based in large part on competitive trends in the employment marketplace, including established and emerging compensation practices at other companies. The Committee initially established the overall level of core compensation for each of these named executive officers within the guideline ranges after considering the recent performance of People s United and the contribution of each named executive officer to those results, the value of each executive s job in the marketplace, and the criticality of each named executive officer to the future success of People s United in attaining its goals. The Committee next evaluated these preliminary compensation decisions in comparison to the compensation of executives having comparable responsibilities at companies in a peer group designated by the Committee. This peer group was different from the peer group used to establish the Chief Executive Officer s compensation, due to the limited amount of data available for comparable executive positions in the first peer group.

For 2012, the companies making up the peer group used as a comparison reference for the compensation packages for the other named executive officers were:

Associated Banc-Corp	Fulton Financial Corp.
City National Corp.	Huntington Bancshares Inc.
Comerica Inc.	M&T Bank Corp.
Commerce Bancshares Inc.	Synovus Financial Corp.
Cullen/Frost Bankers Inc.	Webster Financial Corp.

The companies in this group all participate in relevant executive compensation surveys sponsored by the Committee s independent compensation consultant. Each of these companies is also included in the peer group used as a comparison reference for the Chief Executive Officer s compensation.

The Committee compared its preliminary compensation decisions for the four named executive officers with the peer group data to ensure that those preliminary decisions did not deviate significantly from market practice.

The target value of the four named executive officers core compensation packages, as established by the Committee for 2012 following the steps outlined above and based on equity valuation assumptions as of a date reasonably close to the Committee s action, each fell within or slightly above the third quartile for core compensation paid to executive officers performing similar duties with the companies included in the peer group. The decision to provide certain named executive officers with core compensation packages having target values in excess of the 75th percentile for peers was considered appropriate in view of the value of the officers services to the Company and in view of the officers experience, complexity of responsibility, and expertise in their respective fields of responsibility.

After establishing the target value for each named executive officer s overall core compensation package, the Committee made detailed determinations for each element of that package in order to arrive at the desired overall result:

Base Salary: The Committee first set the 2012 base salary for each named executive officer within target dollar ranges contemplated by the internal guidelines. Base salaries were as follows: Mr. D Amore, $441,775; Mr. Powlus, $417,300; Mr. Tengel, 441,775; and Mr. Walters, $625,200. Salary increases for the four named executive officers represented a combination of normal annual increases of approximately 5.4% compared to base salaries for 2011. At these levels, base salaries represented approximately one-third of the target value of each named executive officer s core compensation package.

STIP Bonus: The 2012 STIP Bonus targets for these four named executive officers were established as a percentage of base salary for 2012. Mr. Walters target STIP Bonus for 2012 was 90% of base salary, and the target STIP Bonus for each other named executive officer was 80% of base salary. The actual amount to be paid out to each named executive officer will be determined in part based on the financial performance of

People s United for the year and in part based on the other factors discussed under the heading *Rating Past Performance; Payout Decisions*. The amount paid out will not exceed 200% of the target amount. See *Rating Past Performance* below for a discussion of the amounts paid out to the named executive officers pursuant to these awards.

The Committee established the named executive officers STIP Bonus targets at these levels in part based on market practice and trends, and in part to achieve the desired mix between base compensation and at-risk compensation.

Long-Term Incentives: To arrive at the desired total target value of the four named executive officers core compensation packages for 2012, and in light of the levels of base salary and STIP Bonus awards already determined, the Committee established the target value of the long-term incentive portion of each named executive officers core compensation packages for 2012 at 120% of base salary for Messrs. D Amore, Tengel and Walters, and at 110% of base salary for Mr. Powlus. The target value of the long-term portion of each named executive officer s compensation package reflects the target value of the LTIP Bonus award, the value of stock options using the Black-Scholes option pricing model, and the assumed value of restricted stock grants. Option values and assumed restricted stock grant values were based on the stock price as of a date reasonably close to the actual grant date.

The relative mix of the three components of these executives long-term compensation packages was designed so that approximately three-quarters of the target value would be attributable to equity-based forms of compensation. The Committee considered this weighting to be an appropriate means of aligning executive compensation with the long-term interests of the Company s shareholders.

The LTIP Bonus targets established for the four named executive officers for the three-year performance cycle beginning with 2012 represent 25% of each executive s long-term incentive compensation target for 2012, or between 28% and 30% of each named executive officer s base salary. The actual amount to be paid out will be determined based on the Company s TSR compared to the TSR of the designated peer group during the three year period of 2012-2014. The amount paid out will not exceed 150% of the target amount.

The Compensation, Nominating and Governance Committee recommended the award of options to purchase shares of People s United common stock to the four named executive officers as follows:

	Optioned Shares	**Target Value**
Mr. D Amore	61,075	$ 132,533
Mr. Powlus	52,884	$ 114,758
Mr. Tengel	61,075	$ 132,533
Mr. Walters	86,433	$ 187,560

Additional information about these options is contained in the Summary Compensation Table and the table headed *Grants of Plan-Based Awards* and accompanying discussion, all of which appear below. These options will have no value unless the market value of our common stock is higher than the exercise price of the options. The actual value realized by each named executive officer upon his exercise of these options will depend on the market value of the Company s stock at the time of exercise. The target value of these stock options represented approximately 25% of each named executive officer s long-term compensation for 2012, reflecting the Committee s decision to weight equity-based awards towards stock grants rather than towards options.

The Compensation, Nominating and Governance Committee also recommended the award of shares of People s United common stock, subject to vesting restrictions, to the four named executive officers as follows:

	Restricted Shares	Target Value
Mr. D Amore	21,231	$ 265,065
Mr. Powlus	18,383	$ 229,515
Mr. Tengel	21,231	$ 265,065
Mr. Walters	30,046	$ 375,120

Additional information about these restricted shares is contained in the table headed *Grant of Plan-Based Awards* below. The actual value realized by each named executive officer from these shares will depend on the market value of our stock at the time he chooses to sell such shares. The target value of these shares represented approximately 50% of each named executive officer s long-term compensation for 2012 based on estimated values for stock options and shares of restricted stock at the time compensation recommendations were formulated.

All Compensation, Nominating and Governance Committee actions taken with respect to the four named executive officers were presented as recommendations for approval by the independent members of the Board of Directors. The Chief Executive Officer participated in the development of these recommendations but did not vote on the adoption of these recommendations by the Committee. All of the Committee s recommendations regarding the compensation of the four named executive officers were approved by the independent members of the Board of Directors in February 2012.

Establishing Performance Targets. In February 2012, the Committee established the performance targets for purposes of determining actual payouts for the 2012 STIP Bonus. The Committee specified a performance target equal to budgeted EPS from continuing operations for the year, or $0.80. The EPS measure established by the Committee differs from EPS as reported under U.S generally accepted accounting principles because it excludes the effects of certain non-routine items.

Management advised the Committee that it considered this target to be challenging in light of a variety of factors, including: continuing weakness in the credit markets; the Company s conscious decision to favor preservation of capital over investment yield; the continuing low interest rate environment; and the general competitive environment for 2012. The Committee thus viewed the performance targets to be challenging yet achievable goals based on this information.

For purposes of the LTIP Bonus awards, the Committee specified the Company s TSR relative to a group of peers for the three-year performance period (2012-2014) as the sole performance measure. This peer group was identical to the peer group used in setting the Chief Executive Officer s compensation for 2012.

Rating Past Performance.

In January 2013, the Compensation, Nominating and Governance Committee evaluated the Company s actual performance during 2012 against the STIP performance target established in February 2012 and the LTIP performance target established in February 2010. For 2012, EPS from continuing operations was $0.75 representing approximately 94% of the performance target established by the Committee at the beginning of 2012. Based on these results, management recommended, and the Committee approved, funding for the overall STIP Bonus pool at 90% of target, consistent with the funding metrics approved at the beginning of 2012.

The Compensation, Nominating and Governance Committee evaluated People s United s TSR relative to the group of peer companies for the purpose of determining LTIP Bonus payouts for the 2010-2012 performance cycle. The Company s TSR for the three-year period ended December 31, 2012 was -16.4%, which ranked in the 17th percentile of the designated peer group. As a result, no LTIP Bonus payouts were made for the three-year performance period ended December 31, 2012.

In determining the 2012 STIP Bonus payouts for the other named executive officers, the Compensation, Nominating and Governance Committee considered the Chief Executive Officer s evaluation of each named executive officer s performance against the individual set of previously-established key performance measures and leadership competencies for each officer. The types of personal objectives established for each named executive officer depend on their respective areas of responsibility. Objectives for executive officers in charge of a business line are focused on attainment of specified revenue, profitability and cost-containment goals. Objectives for executive officers in charge of staff functions include cost containment measures and also focus on process improvement and business integration goals. The level of accomplishment is weighed across all goals to arrive at an overall rating of performance for incentive compensation purposes. Incentive compensation payout ratios for a named executive officer may range from zero to 200% of the target payout for that officer, depending on the level of funding available for the overall incentive compensation pool (determined solely by reference to the Company s performance with respect to the established EPS performance measure) and the overall performance rating for the individual officer. The personal objectives and/or key performance measures established for our named executive officers in 2012 were as follows:

Named Executive Officer	*Key Performance Measures*
Mr. Barnes	Earnings per share; revenue growth; expense control; asset quality; risk management; and project-related goals (e.g., process improvement and business integration)
Mr. D Amore	Revenue growth; loan growth; expense control; deposit growth; and asset quality
Mr. Powlus	Expense control; fee revenue; and project-related goals (e.g., process improvement and business integration)
Mr. Tengel	Revenue growth; loan growth; expense control; deposit growth; and asset quality
Mr. Walters	Earnings per share; revenue growth; expense control; risk management; and project-related goals (e.g., process improvement and business integration)

The Committee evaluated the performance of each of the named executive officers relative to their respective performance measures. Based on those evaluations, the Committee determined that each of the named executive officers met or exceeded expectations with respect to their individual goals. The Committee also considered the leadership behaviors exhibited by each of the named executive officers during the year. As a result of the Committee s evaluation and its recommendations to the full Board, the Board authorized STIP Bonus payouts to the named executive officers ranging from 90-100% of target within the overall opportunity range of zero to 200%. The decision to make no payout with respect to LTIP Bonus awards for the three-year performance period ended December 31, 2012 was made solely on the basis of the Company s total shareholder return for that period and was not affected by individual performance.

Based on each individual s level of achievement and the level of funding available in the STIP Bonus pool, the Committee recommended, and the independent members of the Board of Directors approved, payouts of STIP Bonuses for each named executive officer, as follows:

	Payout Amount	Payout as Percentage of STIP Bonus Target
Mr. Barnes	$ 950,000	100%
Mr. D Amore	$ 318,078	90%
Mr. Powlus	$ 300,456	90%
Mr. Tengel	$ 318,078	90%
Mr. Walters	$ 506,412	90%

Additional information about STIP Bonus awards is contained in the table headed *Grant of Plan-Based Awards* below. No named executive officer received any LTIP Bonus payout for the three-year performance period ended December 31, 2012.

Other Board and Committee Actions.

Special Restricted Stock Award. On February 16, 2012, the Committee recommended and the Board of Directors approved a special restricted stock award of 50,000 shares of the Company s common stock to Mr. Barnes in recognition of the Company s outstanding business performance in 2011 and to help align Mr. Barnes level of ownership of Company stock with that of CEOs at peer companies. Although this award constitutes additional compensation to Mr. Barnes, the decision to make the award was not made for compensation-related reasons. For this reason, the award was not analyzed within the context of the Committee s normal compensation philosophy or standards, and represented an intentional departure from those guidelines.

Compensation Policies and Practices in Relation to Risk Management

The Company has considered the extent to which its compensation policies and practices influence the behaviors of our executives and other employees with respect to taking business risks that could affect the Company. We believe that our compensation policies and practices are not reasonably likely to have a material adverse effect on the Company, either individually or in the aggregate. Executive management, including the Company s Chief Risk Officer, will conduct an annual risk assessment of these policies and practices and will advise the Compensation, Nominating and Governance Committee of their findings and recommendations (if any) for changes to these policies and practices.

Summary Compensation Table

The following table sets forth a summary for the last fiscal year of the cash and non-cash compensation paid or awarded by People s United to its principal executive officer, its principal financial officer, and its three most highly compensated executive officers other than the principal executive officer and principal financial officer who were serving as executive officers at the end of the 2012 fiscal year (the named executive officers).

Name and Principal Position	Year	Salary ($)	Bonus ($)	Stock Awards ($)	Option Awards ($)	Non-Equity Incentive Plan Compensation ($)	Change in Pension Value and Nonqualified Deferred Compensation Earnings ($)	All Other Compensation ($)	Total ($)
John P. Barnes[1]	2012	$ 940,385	$	$ 1,237,900	$ 299,612	$ 950,000	$ 35,847	$ 240,684	$ 3,704,427
President and Chief Executive Officer	2011	890,384		577,707	287,766	1,726,130	28,081	239.983	3,750,051
	2010	699,379		859,376	317,031	788,290	12,462	200,665	2,877,203
Robert R. D Amore	2012	$ 439,703	$	$ 272,376	$ 133,754	$ 318,078	$ 351,795	$ 186,408	$ 1,702,114
Sr. Executive Vice President (Retail and	2011	429,323		267,807	132,296	610,224	791,905	159,196	2,390,750
Business Banking)	2010	420,632		248,527	117,878	378,480	537,798	119,008	1,822,323
Lee C. Powlus[2]	2012	$ 412,050	$	$ 236,349	$ 115,816	$ 300,456	$ 10,759	$ 178,926	$ 1,254,356
Sr. Executive Vice President (Chief Administrative Officer)									
Jeffrey J. Tengel[3]	2012	$ 435,664	$	$ 272,376	$ 133,754	$ 318,078	$ 1,306	$ 72,557	$ 1,233,735
Sr. Executive Vice President	2011	408,654		313,968	155,494	525,075	764	79,016	1,482,971
(Commercial Banking)									
Kirk W. Walters[3]	2012	$ 620,354	$	$ 383,886	$ 189,288	$ 506,412	$ 1,230	$ 189,689	$ 1,890,859
Sr. Executive Vice President (Chief	2011	468,461		1,562,117	997,238	810,000	353	257,050	4,095,218
Financial Officer)									

(1) Served as Senior Executive Vice President (Chief Administrative Officer) until April 25, 2010 and as Interim President and Chief Executive Officer from that date until July 22, 2010 when he was appointed President and Chief Executive Officer.

(2) Was not a named executive officer prior to 2012.

(3) Did not serve as an executive officer prior to 2011.

Amounts shown in the Stock Awards column reflect the value of the awards on the date granted. Stock awards are generally valued at the average of the high and low stock price on the grant date. The value attributed to stock allocated pursuant to the Employee Stock Ownership Plan, which we call the ESOP, is based on the closing price of People s United stock on the date the allocation was made. For more information on stock awards made to the named executive officers during 2012, see the table in this section entitled *Grants of Plan-Based Awards*.

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Amounts shown in the Option Awards column reflect the value of the awards on the date granted. Stock options are valued using the Black-Scholes option pricing model. For 2012, the assumptions shown in the following table were used for the purpose of valuing options granted on the indicated dates. Options granted on February 16, 2012 were granted pursuant to the Long-Term Incentive Plan (LTIP).

			Black-Scholes Assumptions			
Option Grant Date	**Option Value**	**Exercise Price**	**Dividend Yield**	**Expected Volatility Rate**	**Risk-free Interest Rate**	**Expected Term (Years)**
February 16, 2012	$ 2.19	$ 12.65	5.06%	32.56%	1.18%	6.01

The exercise price shown in the above table is equal to the fair value of the underlying stock on the grant date. For more information on option grants made to the named executive officers during 2012, see the table entitled Grants of Plan-Based Awards.

The amounts shown in the Non-Equity Incentive Plan Compensation column for 2012 reflect short-term incentive bonus payments made to the named executive officers in 2013 with respect to performance in 2012, and amounts paid to the named executive officers in 2013 as long-term incentive bonuses based on People s United s performance during the 2010-2012 performance cycle. Details of these amounts are as follows:

	Short-Term Incentive Bonus (STIP Bonus)	**Long-Term Incentive Bonus (LTIP Bonus)**
John P. Barnes	$ 950,000	$
Robert R. D Amore	$ 318,078	$
Lee C. Powlus	$ 300,456	$
Jeffrey J. Tengel	$ 318,078	$
Kirk W. Walters	$ 506,412	$

Amounts shown in the column headed Change in Pension Value and Nonqualified Deferred Compensation Earnings are for the twelve months ended December 31, 2012 which is the pension plan measurement date used by People s United for financial reporting purposes. This column includes above-market earnings on compensation deferred by the named executive officer under the Non-Qualified Savings and Retirement Plan, as follows: Mr. Barnes, $23,547; Mr. D Amore, $14,195; Mr. Powlus, $7,959; Mr. Tengel, $1,306; and Mr. Walters, $1,230. Information about these earnings and how they are calculated is shown in the table headed *Non-Qualified Deferred Compensation* and accompanying text.

Amounts shown as All Other Compensation are attributable to perquisites and other personal benefits, and to other items of compensation that are not reported elsewhere in the Summary Compensation Table. Perquisites and other personal benefits consist of: a company-supplied automobile or automobile allowance; tax preparation and financial planning services; for Messrs. D Amore, Powlus and Walters, the cost of providing local housing in the amount of $19,200, $35,400 and $22,800, respectively; the use by Messrs. Barnes, Powlus and Walters of a company-owned airplane to the extent such use was not considered under applicable regulations to be integrally and directly related to the performance of his duties ($44,301, $31,816 and $41,215, respectively, calculated as described below); and for Messrs. Barnes and D Amore, home security services. For Mr. D Amore, perquisites for 2012 include the cost of a club membership which was used primarily, but not exclusively, for business purposes.

In determining the value attributed to the use of the company-owned airplane, only direct flights between Bridgeport, Connecticut and Burlington, Vermont (or nearby airports if necessary due to weather conditions) were considered. The per-flight cost of each trip on which Mr. Barnes, Mr. Powlus or Mr. Walters was a passenger was divided by the number of Company employees on the same flight for purposes of determining the amount attributable to each of them for such trips. Fixed costs (such as the monthly third-party management fee) associated with the airplane were excluded in making this calculation.

Additional items shown as All Other Compensation for 2012 include: employer matching contributions and credits to the 401(k) Employee Savings Plan and the Non-Qualified Savings and Retirement Plan (Mr. Barnes, $100,690; Mr. D Amore, $37,990; Mr. Powlus, $34,916; Mr. Tengel, $17,427; and Mr. Walters, $41,591); employer retirement contributions and credits to the 401(k) Employee Savings Plan and the Non-Qualified Savings and Retirement Plan (Mr. Barnes, $75,731; Mr. D Amore, $28,707; Mr. Powlus, $26,402; Mr. Tengel, $27,830; and Mr. Walters, $42,911) the employer-paid portion of medical and/or dental insurance premiums (Mr. Barnes, $14,402; Mr. D Amore, $5,007; Mr. Powlus, $15,818; Mr. Tengel, $15,498; and Mr. Walters, $15,818); and for Messrs. D Amore, Powlus and Walters, a tax gross-up payment of $9,185, $18,171 and $11,419, respectively, with respect to the local housing expenses paid on their behalf. For Mr. D Amore, this amount also includes an increase of $67,960 during 2012 in the amount potentially payable to him in the future under the Split-Dollar Cash Value Restoration Plan.

The employer retirement credits made to the Non-Qualified Savings and Retirement Plan for certain named executive officers were made in 2013 with respect to services rendered during 2012 and, accordingly, are not reflected in the table entitled Non-Qualified Deferred Compensation appearing elsewhere in this section.

Grant of Plan-Based Awards. The following table sets forth information concerning grants of plan-based awards made in 2012 to the named executive officers under the Short-Term Incentive Plan, the Long-Term Incentive Plan, the 2007 Recognition and Retention Plan and the Employee Stock Ownership Plan. No grants were made during 2012 to any of the named executive officers under the 2007 Stock Option Plan.

Name	Grant Date[1]	Estimated Future Payouts Under Non-Equity Incentive Plan Awards[2] Threshold ($)	Target ($)	Maximum ($)	All Other Stock Awards; Number of Shares of Stock or Units (#)	All Other Option Awards; Number of Securities Underlying Options (#)	Exercise or Base Price of Option Awards ($/Sh)[3]	Closing Market Price on Grant Date ($)[3]	Grant Date Fair Value of Stock and Option Awards ($)
John P. Barnes	Jan. 26, 2012[4]				6			$ 12.63	$ 78
	Feb. 16, 2012[5]	$ 475,000	$ 950,000	$ 1,900,000					
	Feb. 16, 2012[6]	148,438	296,875	445,313					
	Feb. 16, 2012[7]				47,557			12.70	601,596
	Feb. 16, 2012[7]					136,809	$ 12.65	12.70	299,612
	Feb. 16, 2012[8]				50,000			12.70	632,500
	Dec. 31, 2012[9]				308			12.09	3,726
Robert R. D Amore	Jan. 26, 2012[4]				6			$ 12.63	$ 78
	Feb. 16, 2012[5]	$ 176,710	$ 353,420	$ 706,840					
	Feb. 16, 2012[6]	66,266	132,533	198,799					
	Feb. 16, 2012[7]				21,231			12.70	268,572
	Feb. 16, 2012[7]					61,075	$ 12.65	12.70	133,754
	Dec. 31, 2012[9]				308			12.09	3,726
Lee C. Powlus	Jan. 26, 2012[4]				6			$ 12.63	$ 78
	Feb. 16, 2012[5]	$ 166,920	$ 333,840	$ 667,680					
	Feb. 16, 2012[6]	57,379	114,758	172,136					
	Feb. 16, 2012[7]				18,383			12.70	232,545
	Feb. 16, 2012[7]					52,884	$ 12.65	12.70	115,816
	Dec. 31, 2012[9]				308			12.09	3,726
Jeffrey J. Tengel	Jan. 26, 2012[4]				6			$ 12.63	$ 78
	Feb. 16, 2012[5]	$ 176,710	$ 353,420	$ 706,840					
	Feb. 16, 2012[6]	66,266	132,533	198,799					
	Feb. 16, 2012[7]				21,231			12.70	268,572
	Feb. 16, 2012[7]					61,075	$ 12.65	12.70	133,754
	Dec. 31, 2012[9]				308			12.09	3,726
Kirk W. Walters	Jan. 26, 2012[4]				6			$ 12.63	$ 78
	Feb. 16, 2012[5]	$ 281,340	$ 562,680	$ 1,125,360					
	Feb. 16, 2012[6]	93,780	187,560	281,340					
	Feb. 16, 2012[7]				30,046			12.70	380,082
	Feb. 16, 2012[7]					86,433	$ 12.65	12.70	189,288
	Dec. 31, 2012[9]				308			12.09	3,726

(1) For equity grants other than those made pursuant to the ESOP, this is the date grants were approved by the independent members of the Board of Directors. Share allocations made pursuant to the ESOP are made on the date shares are released by the ESOP trustee from the ESOP s loan repayment account in accordance with the terms of the plan, or as soon as administratively practicable following the date the Administrative Committee authorizes the reallocation of unvested shares forfeited by terminated plan participants to the accounts of then-current participants in the plan.

(2) The threshold payment for a STIP Bonus and for an LTIP Bonus is shown as 50% of the target amount. Zero payouts are also possible. The maximum payout with respect to a STIP Bonus award is 200% of the target amount. The maximum payout with respect to an LTIP Bonus award is 150% of the target amount.

(3) Exercise price is equal to fair market value which is defined in the Long-Term Incentive Plan as the average of the high and low stock price on the grant date. This will usually differ from the closing price on the grant date. The fair value of shares allocated to each executive pursuant to the ESOP is based on the closing price on the date the allocation is made.
(4) Reallocation of pro rata portion of unvested shares forfeited by terminated ESOP participants.
(5) STIP Bonus award for 2012, payable in 2013.
(6) LTIP Bonus award, payable at the end of the 2012-2014 performance cycle.
(7) Granted pursuant to Long-Term Incentive Plan.
(8) Granted pursuant to 2007 Recognition and Retention Plan.
(9) Allocated pursuant to ESOP.

The columns disclosing estimated future payouts under equity incentive compensation plans have been omitted from the table because no named executive officer earned any compensation during 2012 of a type required to be disclosed in those columns.

All stock and option awards shown in this table were made pursuant to the People s United Financial, Inc. 2008 Long-Term Incentive Plan, the People s United Financial, Inc. 2007 Recognition and Retention Plan and the People s United Financial, Inc. Employee Stock Ownership Plan, as noted. The LTIP defines fair market value as the average of the high and low trading price of the common stock on The Nasdaq Stock Market on the date of grant or, if no trades take place on that date, the most recent day for which trading data is available.

Cash dividends paid with respect to shares of restricted stock granted pursuant to the LTIP and the RRP are paid to the grantee at the same time as dividends are paid on all other shares of People s United common stock, regardless of whether awards have vested. Cash dividends paid with respect to shares of stock allocated to the participant s account in the ESOP, whether or not vested, may be paid to the participant at the same time as dividends are paid on all other shares of People s United common stock or may be reinvested in additional shares of common stock, at the participant s election.

Stock and option awards made to named executive officers in 2012 will vest as described below:

Source of Grant (Plan Name)	Grant Date(s)	Vesting Schedule
Long-Term Incentive Plan	Feb. 16, 2012	50% on Mar. 1 following second anniversary of grant date; 25% on Mar. 1 following third anniversary of grant date; 25% on Mar. 1 following fourth anniversary of grant date
2007 Recognition and Retention Plan	Feb. 16, 2012	33 $^{1}/_{3}$% per year on each anniversary of grant date

A participant in the ESOP becomes fully vested once he or she has completed five years of credited service, as defined in the plan. All of the named executive officers except Mr. Tengel are fully vested in shares allocated to their accounts under this plan.

For purposes of this table, the grant date fair value of stock awards is generally equal to the number of shares awarded multiplied by the fair value of the shares as determined pursuant to the applicable plan. For stock allocated pursuant to the ESOP, the fair value is assumed to be equal to the closing price of the common stock on the date the shares were allocated to participants accounts. The grant date fair value of options is determined using the Black-Scholes option pricing model with the assumptions set forth in the text following the Summary Compensation Table for specified grant dates.

Outstanding Equity Awards at Fiscal Year-End

	Option Awards				Stock Awards		
Name	Number of Securities Underlying Unexercised Options (#) Exercisable	Number of Securities Underlying Unexercised Options (#) Unexercisable	Option Exercise Price ($)	Option Expiration Date	Number of Shares or Units of Stock That Have Not Vested (#)	Market Value of Shares or Units of Stock That Have Not Vested ($)	
John P. Barnes	14,650		$ 16.08	Jan. 16, 2018	29,744[(a)]	$ 359,605	
	227,727	56,932[(a)]	15.66	Jan. 17, 2018	3,517[(b)]	42,521	
	22,000		16.94	Feb. 21, 2018	7,390[(c)]	89,345	
	24,505	8,169[(b)]	16.58	Jan. 22, 2019	9,000[(d)]	108,810	
	16,230	16,231[(c)]	15.80	Jan. 28, 2020	15,843[(e)]	191,542	
	42,514	42,514[(e)]	13.05	Sept. 16, 2020	42,759[(f)]	516,956	
		108,591[(f)]	13.42	Feb. 17, 2021	50,000[(g)]	604,500	
		136,809[(h)]	12.65	Feb. 16, 2022	47,557[(h)]	574,964	
Robert R. D Amore	32,130		$ 12.02	Feb. 17, 2015	3,669[(b)]	$ 44,358	
	49,308		14.91	Feb. 16, 2016	7,711[(c)]	93,226	
	23,121		21.63	Feb. 15, 2017	19,658[(f)]	237,665	
	554,911		18.10	Oct. 25, 2017	21,231[(h)]	256,683	
	31,040		16.94	Feb. 21, 2018			
	25,571	8,524[(b)]	16.58	Jan. 22, 2019			
	16,936	16,937[(c)]	15.80	Jan. 28, 2020			
		49,923[(f)]	13.42	Feb. 17, 2021			
		61,075[(h)]	12.65	Feb. 16, 2022			
Lee C. Powlus	5,715		$ 16.94	Feb. 21, 2018	100,0000	0.002%	0.009%

Note 1: The spouse of Mr. Simon To is the owner of these 100,000 H Shares of the Company and accordingly, Mr. Simon To, is taken to be interested in these 100,000 H Shares by virtue of the SFO.

ITEM 7. MAJOR SHAREHOLDERS AND RELATED PARTY TRANSACTIONS.

Major Shareholders

Share Capital Structure

As of December 31, 2003, the total share capital of the Company was 4,374,178,000 shares, of which approximately 50.3% (2,200,000,000 domestic shares) is held by CSAHC, approximately 26.84% (1,174,178,000 H shares) is held by Hong Kong and overseas shareholders and approximately 22.86% (1,000,000,000 A shares) is held by domestic shareholders.

Substantial Shareholders

As of December 31, 2003, the following shareholders had an interest of 5% or more in the Company s shares:

Name	Number of Shares	Approximate Percentage of the Total Number of Shares
CSAHC	2,200,000,000 domestic shares	50.30%
HKSCC Nominees Limited	1,149,955,998 H shares	26.29%

The table below sets forth, as of December 31, 2003, the following entities hold 5% or more of the total number of H shares issued by the Company.

Name	Number of H Shares	Approximate Percentage of the Total Number of H Shares
HKSCC Nominees Limited	1,149,955,998	97.94%

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Domestic shares and H shares have identical voting rights.

Related Party Transactions

The Company enters into transactions from time to time with CSAHC and its affiliates. For a description of such transactions, see Note 25 to the Financial Statements. In particular, the following arrangements, which the Company believes are material to its operations, have been made between the Company and CSAHC and its affiliates. The Company believes that these arrangements are effected in the prevailing market rates and are commercially reasonable and on terms no less favorable than terms available from third parties.

Arrangements with CSAHC

Trademark License Agreement

The Company and CSAHC have entered into the Trademark License Agreement dated May 22, 1997, pursuant to which CSAHC has acknowledged that the Group has the right to use the name China Southern and China Southern Airlines in both Chinese and English, and has granted to the Company a 10-year renewable license to use the kapok logo on a world-wide basis in connection with its airline-related businesses. CSAHC has retained the right to use the kapok logo in connection with its non-airline related businesses conducted as of the date of the Trademark License Agreement and to permit its affiliates that do not compete, directly or indirectly, with the Group to use the kapok logo. Unless CSAHC gives written notice of termination three months before the expiration of the 10-year term of the agreement, the agreement will be automatically extended for another 10-year term.

Leases

The Company as lessee and CSAHC as lessor have entered into the following lease agreements:

The Company and CSAHC have entered into a land lease agreement dated May 22, 1997, in respect of the land used by the Company within Baiyun International Airport. The total rental payment is RMB2.7 million per year. The term of the lease is five years commencing April 1, 1997, and is renewable by the Company thereafter.

The Company and CSAHC have separately entered into four lease agreements dated May 22, 1997, in respect of office premises located at the east wing of the Guangzhou Railway Station on Guangzhou Huanshi Dong Road, office premises at Haikou Airport, office premises in Haikou City, and office premises at Tianhe Airport in Wuhan, Hubei Province. The aggregate rental payment under the four leases is RMB12.6 million per year. The original term of each lease is one year and is renewable annually by the Company thereafter.

The Company and CSAHC have entered into an indemnification agreement dated May 22, 1997, in which CSAHC has agreed to indemnify the Company against any loss or damage caused by or arising from any challenge of, or interference with, the Company s right to use certain land and buildings.

Comprehensive Services and Employee Benefits

The Company and CSAHC have entered into a comprehensive services agreement dated May 22, 1997, pursuant to which CSAHC agrees to provide adequate quarters to eligible employees of the Group as and when required. In return, the Group agrees to pay a fixed annual fee of RMB85 million to CSAHC for a ten-year period effective January 1, 1995.

Arrangements with CSAHC s Affiliates

Southern Airlines (Group) Import and Export Trading Company (SAIETC), a wholly-owned subsidiary of CSAHC

The Company and SAIETC have entered into an agreement dated May 22, 1997, for the import and export of aircraft, flight equipment, special vehicles for airline use, communication and navigation facilities, and training facilities for a term extending from May 22, 1997 to May 22, 2000 which was subsequently extended to May 22, 2006 by mutual agreement between the parties. The parties have mutually agreed that the agreement can be extended automatically.

For the year ended December 31, 2003, the amount incurred by the Group for the import and export of the above equipment was RMB1,155 million, inclusive of agency commission of 1.5% above the contract prices paid to SAIETC.

Southern Airlines Advertising Company (SAAC), which is 90% owned by the Group and 10% owned by CSAHC

In August 2002, the Group entered into a takeover agreement with CSAHC. As a result, the Group owns 90% and CSAHC owns 10% of SAAC.

The Company and SAAC have entered into an agreement dated May 22, 1997, for the provision of advertising services for a term extending from May 22, 1997 to May 22, 2000. The agreement has been extended to May 22, 2006.

For the year ended December 31, 2003, the amount incurred by the Group to SAAC for advertising services was RMB1.3 million.

Southern Airlines Group Finance Company Limited (SA Finance), which is 42% owned by CSAHC, 32% owned by the Company, 26% owned by five subsidiaries of the Company

The Company has entered into a financial agreement dated May 22, 1997, with SA Finance for the provision of financial services such as deposit and loan facilities, credit facilities, financial guarantees and credit references for a term extending from May 22, 1997 to May 22, 2000. As agreed by the parties, the agreement has been extended for six years to May 22, 2006.

Under such agreement, (a) all funds that the Company deposits with SA Finance will be deposited by SA Finance with the Commercial and Industrial Bank of China, Bank of Communications, Bank of Agriculture, China Construction Bank, or other banks of similar creditworthiness; and (b) SA Finance will not at any time have outstanding loans in excess of the amount representing the aggregate of (i) deposits received from entities other than the Company, (ii) SA Finance s shareholders equity and (iii) capital reserves.

As of December 31, 2003, the Group had short-term deposits placed with SA Finance amounting to RMB365.9 million, which earned interest at the rate of 1.98% 3.00% per annum.

Shenzhen Air Catering Company Limited, which is 33% owned by CSAHC, and 67% owned by two independent third parties

The Company and Shenzhen Air Catering Company Limited have entered into an agreement dated May 23, 1997 for the sale and purchase of in-flight meals for flights originating or stopping at the airport in Shenzhen. Pursuant to such agreement, Shenzhen Air Catering Company Limited would supply in-flight meals to the Group from time to time during the term from May 23, 1997 to May 23, 1998. The parties have agreed that the agreement can be extended automatically.

For the year ended December 31, 2003, the amount paid by the Group to Shenzhen Air Catering Company Limited for the provision of in-flight meals was approximately RMB28.2 million.

GAMECO, which is 50% owned by the Company and 50% owned by an independent third party

The Company and GAMECO have entered into an Aircraft Maintenance and Engineering Agreement for the provision of aircraft repair and maintenance services. On May 17, 1996, the Company and GAMECO entered into an agreement regarding the fee arrangement for the provision of such repair and maintenance services (the Fee Agreement). Pursuant to the Fee Agreement and subsequent agreements, GAMECO charged the Company for expendables at cost plus 15%, and labor costs at US$30.0 per hour during 2003.

For the year ended December 31, 2003, the amount incurred by the Company for such repair and maintenance services was RMB587.3 million.

The China Southern West Australian Flying College Pty Ltd (the Australian Pilot College), which is 65% owned by the Company and 35% owned by CSAHC.

CSAHC and the Australian Pilot College entered into an agreement dated October 7, 1993, for the provision of pilot training in Australia to the cadet pilots of CSAHC (the Training Agreement). The Training Agreement will remain in force unless terminated by either party upon 90 days prior written notice to the other party. Pursuant to the Demerger Agreement, the Company has assumed all the interests, rights and obligations of CSAHC under the Training Agreement.

For the year ended December 31, 2003, the amount paid by the Group to the Australian Pilot College for training services was RMB82.4 million.

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Southern Airlines (Group) Economic Development Company (SAGEDC), which is 61% owned by CSAHC and 39% owned by an independent third party.

The Company and SAGEDC have entered into an agreement dated May 22, 1997, for the provision of drinks, snacks, liquor, souvenirs and other products for a term extending from May 22, 1997, to May 22, 2007.

For the year ended December 31, 2003, the amount paid by the Group to Southern Airlines (Group) Economic Development Company for the provision of drinks, snacks, liquor, souvenirs and other products was RMB42.8 million.

Ticket sales arrangements

The Company has entered into ticket agency agreements for the sale of the Group s air tickets with several subsidiaries of CSAHC (the Agents). The Agents charge a commission, at a rate prescribed by the CAAC and the International Air Transport Association, for each air ticket sold in the amount of 3% of the ticket price for domestic tickets and 5% 12% of the ticket price for Hong Kong regional/international tickets, respectively. In addition to the Agents, the Company has other air ticket sales agents in China who charge commission at the same rates. The Agents also act as air ticket sales agents for other Chinese airlines and charge the same rates of commission to such other airlines as those charged to the Company.

For the year ended December 31, 2003, the aggregate amount of ticket sales of the Group conducted through the Agents was RMB143.0 million.

Interests of Experts and Counsel

Not applicable.

ITEM 8. FINANCIAL INFORMATION.

Consolidated Statements and Other Financial Information

See Item 18. Financial Statements for financial statements filed as part of this Annual Report.

Significant Changes

No significant changes have occurred since the date of the financial statements provided in Item 18 below.

Legal Proceedings

The Company is currently involved in a civil litigation (Hong Kong High Court Action No. 515 of 2001) (Litigation). According to the writ of summons for the Litigation, New Link Consultants Limited, the plaintiff, claimed against the Company (as one of the defendants to the Litigation) on the basis of certain evidence proving that United Aero-Supplies System of China, Limited (UASSC) entered into an agreement with the defendants for exclusive purchase of aviation equipment consigned to UASSC for sale and, that as the defendants failed to perform the agreement, UASSC has the right to compensation. Since UASSC is in the course of its winding up proceedings, all the rights and benefits of UASSC in connection with the claim have been transferred to the plaintiff. The Company, as one of the defendants to the Litigation, has been claimed for unspecified damages for breach of the agreement. Given that the Litigation is still at its preliminary stage, it is pre-matured to predict the result of the court judgment. Based on the opinion given by its instructing solicitors, the Company s directors consider that the Company has a reasonable chance of success in its defense to the claim. At present, the Company has filed an objection in respect of the jurisdiction of the court, and has requested the court to transfer the case to the PRC for trial. Accordingly, the Directors of the Company consider that a provision for such claim and/or the associated legal costs is not required.

Other than the above legal proceeding, the Company is not party to any material legal proceedings.

Dividend Information

No interim dividend was paid during the year ended December 31, 2003. The Board of Directors does not recommend the payment of a final dividend in respect of the year ended December 31, 2003.

ITEM 9. THE OFFER AND LISTING.

The principal trading market for the Company s H Shares is the Hong Kong Stock Exchange, and the Company s trading code is 1055 . The ADSs, each representing 50 H Shares, are evidenced by ADRs issued by The Bank of New York as the Depositary for the ADRs, and are listed on the New York Stock Exchange under the symbol ZNH. As of May 31, 2004, approximately 104,740,000 of the Company s H Shares in the form of 2,094,800 ADSs were held in the U.S. by approximately 42 record holders in the U.S., including the Depository Trust Company.

In July 2003, the Company issued and listed 1,000,000,000 A shares on the Shanghai Stock Exchange with trading code of 600029 . The 2,200,000,000 Domestic Shares held by CSAHC are not listed on any stock exchange and are essentially not transferrable by CSAHC.

Set forth below for the periods indicated are the high and low sales prices of H Shares on the Hong Kong Stock Exchange, ADSs on the New York Stock Exchange and A Shares on the Shanghai Stock Exchange.

	The Stock Exchange of Hong Kong Price per H Share (HK$)		**The New York Stock Exchange Price per ADS (US$)**		**The Shanghai Stock Exchange Price per A Share (RMB)**	
	High	**Low**	**High**	**Low**	**High**	**Low**
Annual Market Prices						
Fiscal Year ended December 31, 1998	2.40	0.50	14.75	3.06	N/A	N/A

Fiscal Year ended December 31, 1999	2.25	0.61	13.94	3.88	N/A	N/A
Fiscal Year ended December 31, 2000	2.93	1.02	18.38	6.06	N/A	N/A
Fiscal Year ended December 31, 2001	2.95	1.35	18.10	8.00	N/A	N/A
Fiscal Year ended December 31, 2002	3.60	1.50	22.25	10.35	N/A	N/A
Fiscal Year ended December 31, 2003	3.50	1.46	22.78	9.53	5.34	3.75
Quarterly Market Prices						
Fiscal Year ended December 31, 2000						
First Quarter	1.86	1.02	11.19	6.88	N/A	N/A
Second Quarter	2.05	1.06	12.44	6.06	N/A	N/A
Third Quarter	2.93	1.63	18.38	10.19	N/A	N/A
Fourth Quarter	2.40	1.46	15.06	9.56	N/A	N/A
Fiscal Year ended December 31, 2001						
First Quarter	2.70	1.83	17.38	12.22	N/A	N/A
Second Quarter	2.95	1.89	18.10	12.00	N/A	N/A
Third Quarter	2.53	1.35	16.50	8.00	N/A	N/A
Fourth Quarter	2.42	1.66	15.25	9.8	N/A	N/A
Fiscal Year ended December 31, 2002						

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	The Stock Exchange of Hong Kong Price per H Share (HK$)		The New York Stock Exchange Price per ADS (US$)		The Shanghai Stock Exchange Price per A Share (RMB)	
	High	Low	High	Low	High	Low
First Quarter	2.83	2.22	17.63	14.80	NA	NA
Second Quarter	3.42	2.33	21.74	14.95	NA	NA
Third Quarter	3.60	1.89	22.25	12.00	NA	NA
Fourth Quarter	2.42	1.50	15.00	10.35	NA	NA
Fiscal Year ended December 31, 2003						
First Quarter	2.62	1.71	16.50	11.75	N/A	N/A
Second Quarter	2.40	1.46	14.85	9.53	N/A	N/A
Third Quarter	2.88	2.03	18.59	13.25	4.15	3.75
Fourth Quarter	3.50	2.50	22.78	16.76	5.34	3.86
Monthly Market Prices						
December 2003	3.50	2.92	22.78	19.00	5.34	4.46
January 2004	3.95	3.35	25.18	21.94	6.30	4.95
February 2004	4.68	3.20	29.73	20.91	6.73	5.70
March 2004	4.47	3.30	28.60	21.00	6.57	5.77
April 2004	3.90	3.20	24.89	21.07	6.24	5.49
May 2004	3.53	2.47	22.62	15.95	6.10	4.82

Offer and Listing details

Not applicable.

Plan of Distribution

Not applicable.

Markets

Not applicable.

Selling Shareholders

Not applicable.

Dilution

Not applicable.

Expenses of the Issue

Not applicable.

ITEM 10. ADDITIONAL INFORMATION.

Share Capital

Not applicable.

Memorandum and Articles of Association

The Company is registered with and has obtained a business license from the State Administration Bureau of Industry and Commerce of the People s Republic of China on March 25, 1995. The Company s business license number is 1000001001760.

On March 13, 2003, the Company obtained an approval certificate from the Ministry of Commerce to change to a permanent limited company with foreign investments and obtained the business license (Qi Gu Guo Zi Di No. 000995) on October 17, 2003 issued by the State Administration of Industry and Commerce of the People s Republic of China.

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Director

Pursuant to Article 13 of the Articles of Association, the business purposes of the Company are: (i) to absorb domestic and foreign capital; (ii) to assist in developing the aviation industry of China; (iii) to promote the development of the national economy of China; (iv) to utilize corporate incentive mechanisms of privatization; (v) to draw on the advanced management expertise of other domestic and foreign companies; (vi) to continuously improve the management of the Company; (vii) to enhance the market competitiveness of the Company; (viii) to generate economic and social benefits for the Company; and (ix) to generate steady income for the Company s shareholders. Pursuant to Article 14 of the Articles of Association, the scope of business of the Company shall be consistent with and subject to the scope of business approved by the relevant supervisory department of the State. The scope of business of the Company includes: (i) provision of scheduled and non-scheduled domestic, regional and international air transportation services for passengers, cargo, mail and luggage; (ii) undertaking general aviation services; (iii) provision of aircraft repair and maintenance services; (iv) acting as agent for other domestic and international airlines; (v) provision of air catering services and (vi) engaging in other airline or airline-related business, including advertising for such services.

Pursuant to Article 154 of the Articles of Association, where a director of the Company is in any way, directly or indirectly, materially interested in a contract, transaction or arrangement or proposed contract, transaction or arrangement with the Company, (other than his contract of service with the Company), he shall declare the nature and extent of his interests to the board of directors at the earliest opportunity, whether or not the contract, transaction or arrangement or proposal therefor is otherwise subject to the approval of the board of directors.

Pursuant to Article 108 of the Articles of Association, where a director is interested in any resolution proposed at a board meeting, such director shall not be present and shall not have a right to vote. Such director shall not be counted in the quorum of the relevant meeting.

Pursuant to Article 162 of the Articles of Association, the Company shall, with the prior approval of shareholders in general meeting, enter into a contract in writing with a director wherein his emoluments are stipulated. The aforesaid emoluments include, emoluments in respect of his service as director, supervisor or senior administrative officer of the Company or any subsidiary of the Company; emoluments in respect of the provision of other services in connection with the management of the affairs of the Company and any of its subsidiaries; and payment by way of compensation for loss of office, or as consideration for or in connection with his retirement from office.

Pursuant to Article 102(6) of the Articles of Association, the board of directors has the power to formulate proposals for increases or reductions in the Company s registered capital and the issue of debentures of the Company; such resolutions must be passed by more than two-thirds of all the directors.

There is no mandatory retirement age for the directors of the Company. The directors of the Company are not required to hold shares of the Company.

Ordinary Shares

Pursuant to Article 19 of the Articles of Association**,** subject to the approval of the securities authority of the State Council, the Company may issue and offer shares to domestic investors or foreign investors for subscription. Foreign investors are those investors of foreign countries and regions of Hong Kong, Macau and Taiwan who subscribe for shares issued by the Company. Domestic investors are those investors within the territory of the PRC (excluding investors of the regions referred to in the preceding sentence) who subscribe for shares issued by the Company.

Pursuant to Article 20 of the Articles of Association**,** Shares issued by the Company to domestic investors for subscription in Renminbi shall be referred to as Domestic-Invested Shares . Shares issued by the Company to foreign investors for subscription in foreign currencies shall be referred to as Foreign-Invested Shares . Foreign-Invested Shares which are listed overseas are called Overseas-Listed Foreign-Invested Shares . The foreign currencies mean the legal currencies (apart from Renminbi) of other countries or districts which are recognized by the foreign exchange control authority of the State and can be used to pay the Company for the share price.

Pursuant to Article 21 of the Articles of Association**,** Domestic-Invested Shares issued by the Company shall be called A Shares . Overseas-Listed Foreign-Invested Shares issued by the Company and listed in Hong Kong shall be called H Shares . H Shares are shares which have been admitted for listing on The Stock Exchange of Hong Kong Limited, the par value of which is denominated in Renminbi and which are subscribed for and traded in Hong Kong dollars. H Shares can also be listed on a stock exchange in the United States of America in the form of American depositary receipts.

The Company has issued a total of 4,374,178,000 ordinary shares, of which (a) 2,200,000,000 domestic shares are held by CSAHC, (b) 1,174,178,000 H shares are held by Hong Kong and overseas shareholders and (c) 1,000,000,000 A shares are held by the PRC shareholders.

Pursuant to Article 54 of the Articles of Association, the ordinary shareholders of the Company shall enjoy the following rights:

(1) the right to attend or appoint a proxy to attend shareholders general meetings and to vote thereat;

(2) the right to dividends and other distributions in proportion to the number of shares held;

(3) the right of supervisory management over the Company s business operations, and the right to present proposals or enquiries;

(4) the right to transfer, donate or pledge his shares in accordance with laws, administrative regulations and provisions of these articles of association;

(5) the right of knowledge and decision making power with respect to important matters of the Company in accordance with laws, administrative regulations and these articles of association;

(6) the right to obtain relevant information in accordance with the provisions of these articles of association, including:

(i) the right to obtain a copy of these articles of association, subject to payment of the cost of such copy;

(ii) the right to inspect and copy, subject to payment of a reasonable charge:

(a) all parts of the register of shareholders;

(b) personal particulars of each of the Company s directors, supervisors, president and other senior administrative officers, including:

(aa) present name and alias and any former name or alias;

(bb) principal address (residence);

(cc) nationality;

(dd) primary and all other part-time occupations and duties;

(ee) identification documents and their relevant numbers;

(c) state of the Company s share capital;

(d) reports showing the aggregate par value, quantity, highest and lowest price paid in respect of each class of shares repurchased by the Company since the end of last accounting year and the aggregate amount paid by the Company for this purpose;

(e) minutes of shareholders general meetings;

(f) interim and annual reports of the Company.

(7) in the event of the termination or liquidation of the Company, to participate in the distribution of surplus assets of the Company in accordance with the number of shares held;

(8) other rights conferred by laws, administrative regulations and these articles of association.

Pursuant to Article 55 of the Articles of Association, the ordinary shareholders of the Company shall assume the following obligations:

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(1) to abide by these articles of association;

(2) to pay subscription monies according to the number of shares subscribed and the method of subscription;

(3) no right to return shares to the Company unless laws and regulations provide otherwise;

(4) other obligations imposed by laws, administrative regulations and these articles of association.

Shareholders are not liable to make any further contribution to the share capital other than as agreed by the subscriber of the relevant shares on subscription.

Action necessary to change rights of shareholders

Pursuant to Article 92 of the Articles of Association, those shareholders who hold different classes of shares are shareholders of different classes.

The holders of the Domestic-Invested shares and holders of Overseas-Listed Foreign-Invested Shares shall be deemed to be shareholders of different classes.

Pursuant to Article 93 of the Articles of Association, rights conferred on any class of shareholders in the capacity of shareholders (class rights) may not be varied or abrogated unless approved by a special resolution of shareholders in general meeting and by holders of shares of that class at a separate meeting conducted in accordance with Articles 95 to 99.

Pursuant to Article 95 of the Articles of Association, shareholders of the affected class, whether or not otherwise having the right to vote at shareholders general meetings, shall nevertheless have the right to vote at class meetings in respect of matters concerning sub-paragraphs (2) to (8), (11) and (12) of Article 94, but interested shareholder(s) shall not be entitled to vote at class meetings. Interested shareholder(s) is:

(1) in the case of a repurchase of shares by offers to all shareholders or public dealing on a stock exchange under Article 31, a controlling shareholder within the meaning of Article 57;

(2) in the case of a repurchase of share by an off-market contract under Article 31, a holder of the shares to which the proposed contract relates;

(3) in the case of a restructuring of the Company, a shareholder within a class who bears less than a proportionate obligation imposed on that class under the proposed restructuring or who has an interest in the proposed restructuring different from the interest of shareholders of that class.

Pursuant to Article 96 of the Articles of Association, resolutions of a class of shareholders shall be passed by votes representing more than two-thirds of the voting rights of shareholders of that class represented at the relevant meeting who, according to Article 95, are entitled to vote at class meetings.

Pursuant to Article 97 of the Articles of Association, written notice of a class meeting shall be given forty-five (45) days before the date of the class meeting to notify all of the shareholders in the share register of the class of the matters to be considered, the date and the place of the class meeting. A shareholder who intends to attend the class meeting shall deliver his written reply concerning attendance at the class meeting to the Company twenty (20) days before the date of the class meeting.

If the number of shares carrying voting rights at the meeting represented by the shareholders who intend to attend the class meeting reaches more than one half of the voting shares at the class meeting, the Company may hold the class meeting; if not, the Company shall within five (5) days notify the shareholders again by public notice of the matters to be considered, the date and the place for the class meeting. The Company may then hold the class meeting after such publication of notice.

Pursuant to Article 98 of the Articles of Association, notice of class meetings need only be served on shareholders entitled to vote thereat.

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Meeting of any class of shareholders shall be conducted in a manner as similar as possible to that of general meetings of shareholders. The provisions of these articles of association relating to the manner to conduct any shareholders general meeting shall apply to any meeting of a class of shareholders.

Pursuant to Article 99 of the Articles of Association, the special procedures for voting at any meeting of a class of shareholders shall not apply to the following circumstances:

(1) where the Company issues, upon the approval by special resolution of its shareholders in general meeting, either separately or concurrently once every twelve months, not more than 20 per cent of each of its existing issued Domestic-Invested Shares and Overseas-Listed Foreign-Invested Shares;

(2) where the Company s plan to issue Domestic-Invested Shares and Overseas-Listed Foreign-Invested Shares at the time of its establishment is carried out within fifteen (15) months from the date of approval of the Securities Committee of the State Council.

Meetings of shareholders

Shareholders general meetings is the organ of authority of the Company and shall exercise its functions and powers, among other things, to decide on the Company s operational policies and investment plans, to elect and replace directors and decide on matters relating to the remuneration of directors, to examine and approve reports of the board of directors, etc.

There are two types of shareholders general meetings: annual general meetings and extraordinary general meetings. Shareholders general meetings shall be convened by the board of directors. Annual general meetings are held once every year and within six (6) months from the end of the preceding financial year.

Under any of the following circumstances, the board of directors shall convene an extraordinary general meeting within two (2) months:

(1) when the number of directors is less than the number of directors required by the Company Law or two thirds of the number of directors specified in the Articles of Association;

(2) when the unrecovered losses of the Company amount to one third of the total amount of its share capital;

(3) when shareholder(s) holding 10 per cent or more of the Company s issued and outstanding shares carrying voting rights request(s) in writing the convening of an extraordinary general meeting;

(4) when deemed necessary by the board of directors or as requested by the supervisory committee.

When the Company convenes a shareholders general meeting, written notice of the meeting shall be given forty five (45) days before the date of the meeting to notify all of the shareholders in the share register of the matters to be considered and the date and the place of the meeting. A shareholder who intends to attend the meeting shall deliver his written reply concerning the attendance of the meeting to the Company twenty (20) days before the date of the meeting.

The Company shall, based on the written replies received twenty (20) days before the date of the shareholders general meeting from the shareholders, calculate the number of voting shares represented by the shareholders who intend to attend the meeting. If the number of voting shares represented by the shareholders who intend to attend the meeting reaches one half or more of the Company s total voting shares, the Company may hold the meeting; if not, then the Company shall within five (5) days notify the shareholders again by public notice of the matters to be considered, the place and date for, the meeting. The Company may then hold the meeting after such publication of notice.

Limitation on right to own securities

The PRC Special Regulations on Overseas Offering and the Listing of Shares by Companies Limited by Share (the Special Regulations) and the Mandatory Provisions for Articles of Association of Companies to be Listed Overseas (the Mandatory Provisions) provide for different classes of shares to be subscribed for and traded by local and overseas investors respectively. Shares which can be traded by overseas investors must be in registered form and while denominated in Renminbi, they are traded in foreign currency with dividends payable in foreign currency. Local investors are prohibited from dealing in such shares.

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Merger, acquisition or corporate restructuring

Pursuant to Article 193 of the Articles of Association, in the event of the merger or division of the Company, a plan shall be presented by the Company s board of directors and shall be approved in shareholders general meeting and the relevant examining and approving formalities shall be processed as required by law. A shareholder who objects to the plan of merger or division shall have the right to demand the Company or the shareholders who consent to the plan of merger or division to acquire that dissenting shareholder s shareholding at a fair price. The contents of the resolution of merger or division of the Company shall be made into special documents for shareholders inspection. Such special documents shall be sent by mail to holders of Overseas-Listed Foreign-Invested Shares.

The Articles of Association do not contain any provisions governing the ownership threshold above which shareholder ownership must be disclosed.

Material Contracts

The Company has not entered into any material contracts, other than in the ordinary course of business, during the preceding two years.

Exchange Controls

Under current Chinese foreign exchange regulations, Renminbi is fully convertible for current account transactions, but is not freely convertible for capital account transactions. Conversion from Renminbi into a foreign currency or vice versa for purposes of capital account transactions requires prior approvals of relevant Chinese Government agencies.

The Company is generally required by law to sell all its foreign exchange revenues to Chinese banks at the exchange rates published by Chinese banks on each business day, which rates may deviate only within a very narrow range from the official rate published daily by the People s Bank of China, China s central bank.

The Company may purchase foreign exchange directly from Chinese banks for any current account transactions, such as trade transactions in its normal course of business, including acquisition of aircraft and flight equipment (such acquisition requires approvals from relevant Chinese Government agencies).

Payment of dividends by the Company to holders of the Company s H Shares and ADSs is considered a current account transaction under Chinese law. Therefore, there is no legal restriction on the conversion of Renminbi into foreign exchange for the purpose of paying dividends to such holders of H Shares and ADSs. In addition, the Company s Articles of Association require the Company to pay dividends to holders of the Company s H Shares and ADSs in foreign exchange.

Other Limitations

There are no limitations on the right of non-resident or foreign owners to hold or vote H Shares or ADSs imposed by Chinese law or by the Articles of Association or other constituent documents of the Company. However, under current Chinese law, foreign ownership of the Company may not exceed 49%.

Taxation

The following is a general summary of certain Chinese tax consequences of the acquisition, ownership and disposition of H Shares and ADSs. This summary is based upon tax laws of China as in effect on the date of this Annual Report, including the income tax treaty between the United States and China (the U.S.-PRC Tax Treaty), all of which are subject to change or different interpretation.

In general, for Chinese tax purposes, holders of ADSs will be treated as the owners of the H Shares represented by those ADSs, and exchanges of H Shares for ADSs, and ADSs for H Shares, will not be subject to taxation under the laws of China.

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This summary does not purport to address all material tax consequences for holders or prospective purchasers of H Shares or ADSs, and does not take into account the specific circumstances of such investors. Investors should consult their own tax advisors as to Chinese or other tax consequences of the acquisition, ownership and disposition of H Shares or ADSs.

Dividends

Chinese tax law generally provides for the imposition of a withholding tax on dividends paid by a Chinese company to a non-Chinese shareholder at a rate of 20%. However, the Chinese tax authorities have temporarily suspended imposition of this withholding tax. Accordingly, dividends paid by the Company to holders of H Shares or ADSs who are foreign individuals not resident in China or which are foreign enterprises with no permanent establishment in China will currently not be subject to Chinese withholding tax. In the event that the suspension of the withholding tax is lifted, such payments will be subject to withholding tax at the 20% rate unless the holder is entitled to a tax waiver or a lower tax rate under an applicable double-taxation treaty.

China currently has double-taxation treaties with a number of countries, including Australia, Canada, France, Germany, Japan, Malaysia, the Netherlands, Singapore, the United Kingdom and the United States. Under the U.S.-PRC Tax Treaty, China may tax a dividend paid by the Company to a U.S. holder up to a maximum of 10% of the gross amount of such dividend.

Capital Gains from Transfer or Disposition of Shares

Chinese tax law generally provides that an individual who transfers or otherwise disposes of a company s shares of capital stock is subject to a 20% capital gains tax. Currently, foreign enterprises and all individuals are temporarily exempt from capital gains tax on transfers of shares of capital stock of joint stock companies, such as the Company. Should such temporary exemption be discontinued, such holders may be subject to a 20% capital gains tax unless reduced by an applicable double-taxation treaty. Under the U.S.-PRC Tax Treaty, for example, China may only impose a 20% capital gains tax from the sale or other disposition by a U.S. holder of H Shares or ADSs representing an interest in the Company of 25% or more.

Stamp Duty

Transfers of shares of capital stock of a company are not subject to Chinese stamp duty if the transfer does not take place within China (excluding Hong Kong, Macau and Taiwan).

Dividends and paying Agents

Not applicable.

Statement by Experts

Not applicable.

Documents on Display

The Company has filed this Annual Report on Form 20-F with the Securities and Exchange Commission under the Securities Exchange Act of 1934, as amended. Statements made in this annual report as to the contents of any document referred to are not necessarily complete. With respect to each such document filed as an exhibit to this annual report, reference is made to the exhibit for a more complete description of the matter involved, and each such statement shall be deemed qualified in its entirety by such reference.

The Company is subject to the informational requirements of the Exchange Act and file reports and other information with the Securities and Exchange Commission. Reports and other information which the Company filed with the Securities and Exchange Commission, including this Annual Report on Form 20-F, may be inspected and copied at the public reference room of the Securities and Exchange Commission at

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450 Fifth Street N.W. Washington D.C. 20549

You can also obtain copies of this material by mail from the Public Reference Section of the Securities and Exchange Commission, 450 Fifth Street, N.W., Washington D.C. 20549, at prescribed rates. Additionally, copies of this material may be obtained from the Securities and Exchange Commission s Internet site at http://www.sec.gov. The Commission s telephone number is 1-800-SEC-0330.

Subsidiary Information

Not applicable.

ITEM 11. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

The Group is subject to market risks due to fluctuations in interest rates. The majority of the Group s borrowings is in the form of long-term fixed- and variable-rate debts with original maturities ranging from two to 12 years. Fluctuations in interest rates can lead to significant fluctuations in the fair value of such debt instruments. From time to time, the Group may enter into interest rate swaps designed to mitigate exposure relating to interest rate risks. No such contract was outstanding as of December 31, 2003.

The Group is also exposed to foreign currency risk as a result of its aircraft and flight equipment being sourced from overseas suppliers. Specifically, the Group s foreign currency exposure relates primarily to its foreign currency long-term debts used to finance such capital expenditures and its capital commitments. Subject to certain restrictive conditions imposed by the State Administration of Foreign Exchange, the Group may, from time to time, enter into forward foreign exchange contracts to mitigate its foreign currency exposures. No such contract was outstanding as of December 31, 2003.

As of December 31, 2003, the Group operated a total of 83 aircraft under operating and capital leases at rates that are substantially fixed. Such leases expose the Group to market risks; however, in accordance with Item 305 of Regulation S-K, such leases have been excluded from the following market risk tables. Commitments under operating and capital leases are disclosed in Note 17 to the Financial Statements.

The following table provides information regarding the Group s material interest rate sensitive financial instruments as of December 31, 2003 and 2002:

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	As of December 31, 2003								As of December 31, 2002	
	Expected maturity date									
	2004	2005	2006	2007	2008	Thereafter	Total recorded amount	Fair value(2)	Total recorded amount	Fair value(2)
Debt										
Fixed-rate notes payable										
In US$	624	645	402	370	217	369	2,627	2,915	3,429	3,793
Average interest rate	6.81%	6.78%	6.78%	6.78%	6.78%	6.79%	6.79%		6.86%	
Variable-rate notes payable										
In US$	5,867				229	2,276	8,372	8,372	2,254	2,254
Average interest rate	1.91%				1.48%	1.49%	1.63%		2.10%	
In RMB	606	5	2	2	2	3	620	620	5,393	5,393
Average interest rate	4.16%	3.43%	5.14%	5.14%	5.14%	5.14%	4.46%		4.65%	

(1) These interest rates are calculated based on the year end indices.

(2) Fair value of debt instruments was estimated based on the interest rates applicable to similar debt instruments as of December 31, 2003 and 2002.

The following table provides information regarding the Group s material foreign currency sensitive financial instruments and capital commitments as of December 31, 2003 and 2002:

	As of December 31, 2003								As of December 31, 2002	
	Expected maturity date									
	2004	2005	2006	2007	2008	Thereafter	Total recorded amount	Fair value(2)	Total recorded amount	Fair value(2)
Debt										
Fixed-rate notes payable										
In US$	624	645	402	370	217	369	2,627	2,915	3,429	3,793
Average interest rate	6.81%	6.78%	6.78%	6.78%	6.78%	6.79%	6.79%		6.86%	

Variable-rate notes payable In US$	5,867				229	2,276	8,372	8,372	2,254	2,254
Average interest rate	1.91%				1.48%	1.49%	1.63%		2.10%	
Capital commitment in US$	4,585	6,030					10,615	10,615	5,876	5,876

(1) These interest rates are calculated based on the year end indices.

(2) Fair value of debt instruments was estimated based on the floating interest rates applicable to similar debt instruments as of December 31, 2002 and 2003.

ITEM 12. DESCRIPTION OF SECURITIES OTHER THAN EQUITY SECURITIES.

Not applicable.

PART II

ITEM 13. DEFAULTS, DIVIDEND ARREARAGES AND DELINQUENCIES.

None.

ITEM 14. MATERIAL MODIFICATIONS TO THE RIGHTS OF SECURITY HOLDERS AND USE OF PROCEEDS.

There were no material modifications affecting the rights of securities holders made during the fiscal year ended December 31, 2003.

Use of Proceeds

(1) Effective date of the Securities Act registration statement for which the use of proceeds information is being disclosed:

July 23, 1997.

SEC file number assigned to such registration statement: 333-7114.

(2) The offering commenced on July 23, 1997.

(3) The offering was not terminated prior to the sale of any securities registered under the registration statement.

(4) (i) The offering was not terminated prior to the sale of all securities registered under the registration statement.

(ii) Name of the managing underwriter:

Goldman Sachs (Asia) L.L.C. (global coordinator).

(iii) and (iv)

Title of each class of securities registered	**Amount registered(1)**	**Aggregate price of offering amount registered(2)**	**Amount sold(3)**	**Aggregate offering price of amount sold(4)**
Ordinary H Shares of par value RMB 1.00 per share represented by American Depositary Shares	861,823,000 shares	US$528,469,864	851,501,000 shares	US$522,140,413

Notes:

(1) The amount does not include 322,677,000 H Shares (some of which in the form of ADSs) which have not been registered with the SEC, of which 290,477,000 H Shares were sold to certain corporate investors in Hong Kong as part of the global offering of the Company in July 1997 and 32,200,000 H Shares were sold to certain limited partnership investment funds affiliated with Goldman, Sachs & Co. in a private placement in June 1997 prior to the Company s global offering.

(2) Assumes that all H Shares were sold in the form of ADSs. The price to public for each ADS is US$30.66. Each ADS represents 50 H Shares.

(3) The amount does not include 322,677,000 H Shares referred to in note (1) above.

(4) The amount does not include US$197,865,536 which represents the proceeds from the sale of 322,677,000 H Shares referred to in note (1) above. If the latter amount is included, the aggregate amount of proceeds to the Company would be US$720,005,950. In addition, the aggregate amount is calculated on the assumption that all H Shares were sold in the form of ADSs. Based on the actual sale of H Shares and ADSs, the aggregate amount of proceeds to the Company was US$719,494,700. The issue price per H Share was HK$4.70.

(v)

Underwriting discounts and commissions	US$36,593,000
Finder s fees	
Expenses paid to or for underwriters	US$2,958,000
Other expenses	US$21,411,000
Total expenses	US$60,962,000

Note: No direct or indirect payments were made to directors, officers, general partners of the Company or their associates, or to persons owning ten percent or more of any class of equity securities of the Company, or to affiliates of the Company. All payments were made to third parties.

(vi) Net offering proceeds to the Company after deducting the total expenses in item (4)(v) above:

US$658,532,700

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Note: The amount is calculated on the basis of the actual aggregate amount of proceeds to the Company, and includes the proceeds from the sale of 322,677,000 H Shares referred to in note (1) of item (4)(iv) above.

(vii) As of December 31, 2003, the net offering proceeds to the Company was used up as follows:

Construction of plant, building and facilities	US$41.9 million
Purchase and installation of machinery and equipment	US$394.6 million
Purchase of real estate	
Acquisition of other business(es)	
Repayment of indebtedness	US$192.4 million
Working Capital	US$29.6 million

Note: No direct or indirect payments were made to directors, officers, general partners of the Company or their associates, or to persons owning ten percent or more of any class of equity securities of the Company, or to affiliates of the Company. All payments were made to third parties.

(viii) The uses of proceeds do not represent a material change in the use of proceeds described in the prospectus.

PART III

ITEM 15. CONTROLS AND PROCEDURES

Our president and chief financial officer have evaluated the effectiveness of our disclosure controls and procedures (as defined in the Exchange Act Rules 13a-15(e) or 15d-15(e), and concluded that, based on their evaluation, our disclosure controls and procedures are effective as of the end of the period covered by this Annual Report to ensure that material information required to be included in this Annual Report would be made known to them by others on a timely basis.

There has been no significant change in our internal controls or in other factors that could significantly affect these controls subsequent to the Evaluation Date.

ITEM 16.

ITEM 16A. AUDIT COMMITTEE FINANCIAL EXPERT

The Board of Directors has determined that Mr. Wei Ming Hai qualifies as an audit committee financial expert in accordance with the terms of Item 16.A of Form 20-F. See Item 6 Directors, Senior Management and Employees Directors and Senior Management

ITEM 16B. CODE OF ETHICS

As of the date of this Annual Report, the Company does not have, in form, a code of ethics that applies to the president, chief financial officer and principal accounting officer, or collectively, the senior corporate officers. The senior executive officers, all of whom currently serve as our directors, are subject to the director service contracts that they have with the Company. Under the director service contracts, the directors, including the senior corporate officers, agree that each director owes a fiduciary and diligence obligation to the Company and that no such director shall engage in any activities in competition with the Company s business or carry any activities detrimental to the interests of the Company. Each of the directors, including the senior corporate officers, also agreed to perform their respective duties as directors and senior officers in accordance with the Company Law of the PRC, relevant rules and regulations promulgated by China Securities Regulatory Commission and the Mandatory Provisions of Articles of Association of Overseas Listed Companies.

ITEM 16C. PRINCIPAL ACCOUNTING FEES AND SERVICES

The following table sets forth the aggregate audit fees, audit-related fees, tax fees of the Company s principal accountants and all other fees billed for products and services provided by the Company s principal accountants other than the audit fees, audit-related fees and tax fees for each of the fiscal years 2002 and 2003:

	Audit Fees	Audit-Related Fees	Tax Fees	Other Fees
2002	RMB8.2 million	RMB4.1 million	RMB0.14 million	
2003	RMB8.2 million	RMB7.0 million	RMB0.17 million	RMB1.1 million

Audit-related fees

Services provided primarily consist of the following:

a) Review of the Group s 2003 interim financial report prepared under IFRS;

b) Audits of the Group s financial statements prepared under PRC Accounting Rules and Regulations in connection with the Company s listing of its A shares in the PRC; and

c) Audits of the financial statements of China Northern Airlines Company and Xinjiang Airlines Company in connection with the Company s proposed acquisition of these airlines.

Tax fees

Services provided primarily consist of tax compliance services.

Others

Services provided primarily consist of services to assist the Group in documenting its internal controls over financial reporting and provide observations and recommendations.

Before our principal accountants were engaged by the Company to render audit or non-audit services, the engagement has been approved by our audit committee.

Exemptions from the Listing Standards for Audit Committee

Not applicable.

ITEM 16D. PURCHASES OF EQUITY SECURITIES BY THE ISSUER AND AFFILIATED PURCHASERS

The Company and its affiliated companies have not purchased any issued common shares of the Company during 2003 and up to the date of this Annual Report.

PART IV

ITEM 17. FINANCIAL STATEMENTS.

Not applicable.

ITEM 18. FINANCIAL STATEMENTS.

Index to Financial Statements

ITEM 19. EXHIBITS.

Exhibit No.	Description of Exhibit
1	Articles of Association
4.1	Form of Director s Service Agreement is incorporated by reference in Exhibit 4(c).1 of Form 20-F for the year of 2003.
4.2	Form of Non-Executive Director s Service Agreement is incorporated by reference in Exhibit 4(c).2 of Form 20-F for the year of 2003.
8	Subsidiaries of the Company
12.1	Section 302 Certification of Chairman
12.2	Section 302 Certification of President
12.3	Section 302 Certification of Chief Financial Officer
13.1	Section 906 Certification of Chairman
13.2	Section 906 Certification of President
13.3	Section 906 Certification of Chief Financial Officer

**CHINA SOUTHERN AIRLINES COMPANY LIMITED
AND SUBSIDIARIES**

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Shareholders of
China Southern Airlines Company Limited:

We have audited the accompanying consolidated balance sheets of China Southern Airlines Company Limited and its subsidiaries as of December 31, 2002 and 2003, and the related consolidated statements of operations, cash flows and changes in shareholders equity for each of the years in the three-year period ended December 31, 2003, all expressed in Renminbi. These consolidated financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of China Southern Airlines Company Limited and its subsidiaries as of December 31, 2002 and 2003, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2003 in conformity with International Financial Reporting Standards promulgated by the International Accounting Standards Board.

International Financial Reporting Standards vary in certain significant respects from accounting principles generally accepted in the United States of America. Information relating to the nature and effect of such differences is presented in Note 33 to the consolidated financial statements.

The accompanying consolidated financial statements as of and for the year ended December 31, 2003 have been translated into United States dollars solely for the convenience of the reader. We have audited the translation, and in our opinion, the consolidated financial statements expressed in Renminbi have been translated into United States dollars on the basis set forth in Note 1 to the consolidated financial statements.

KPMG
Hong Kong
April 23, 2004

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CHINA SOUTHERN AIRLINES COMPANY LIMITED AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS
For the years ended December 31, 2001, 2002 and 2003

(Amounts in thousands, except per share data)

	Note	2001	2002	2003	2003
		RMB	RMB	RMB	U.S. dollars
Operating revenue:					
Traffic revenue, net	3	16,461,532	17,481,892	16,964,800	2,049,706
Other revenue	4	418,126	536,728	505,323	61,053
Total operating revenue		16,879,658	18,018,620	17,470,123	2,110,759
Operating expenses:					
Flight operations	5	6,905,628	6,732,543	7,070,031	854,209
Maintenance	6	2,014,579	2,333,419	2,588,613	312,759
Aircraft and traffic servicing	7	2,297,521	2,511,284	2,767,488	334,371
Promotion and sales	8	1,540,780	1,499,587	1,480,168	178,836
General and administrative	9	892,233	1,060,010	1,053,319	127,263
Depreciation and amortization		1,814,974	1,839,871	2,037,971	246,230
Other		13,270	15,829	16,804	2,029
Total operating expenses		15,478,985	15,992,543	17,014,394	2,055,697
Operating income		1,400,673	2,026,077	455,729	55,062
Non-operating income/(expenses):					
Equity income of affiliated companies		53,077	36,988	47,798	5,775
Equity loss of jointly controlled entities		(4,034)	(3,352)	(39,495)	(4,772)
(Loss)/gain on sale of fixed assets	13, 24	(55,889)	170,740	(22,217)	(2,684)
Interest income		49,878	52,618	13,061	1,578
Interest expense	16	(933,717)	(959,193)	(823,725)	(99,523)
Exchange gain/(loss), net		296,777	(175,451)	(164,443)	(19,868)
Other, net		(11,509)	(9,328)	21,682	2,619
Total non-operating expenses		(605,417)	(886,978)	(967,339)	(116,875)

Income/(loss) before taxation and minority interests		795,256	1,139,099	(511,610)	(61,813)
Taxation (expense)/credit	10	(320,519)	(398,227)	324,277	39,179
Income/(loss) before minority interests		474,737	740,872	(187,333)	(22,634)
Minority interests		(134,512)	(165,111)	(170,934)	(20,652)
Net income/(loss)		340,225	575,761	(358,267)	(43,286)
Basic earnings/(loss) per share	2(w)	0.10	0.17	(0.09)	(0.01)

See accompanying notes to consolidated financial statements

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CHINA SOUTHERN AIRLINES COMPANY LIMITED AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS
As of December 31, 2002 and 2003

(Amounts in thousands)

	Note	2002	2003	2003
		RMB	RMB	U.S. dollars
ASSETS				
CURRENT ASSETS				
Cash and cash equivalents	11	3,771,043	2,080,174	251,329
Trade receivables	12	671,776	833,604	100,717
Other receivables		372,586	296,047	35,769
Inventories		545,700	543,777	65,700
Prepaid expenses and other current assets		244,690	247,926	29,954
TOTAL CURRENT ASSETS		5,605,795	4,001,528	483,469
FIXED ASSETS	13	26,920,829	28,535,907	3,447,739
CONSTRUCTION IN PROGRESS	14	661,352	1,629,689	196,901
LEASE PREPAYMENTS		201,854	348,652	42,124
INVESTMENTS	15	1,355,842	1,358,495	164,135
LEASE AND EQUIPMENT DEPOSITS		2,147,038	2,932,591	354,319
OTHER ASSETS		295,337	255,233	30,838
TOTAL ASSETS		37,188,047	39,062,095	4,719,525
LIABILITIES AND SHAREHOLDERS EQUITY				
CURRENT LIABILITIES				
Notes payable, including current installments of long-term notes payable	16	5,240,726	7,096,846	857,449
Current installments of obligations under capital leases	17	1,566,698	1,297,855	156,808
Accounts payable		532,480	928,093	112,133
Bills payable		1,299,680	438,135	52,936
Sales in advance of carriage		390,531	466,087	56,313
Taxes payable		78,145	89,954	10,868
Amounts due to related companies		525,090	929,003	112,243
Accrued expenses	18	2,341,454	2,527,794	305,411
Other liabilities		646,989	1,019,811	123,215
TOTAL CURRENT LIABILITIES		12,621,793	14,793,578	1,787,376

NOTES PAYABLE, EXCLUDING CURRENT INSTALLMENTS	16	5,835,434	4,521,735	546,321
OBLIGATIONS UNDER CAPITAL LEASES, EXCLUDING CURRENT INSTALLMENTS	17	6,631,751	5,543,084	669,722
PROVISION FOR MAJOR OVERHAULS	6	141,887	189,464	22,891
DEFERRED CREDITS	19	48,095	46,554	5,625
DEFERRED TAXATION	20	779,234	398,305	48,124
TOTAL LIABILITIES		26,058,194	25,492,720	3,080,059
MINORITY INTERESTS		1,516,646	1,673,668	202,214
SHAREHOLDERS EQUITY	21,22	9,613,207	11,895,707	1,437,252
TOTAL LIABILITIES AND SHAREHOLDERS EQUITY		37,188,047	39,062,095	4,719,525

See accompanying notes to consolidated financial statements.

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CHINA SOUTHERN AIRLINES COMPANY LIMITED AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS
For the years ended December 31, 2001, 2002 and 2003

(Amounts in thousands)

	Note	2001	2002	2003	2003
		RMB	RMB	RMB	U.S. dollars
Cash inflows from operations	28(a)	3,185,523	4,762,923	3,074,718	371,491
Interest received		49,878	52,618	13,061	1,578
Interest paid		(970,734)	(1,051,027)	(923,901)	(111,627)
Income tax paid		(40,724)	(66,970)	(35,129)	(4,244)
Net cash inflows from operating activities		2,223,943	3,697,544	2,128,749	257,198
Investing activities:					
Proceeds from sale of aircraft		566,493	778,047	29,275	3,537
Proceeds from sale of other fixed assets		38,892	47,150	27,802	3,359
Proceeds from sale of investments in equity securities			68		
Dividends received from affiliated companies		5,946	3,093		
(Increase)/decrease in other assets		(345)	(943)	5,654	683
Payment of lease and equipment deposits		(2,027,063)	(1,999,233)	(1,851,726)	(223,727)
Refund of lease and equipment deposits		200,029	2,117,386	1,066,086	128,806
Capital expenditures		(1,492,126)	(6,351,030)	(4,706,740)	(568,674)
Purchase of investments in equity securities		(1,241)	(6,721)	(1,065)	(129)
Investments in affiliated companies		(147,875)	(136,500)		
Investments in jointly controlled entities		(178,372)	(295,670)	(2,999)	(362)
Governmental subsidy for safety related capital expenditures			40,240		
Effect of acquisition of subsidiaries, net of cash and cash equivalents acquired	28(c)		(90,491)		
Net cash used in investing activities		(3,035,662)	(5,894,604)	(5,433,713)	(656,507)
Net cash outflows before financing activities		(811,719)	(2,197,060)	(3,304,964)	(399,309)

Financing activities:

Proceeds from A share issue, net of issuance costs			2,640,767	319,060
Proceeds from bank notes payable	2,123,613	6,996,780	8,913,992	1,076,998
Repayment of bank notes payable	(890,228)	(2,194,630)	(8,371,362)	(1,011,437)
Repayment of principal under capital lease obligations	(1,756,098)	(1,546,185)	(1,555,390)	(187,924)
Minority shareholders contributions	707	10,625	1,050	127
Dividends paid to shareholders		(67,484)		
Dividends paid to minority shareholders	(45,867)	(48,866)	(14,962)	(1,807)
Net cash (outflows)/inflows from financing activities	(567,873)	3,150,240	1,614,095	195,017
(Decrease)/increase in cash and cash equivalents	(1,379,592)	953,180	(1,690,869)	(204,292)
Cash and cash equivalents at beginning of year	4,197,455	2,817,863	3,771,043	455,621
Cash and cash equivalents at end of year	2,817,863	3,771,043	2,080,174	251,329

See accompanying notes to consolidated financial statements.

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**CHINA SOUTHERN AIRLINES COMPANY LIMITED
AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS EQUITY
For the years ended December 31, 2001, 2002 and 2003**

(Amounts in thousands)

	Note	Share capital	Share premium	Other reserves	Retained profits	Total
		RMB	RMB	RMB	RMB	RMB
Shareholders equity at January 1, 2001		3,374,178	3,813,659	664,945	1,028,656	8,881,438
Net income					340,225	340,225
Appropriations to reserves				22,229	(22,229)	
Shareholders equity at December 31, 2001		3,374,178	3,813,659	687,174	1,346,652	9,221,663
Land use rights adjustment	22(f)		(129,703)		12,970	(116,733)
Adjustments from adoption of new PRC accounting regulations	22(c)			(185,540)	185,540	
Dividend paid					(67,484)	(67,484)
Net income					575,761	575,761
Appropriations to reserves				83,738	(83,738)	
Shareholders equity at December 31, 2002		3,374,178	3,683,956	585,372	1,969,701	9,613,207
Issue of A shares	21	1,000,000	1,640,767			2,640,767
Net loss					(358,267)	(358,267)
Appropriations to reserves				24,969	(24,969)	
Shareholders equity at December 31, 2003		4,374,178	5,324,723	610,341	1,586,465	11,895,707
Shareholders equity at December 31, 2003 in U.S. dollars		528,493	643,339	73,741	191,679	1,437,252

See accompanying notes to consolidated financial statements.

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CHINA SOUTHERN AIRLINES COMPANY LIMITED AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Amounts in thousands, except share data)

1. BASIS OF PRESENTATION

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

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

The Company s H Shares and American Depositary Shares (ADS) (each ADS representing 50 H Shares) are listed on the Stock Exchange of Hong Kong Limited and the New York Stock Exchange, respectively, since July 1997. In July 2003, the Company issued 1,000,000,000 A shares which are listed on the Shanghai Stock Exchange.

The consolidated financial statements have been prepared in Renminbi (RMB), the national currency of China. Solely for the convenience of the reader, the 2003 financial statements have been translated into United States dollars at the rate of US$ 1.00 = RMB 8.2767, the rate quoted by the People s Bank of China on December 31, 2003. No representation is made that the RMB amounts could have been, or could be, converted into United States dollars (US$) at that rate or at any other certain rate on December 31, 2003 or at any other certain date.

2. PRINCIPAL ACCOUNTING POLICIES

(a) Statement of compliance

The consolidated financial statements of the Group have been prepared in accordance with International Financial Reporting Standards (IFRS) promulgated by the International Accounting Standards Board. IFRS includes International Accounting Standards (IAS) and related interpretations.

Information relating to the nature and effect of the significant differences between IFRS and accounting principles generally accepted in the United States of America (U.S. GAAP) are set forth in Note 33.

(b) Basis of preparation

The consolidated financial statements of the Group are prepared on the historical cost basis as modified by the revaluation of certain fixed assets (Note 13). The accounting policies have been consistently applied by the Group and except for a change in accounting policy for land use rights in 2002 (Note 22(f)), are consistent with those used in previous years.

CHINA SOUTHERN AIRLINES COMPANY LIMITED AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)
(Amounts in thousands, except share data)

(c) Basis of consolidation

The consolidated financial statements include the financial statements of the Company and all of its subsidiaries (see Note 29 for details of the Company s principal subsidiaries) made up to December 31, each year. Subsidiaries are those enterprises controlled by the Group. Control exists when the Group has the power, directly or indirectly, to govern the financial and operating policies of an enterprise so as to obtain benefits from its activities. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control effectively commences until the date that control effectively ceases.

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

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

(d) Interest- bearing borrowings

Interest-bearing borrowings are recognized initially at cost, less attributable transaction costs. Subsequent to initial recognition, interest-bearing borrowings are stated at amortized cost with any difference between cost and redemption value being recognized in the consolidated statements of operations over the period of the borrowings on an effective interest basis.

(e) Cash and cash equivalents

Cash and cash equivalents consist of cash in hand and balances with banks and other financial institutions with an original maturity within three months. For the purposes of the consolidated statements of cash flows, the Group considers all highly liquid debt instruments purchased with an original maturity of three months or less to be cash equivalents. None of the Group s cash and cash equivalents is restricted as to withdrawal.

(f) Trade and other receivables

Trade and other receivables are stated at cost less allowance for doubtful accounts. Allowance for doubtful accounts are established based on evaluation of the recoverability of these accounts at the balance sheet date. In establishing such allowance, the Group considers various factors including its historical write-off experience and industry economic trend. Past due balances over a specific period and balances over a specific amount are reviewed individually for collectibility. All other balances are reviewed on a pooled basis.

CHINA SOUTHERN AIRLINES COMPANY LIMITED
AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)
(Amounts in thousands, except share data)

(g) Inventories

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

(h) Fixed assets and depreciation

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

Depreciation is provided to write off the costs, or revalued amounts where appropriate, of the fixed assets on a straight line basis over their estimated useful lives, to residual values, as follows:

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

No depreciation is provided in respect of construction in progress.

(i) Leased assets

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

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

**CHINA SOUTHERN AIRLINES COMPANY LIMITED
AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)
(Amounts in thousands, except share data)**

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

Operating lease payments are charged to the consolidated statements of operations on a straight line basis over the terms of the related leases.

(j) Construction in progress

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

(k) Lease prepayments

Lease prepayments represent the purchase costs of land use rights and are amortized on a straight line basis over the period of land use rights (Note 22(f)).

(l) Investments

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

A jointly controlled entity is an entity over whose activities the Group has joint control, established by contractual agreement.

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

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

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**CHINA SOUTHERN AIRLINES COMPANY LIMITED
AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)
(Amounts in thousands, except share data)**

(m) Deferred expenditure

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

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

(n) Impairment loss

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

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

(o) Deferred credits

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

**CHINA SOUTHERN AIRLINES COMPANY LIMITED
AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)
(Amounts in thousands, except share data)**

(p) Revenue recognition

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

Interest income is recognized as it accrues unless collectibility is in doubt. Dividend income is recognized when the Group s right to receive payment is established.

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

(q) Traffic commissions

Traffic commissions are expensed when the transportation is provided and the related revenue is recognized. Traffic commissions for transportation not yet provided are recorded in the consolidated balance sheets as a prepaid expense.

(r) Maintenance and overhaul costs

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

(s) Translation of foreign currencies

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

Foreign currency monetary balances at the balance sheet date are translated into Renminbi at the exchange rates quoted by the People s Bank of China ruling at the balance sheet date. Exchange differences are dealt with in the consolidated statements of operations.

(t) Borrowing costs

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

**CHINA SOUTHERN AIRLINES COMPANY LIMITED
AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)
(Amounts in thousands, except share data)**

(u) Deferred taxation

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

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

(v) Retirement benefits

Contributions to retirement schemes and additional retirement benefits paid to retired employees are charged to the consolidated statements of operations as and when incurred (Note 24).

(w) Basic earnings/(loss) per share

Basic earnings/(loss) per share for the years ended December 31, 2001, 2002 and 2003 have been computed by dividing net income/(loss) of RMB340,225, RMB575,761 and RMB(358,267), respectively, by the weighted average number of shares in issue of 3,374,178,000 in 2001 and 2002, and 3,831,712,000 in 2003, respectively.

The amount of diluted earnings/(loss) per share is not presented, as there were no dilutive potential ordinary shares in existence during the years ended December 31, 2001, 2002 and 2003.

(x) Frequent flyer award programs

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

Revenue from mileage sales to third parties under the frequent flyer award programs is recognized when the related transportation services are provided.

**CHINA SOUTHERN AIRLINES COMPANY LIMITED
AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)
(Amounts in thousands, except share data)**

(y) Provisions

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

(z) Related parties

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

(aa) Segmental reporting

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

(i) Traffic revenue from domestic services within the PRC (excluding Hong Kong) is attributed to the domestic operation. Traffic revenue from inbound/outbound services between the PRC and Hong Kong, and the PRC and overseas destinations is attributed to the Hong Kong regional operation and international operation, respectively.

(ii) Other revenue from ticket selling, general aviation and ground services, air catering and other miscellaneous services is attributed on the basis of where the services are performed.

(ab) Use of estimates

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

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CHINA SOUTHERN AIRLINES COMPANY LIMITED AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)
(Amounts in thousands, except share data)

3. TRAFFIC REVENUE

Traffic revenue is stated net of sales tax and levies paid to PRC authorities and consists of:

	Year ended December 31,		
	2001	2002	2003
	RMB	RMB	RMB
Passenger	15,055,496	15,695,622	15,009,885
Cargo and mail	1,406,036	1,786,270	1,954,915
	16,461,532	17,481,892	16,964,800

Pursuant to various PRC revenue tax rules and regulations, the Group is required to pay sales tax to national and local tax authorities at the rate of approximately 3% of the ticket value in respect of flights originated in the PRC during the years ended December 31, 2001, 2002 and 2003, except for the period from May 1, 2003 to December 31, 2003 during which passenger revenue was exempted from sales tax. Sales tax incurred by the Group for the years ended December 31, 2001, 2002 and 2003 amounted to RMB535,473, RMB557,784 and RMB205,925, respectively.

In addition, the Group is required to pay contributions to the CAAC Infrastructure Development Fund which were calculated at the rates of 5% and 2%, respectively, of the domestic and international/Hong Kong regional traffic revenue during the years ended December 31, 2001, 2002 and 2003, except for the period from May 1, 2003 to December 31, 2003 during which the Group was exempted from paying the contributions. Contributions to the CAAC Infrastructure Development Fund payable by the Group for the years ended December 31, 2001, 2002 and 2003 totaled RMB759,385, RMB798,386 and RMB250,802, respectively.

Pursuant to approval documents issued by the CAAC, the Group imposes a fuel surcharge on passengers carried by its domestic and Hong Kong regional flights at certain prescribed rates on ticket fares. The fuel surcharge forms part of the traffic revenue of the Group. For the years ended December 31, 2001, 2002 and 2003, the fuel surcharge revenue totaled RMB1,001,000, RMB554,000 and RMB740,000, respectively.

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CHINA SOUTHERN AIRLINES COMPANY LIMITED AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)
(Amounts in thousands, except share data)

4. OTHER OPERATING REVENUE

	Year ended December 31,		
	2001	2002	2003
	RMB	RMB	RMB
Commission income	129,157	137,928	140,180
General aviation income	61,292	68,225	40,309
Ground services income	55,388	78,616	99,130
Air catering income	29,523	38,077	30,756
Net income from lease arrangements (Note 13)		51,682	69,121
Rental income			40,307
Aircraft lease income	65,486	46,640	
Other	77,280	115,560	85,520
	418,126	536,728	505,323

5. FLIGHT OPERATIONS EXPENSES

	Year ended December 31,		
	2001	2002	2003
	RMB	RMB	RMB
Fuel costs	3,548,860	3,519,005	3,866,932
Operating lease rentals	1,912,832	1,416,524	1,536,466
Air catering expenses	554,165	625,489	509,839
Aircraft insurance	123,439	256,238	195,700
Flight personnel payroll and welfare	657,193	781,223	728,175
Training expenses	24,374	38,908	123,438
Other	84,765	95,156	109,481
	6,905,628	6,732,543	7,070,031

**CHINA SOUTHERN AIRLINES COMPANY LIMITED
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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)
(Amounts in thousands, except share data)**

6. MAINTENANCE EXPENSES

	Year ended December 31,		
	2001	2002	2003
	RMB	RMB	RMB
Repairing and maintenance charges	1,558,331	1,842,213	2,076,916
Maintenance materials	286,505	292,492	299,719
Labor costs	104,949	130,254	139,355
Other	64,794	68,460	72,623
	2,014,579	2,333,419	2,588,613

An analysis of provision for major overhauls in respect of aircraft held under operating leases is as follows:

	Year ended December 31,		
	2001	2002	2003
	RMB	RMB	RMB
Balance at beginning of year	241,895	187,125	193,887
Additional amount provided	12,889	49,051	68,620
Amount utilized	(67,659)	(42,289)	(62,326)
Balance at end of year	187,125	193,887	200,181

Balance of provision for major overhauls at December 31, 2002 and 2003 consisted of:

	December 31,	
	2002	2003

	RMB	RMB
Current portion (included in accrued expenses) (Note 18)	52,000	10,717
Non-current portion	141,887	189,464
	193,887	200,181

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CHINA SOUTHERN AIRLINES COMPANY LIMITED
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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)
(Amounts in thousands, except share data)

7. AIRCRAFT AND TRAFFIC SERVICING EXPENSES

	Year ended December 31,		
	2001	2002	2003
	RMB	RMB	RMB
Landing and navigation fees	2,157,392	2,353,412	2,562,488
Ground service charges	140,129	157,872	205,000
	2,297,521	2,511,284	2,767,488

8. PROMOTION AND SALES EXPENSES

	Year ended December 31,		
	2001	2002	2003
	RMB	RMB	RMB
Sales commissions	891,646	749,953	757,423
Ticket office expenses	440,445	515,648	503,623
Computer reservation services	153,409	174,547	175,197
Advertising and promotion	26,434	31,513	23,756
Other	28,846	27,926	20,169
	1,540,780	1,499,587	1,480,168

9. GENERAL AND ADMINISTRATIVE EXPENSES

	Year ended December 31,		
	2001	2002	2003

	RMB	RMB	RMB
General corporate expenses	557,083	658,833	680,141
Salaries and welfare	312,396	379,406	339,343
Provision for doubtful accounts (Note 32)	1,729	1,304	12,031
Other taxes and levies	21,025	20,467	21,804
	892,233	1,060,010	1,053,319

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CHINA SOUTHERN AIRLINES COMPANY LIMITED
AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)
(Amounts in thousands, except share data)

10. TAXATION EXPENSE/(CREDIT)

On October 17, 2003, the Company s registered address was moved to Guangzhou Economic & Technology Development Zone. In accordance with the Rules and Regulations for Implementation of Income Tax for Foreign Investment Enterprises and Foreign Enterprises of the PRC and a taxation approval document Guangzhou Municipal State Tax Bureau Suo De Shui Zi Que 020043 , the Company is entitled to enjoy the preferential tax policy implemented in the Guangzhou Economic & Technology Development Zone effective October 1, 2003. As a result, the Company s income tax rate has been changed to 15% from 33% beginning from that date.

As a result of the reduction in income tax rate, the Company s net deferred taxation liability balance brought forward from December 31, 2002 of RMB507,077 was reduced by RMB392,137 and a net deferred tax credit of RMB392,137 was recognized for such reduction in income tax rate in the consolidated statement of operations for the year ended December 31, 2003.

In respect of the Group s overseas airline activities, the Group has either obtained exemptions from overseas taxation pursuant to the bilateral aviation agreements between the overseas governments and PRC governments, or has sustained tax losses in these overseas jurisdictions. Accordingly, no provision for overseas tax has been made for the years ended December 31, 2001, 2002 and 2003.

Taxation expense/(credit) consisted of:

	Year ended December 31,		
	2001	**2002**	**2003**
	RMB	**RMB**	**RMB**
Provision for PRC income tax:			
Company and subsidiaries	37,032	71,651	46,938
Affiliated companies	8,085	9,424	3,342
Jointly controlled entities			6,372
	45,117	81,075	56,652
Deferred taxation (Note 20)			
- current year	275,402	317,152	11,208
- adjustment for change in income tax rate			(392,137)
	320,519	398,227	(324,277)

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CHINA SOUTHERN AIRLINES COMPANY LIMITED
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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)
(Amounts in thousands, except share data)

Actual taxation amount in the consolidated statements of operations for the years ended December 31, 2001, 2002 and 2003 differed from the amounts computed by applying the PRC income tax rate of 33%, 33% and 15%, respectively, to income/(loss) before taxation and minority interests as a result of the following:

	Year ended December 31,		
	2001	**2002**	**2003**
	RMB	**RMB**	**RMB**
Expected PRC taxation expense/(credit)	262,434	375,903	(76,742)
Adjustments:			
Gains on sale and leaseback transactions and their amortization	(5,075)	(851)	
Effect on change in income tax rate on deferred taxation			(392,137)
Rate differential on subsidiaries	(51,245)	(60,530)	5,140
Non-deductible expenses	154,152	61,454	79,907
Unrecognized tax losses			21,894
Expired tax losses			34,218
Other, net	(39,747)	22,251	3,443
	320,519	398,227	(324,277)

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

The PRC withholding tax payable in respect of the operating leases executed after September 1, 1999 of RMB11,962, RMB14,305 and RMB7,706, respectively, during 2001, 2002 and 2003 has been included as part of the operating lease rentals.

11. CASH AND CASH EQUIVALENTS

As of December 31, 2002 and 2003, cash and cash equivalents comprise cash at bank and in hand and deposits with Southern Airlines Group Finance Company Limited (SA Finance), a PRC authorized financial institution controlled by CSAHC and an affiliated company of the Group. In accordance with the financial agreement dated

May 22, 1997 between the Company and SA Finance, all the Group s deposits accepted by SA Finance as of December 31, 2002 and 2003 were simultaneously placed with several designated major PRC banks by SA Finance. As of December 31, 2002 and 2003, the Group s deposits with SA Finance totaled RMB900,979 and RMB365,906, respectively (Note 25).

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12. TRADE RECEIVABLES

	December 31,	
	2002	**2003**
	RMB	**RMB**
Trade receivables, principally traffic	731,894	903,601
Less: Allowance for doubtful accounts (Note 32)	60,118	69,997
	671,776	833,604

13. FIXED ASSETS

	December 31,	
	2002	**2003**
	RMB	**RMB**
Buildings	3,160,073	3,287,593
Aircraft	24,970,695	27,684,935
Flight equipment, including rotable spares	6,283,470	6,842,064
Machinery, equipment and vehicles	1,782,400	1,930,273
	36,196,638	39,744,865
Less: Accumulated depreciation and amortization	9,275,809	11,208,958
	26,920,829	28,535,907

Substantially all of the Group s buildings are located in the PRC. The Group was formally granted the rights to use the twenty one parcels of land in Guangzhou, Shenzhen, Zhuhai, Beihai, Changsha, Shantou, Haikou, Zhengzhou, Guiyang and Wuhan by the relevant PRC authorities for a period of 30 to 70 years, which expire between 2020 and 2068. For other land in the PRC on which the Group s buildings are erected, the Group was formally granted the rights to use such land for periods of one to five years commencing in the second quarter of 1997 pursuant to various lease agreements between the Group and CSAHC. The leases with initial one-year term are automatically renewable for another one-year period unless the Group gives appropriate notice of termination. In this connection, rental payments totaling RMB15,224 were paid to CSAHC for each of the years ended December 31, 2001, 2002 and 2003 in respect of these leases (Note 23).

The Group is obligated under various capital leases for aircraft that expire at various dates during the next six years. The gross amount of aircraft and related accumulated amortization recorded under capital leases are as follows:

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	December 31,	
	2002	2003
	RMB	RMB
Aircraft	11,459,978	10,462,575
Less: Accumulated amortization	2,499,495	2,605,406
	8,960,483	7,857,169

As of December 31, 2002 and 2003, certain aircraft of the Group with an aggregate carrying amount of approximately RMB5,822,076 and RMB6,718,737, respectively, were pledged as security under certain loan agreements (Note 16).

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

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

The effect of the above revaluations was to increase annual depreciation charges by approximately RMB65,000, RMB33,000 and RMB 33,000, respectively, for 2001, 2002 and 2003.

During 2003, the Group incurred a loss of RMB20,405 on early retirement of two old Boeing 737-200 aircraft. During 2001 and 2002, pursuant to certain sale and leaseback arrangements, the Group sold two Airbus 320-200 aircraft and four Boeing 757-200 aircraft, respectively, to independent third parties and then entered into operating leases with such parties to lease back the aircraft for a period of eight to nine years. The Group recognized a gain of RMB59,855 and RMB199,394, respectively, in 2001 and 2002, being the excess of the sale proceeds which approximated the aircraft s fair value on the date of disposal over the aircraft s net book value and related disposal costs. Such loss/gain was included under the sub-item (Loss)/gain on sale of fixed assets under Non-operating income/(expenses) in the consolidated statements of operations.

During 2003, the Group entered into operating lease arrangements to lease certain flight training facilities and buildings to Zhuhai Xiang Yi Aviation Technology Company Limited (Zhuhai Xiang Yi), a jointly controlled entity of the Group. The leases with initial one-year term are automatically renewable for another one year unless either party gives appropriate notice of

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termination. In this connection, rental income totaling RMB34,175 was received by the Group during 2003 in respect of the leases. As of December 31, 2003, the cost and accumulated amortization of the relevant fixed assets totaled RMB787,432 and RMB462,281, respectively. As of December 31, 2003, the Group s rental receivable in respect of the leases due in 2004 amounted to RMB34,175.

During 2001 and 2002, the Group entered into arrangements to lease several of its aircraft to independent third parties. The terms of such leases generally range from one to twelve months.

The Group entered into two separate arrangements (the Arrangements) with certain independent third parties during each of 2002 and 2003. Under each of the Arrangements, the Group sold an aircraft and then immediately leased back the aircraft for an agreed period. As agreed, the lease payment obligations, with pre-determined net present value, are to be satisfied solely out of the sale proceeds and such amount has been placed irrevocably by the Group in form of deposits and debt securities in favour of the lessors. The Group has an option to purchase the aircraft at a pre-determined date and an agreed purchase price to be satisfied by the balances of the deposits and debt securities outstanding at that date. In the event that the lease agreement is early terminated by the Group, the Group is liable to pay a pre-determined penalty to the lessor. As long as the Group complies with the lease agreements, the Group is entitled to the continued possession and operation of the aircraft. Since the Group retains substantially all risks and rewards incident to ownership of the aircraft and enjoys substantially the same rights to their use as before the Arrangements, no adjustment has been made to the fixed assets. As of December 31, 2002 and 2003, the net present value of the lease commitments and the corresponding defeased deposits and debt securities amounted to RMB1,322,843 and RMB2,409,252, respectively. As a result of the Arrangements, the Group received net cash benefits of RMB51,682 and RMB69,121 in 2002 and 2003, respectively, which have been recognized as income for the respective years.

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14. CONSTRUCTION IN PROGRESS

As of December 31, 2002 and 2003, included in construction in progress was an amount of RMB432,580 and RMB1,445,760, respectively, in relation to the construction of Guangzhou New Airport.

15. INVESTMENTS

	December 31,	
	2002	2003
	RMB	RMB
Share of net assets in affiliated companies	692,026	422,201
Share of net assets in jointly controlled entities	461,962	731,323
Other investments, at cost	201,854	204,971
	1,355,842	1,358,495

Details of the Group s principal affiliated companies and jointly controlled entities are set out in Note 29.

16. DEBT

Short-term notes payable

	December 31,	
	2002	2003
	RMB	RMB
Short-term notes payable	4,422,926	6,408,806

As of December 31, 2002 and 2003, borrowings under short-term notes payable of the Group totaling RMB1,450,000 and RMB130,500, respectively, were guaranteed by CSAHC. In addition, as of December 31, 2003, borrowings under short-term notes payable of the Group totaling RMB63,000 and RMB21,000 were guaranteed by Guangzhou Baiyun International Airport Company Limited and Shenzhen Yingshun Investment Development

Company Limited, respectively.

Borrowings under short-term notes payable are used primarily to finance working capital needs and are repayable in full on the respective due dates with interest rates ranging from 1.42% to 5.31%. The Group s weighted average interest rate on short-term notes payable was 3.11% and 1.76%, respectively, as of December 31, 2002 and 2003.

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Long-term notes payable

	Interest rate and final maturity	December 31, 2002	December 31, 2003
		RMB	RMB
Renminbi denominated notes payable:			
Loans for construction projects	Floating interest rates ranging from 4.94% to 5.25% per annum as of December 31, 2003, with maturities through 2009.	893,838	12,357
	Non-interest bearing loan from a municipal government authority, repayable in 2005	3,000	3,000
Loans for purchase of aircraft	Floating interest rate of 5.49% per annum as of December 31, 2003, with maturities through 2004	2,310,268	63,500
U.S. dollar denominated notes payable:			
Loans for purchase of aircraft	Fixed interest rates ranging from 5.00% to 8.33% per annum as of December 31, 2003, with maturities through 2011.	3,426,038	2,612,687
	Floating interest rates ranging from 1.48% to 1.50% per annum as of December 31, 2003 with maturities through 2013		2,505,134
Loan for purchase of flight equipment	Fixed interest rate of 8.35% per annum as of December 31, 2003, with maturity in 2004	20,090	13,097
		6,653,234	5,209,775
Less: current installments		(817,800)	(688,040)

5,835,434	4,521,735

As of December 31, 2002 and 2003, borrowings under long-term notes payable of the Group totaling RMB3,360,945 and RMB2,564,586, respectively, were guaranteed by certain financial institutions and secured by the mortgages over certain of the Group s aircraft. In addition, as of December 31, 2002 and 2003, borrowings under long-term notes payable of the Group totaling RMB1,890,118 and RMB228,800, respectively, were guaranteed by CSAHC and RMB561,531 and RMB10,052, respectively, were guaranteed by SA Finance.

As of December 31, 2003, the Group had banking facilities with several PRC commercial banks for providing loan finance up to an amount of RMB9,860,000. As of December 31, 2003, an amount of approximately RMB4,412,000 was utilized.

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The aggregate annual maturities of long-term notes payable for each of the five years subsequent to December 31, 2003 and thereafter are as follows:

	RMB
Year ending December 31,	
2004	688,040
2005	649,492
2006	403,994
2007	372,251
2008	447,465
Thereafter	2,648,533
	5,209,775

Interest expense, net of the amounts capitalized, represents:

	Year ended December 31,		
	2001	2002	2003
	RMB	RMB	RMB
Interest incurred	938,944	1,023,379	906,802
Interest capitalized	(5,227)	(64,186)	(83,077)
Interest expense	933,717	959,193	823,725

Interest rates per annum at which borrowing costs were capitalized were 5.70%, 5.70% and 1.62% to 5.46%, respectively, for the years ended December 31, 2001, 2002 and 2003.

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17. LEASE OBLIGATIONS

Capital leases

As of December 31, 2003, the Group leased 29 aircraft under capital leases. The majority of these leases have terms of 10 to 15 years, and expiration dates range from 2004 through 2009.

As of December 31, 2003, future scheduled minimum lease payments under capital leases, which were 74% and 26%, respectively, denominated in U.S. dollars and Japanese yen, are as follows:

	Payments RMB	*Interest RMB	Obligations RMB
Year ending December 31,			
2004	1,648,141	350,286	1,297,855
2005	1,356,614	290,163	1,066,451
2006	1,405,424	208,566	1,196,858
2007	1,445,207	157,349	1,287,858
2008	1,497,604	73,503	1,424,101
Thereafter	608,124	40,308	567,816
	7,961,114	1,120,175	6,840,939
Less: current instalments of obligations under capital leases			(1,297,855)
			5,543,084

*Interest rates ranged from 2.23% to 9.36%.

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

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

In addition to the assets mortgaged as security under certain loan agreements (Note 13), certain of the Group s aircraft with an aggregate carrying amount of RMB8,960,483 and RMB7,857,169, respectively, as of December 31, 2002 and 2003 were mortgaged to secure facilities with financial institutions granted to lessors totaling RMB8,198,449 and RMB6,840,939, respectively, on these dates.

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Operating leases

As of December 31, 2003, future minimum lease payments under non-cancellable aircraft and flight equipment operating leases were as follows (principally denominated in U.S. dollars):

	RMB
Year ending December 31,	
2004	1,482,888
2005	1,411,520
2006	1,143,745
2007	921,456
2008	771,374
Thereafter	2,388,874
Total minimum lease payments	8,119,857

Amounts charged to rental expenses for operating leases for the years ended December 31, 2001, 2002 and 2003 totaled RMB1,723,338, RMB1,348,277 and RMB1,408,574, respectively.

All of the Group s obligations under capital and operating leases are guaranteed by financial institutions.

18. ACCRUED EXPENSES

	December 31,	
	2002	2003
	RMB	RMB
Landing and navigation fees	497,372	825,811
Duties and levies	360,827	336,839
Fuel	297,626	254,801
Interest	174,626	157,527
Lease charges	40,900	18,144
Accrued salaries, wages and benefits	245,124	197,332
Repairs and maintenance	198,465	286,636
Current portion of provision for major overhauls (Note 6)	52,000	10,717
Lump sum housing benefits payable (Note 24)	213,675	129,521

Other	260,839	310,466
	2,341,454	2,527,794

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19. DEFERRED CREDITS

	December 31,	
	2002	2003
	RMB	RMB
Operating lease rebates	7,857	6,316
Governmental subsidy for safety related capital expenditures	40,238	40,238
	48,095	46,554
Movements during the year are as follows:		
Balance at beginning of year	15,072	48,095
Additions during the year	40,238	
Transferred to consolidated statement of operations	(7,215)	(1,541)
Balance at end of year	48,095	46,554

Operating lease rebates

Pursuant to several operating lease arrangements for aircraft commenced in January 1998, the Group received cash rebates totaling RMB24,838 from an operating lessor in 1998. Such rebates have been deferred and amortized over the terms of the respective lease to reduce the future operating lease charges.

Governmental subsidy for safety related capital expenditures

During 2002, the Group received governmental subsidy for safety related capital expenditures amounting to RMB40,240 for enhancing future flight protection and safety standards. Such governmental subsidy is to be amortized over the depreciable lives of the related fixed assets.

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20. DEFERRED TAXATION

Movements in net deferred tax liabilities are as follows:

	December 31,	
	2002	2003
	RMB	RMB
Balance at beginning of year	(519,577)	(779,234)
Land use rights adjustment (Note 22(f))	57,495	
Transferred to consolidated statement of operations (Note 10)		
- current year	(317,152)	(11,208)
- adjustment for change in income tax rate		392,137
Balance at end of year	(779,234)	(398,305)

The net deferred tax liabilities were made up of the following taxation effects:

	December 31,	
	2002	2003
	RMB	RMB
Deferred tax assets:		
Tax losses carried forward	149,338	222,936
Fixed assets, principally due to repair charges capitalized	319,697	261,312
Accrued expenses	375,789	106,491
Other	129,423	8,989
Total deferred tax assets	974,247	599,728
Deferred tax liabilities:		
Undistributed profits of subsidiaries	254,210	
Accrued expenses	78,083	80,545

Fixed assets, principally due to difference in depreciation	1,403,278	847,781
Other	17,910	69,707
Total deferred tax liabilities	1,753,481	998,033
Net deferred tax liabilities	(779,234)	(398,305)

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In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable profits during the periods in which those temporary differences become deductible. Management considers the scheduled reversal of deferred tax liabilities and projected future taxable profits in making this assessment. Based upon the projections for future taxable profits over the periods in which the deferred tax assets are deductible, management believes it is more likely than not that the Group will realize the benefits of these deductible differences. The amount of the deferred tax assets considered realizable, however, could be reduced in the near term if estimates of future taxable profits during the carryforward period are reduced.

As of December 31, 2003, the Group had tax losses for PRC income tax purposes totaling approximately RMB1,486,240. Such tax losses are available for carry forward to set-off against future PRC assessable income for a maximum period of five years. Of these tax losses, approximately RMB262,957, RMB106,156 and RMB1,117,127 will expire after December 31, 2004, 2007 and 2008, respectively. As of December 31, 2003, the Group recorded a deferred tax asset of RMB222,936 for such tax losses.

As of December 31, 2003, the Group had tax losses of approximately RMB303,000 available for offset against future assessable profits arising from Hong Kong profits, if any, over an indefinite period. The Group has not recognized a deferred tax asset in respect of such tax losses as it would not be probable that future taxable profits will be available against which the taxable losses can be utilized.

21. SHARE CAPITAL

	December 31,	
	2002	2003
	RMB	RMB
Registered capital as of December 31:		
2,200,000,000 domestic shares of RMB 1.00 each	2,200,000	2,200,000
1,174,178,000 H shares of RMB 1.00 each	1,174,178	1,174,178
1,000,000,000 A share of RMB1.00 each		1,000,000
	3,374,178	4,374,178
Issued and paid up capital as of December 31:		
2,200,000,000 domestic shares of RMB 1.00 each	2,200,000	2,200,000
1,174,178,000 H shares of RMB 1.00 each	1,174,178	1,174,178
1,000,000,000 A share of RMB1.00 each		1,000,000

	3,374,178	4,374,178

In July 2003, the Company issued 1,000,000,000 A shares with a par value of RMB1.00 each at issue price of RMB2.70 by way of a public offering to natural persons and institutional investors in the PRC. The share premium received by the Company, net of the issuance costs of RMB59,233, amounted to RMB1,640,767 and was credited to share premium account.

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

As of December 31, 2002 and 2003, the retained earnings of the Group included RMB135,010 and RMB112,985, respectively, of undistributed earnings of companies which are 50% or less owned by the Group and accounted for under the equity method.

22. RESERVES

Movements of reserves are as follows:

	December 31,	
	2002	2003
	RMB	RMB
Statutory surplus reserve (Note (a))		
Balance at beginning of year	391,867	337,195
Adjustments from adoption of PRC accounting regulations (Note (c))	(106,007)	
Transferred from consolidated statement of operations	51,335	23,856
Balance at end of year	337,195	361,051
Statutory public welfare fund (Note (b))		
Balance at beginning of year	225,440	171,574
Adjustments from adoption of PRC accounting regulations (Note (c))	(79,533)	
Transferred from consolidated statement of operations	25,667	1,113
Balance at end of year	171,574	172,687
Discretionary surplus reserve (Note (d))		
Balance at beginning of year	69,867	76,603
Transferred from consolidated statement of operations	6,736	
Balance at end of year	76,603	76,603

	585,372	610,341

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Notes:

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

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

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

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

(d) The usage of this reserve is similar to that of statutory surplus reserve.

(e) Dividend distributions may be proposed at the discretion of the Company s Board of Directors, after consideration of the transfers referred to above and making up cumulative prior years losses, if any. Pursuant to the Company s Articles of Association, the net income of the Company for the purpose of dividend distribution is deemed to be the lesser of net income determined in accordance with (i) PRC accounting principles and financial regulations, and (ii) IFRS; or if the financial statements of the Company are not prepared in accordance with IFRS, the accounting standards of one of the countries in which its shares are listed (Note 27).

(f) The Group adopted IAS 40 Investment Property in 2002. According to IAS 40, the land use rights which were previously included in fixed assets at revaluation base are now presented as lease prepayments and carried at historical cost base with effect from January 1, 2002. Accordingly, the unamortized surplus on previous revaluations of the land use rights, net of related deferred tax asset, are reversed to the share premium and retained profits accounts. The IAS 40 was adopted prospectively in 2002 as the effect of this change did not have a material impact on the Group s financial condition and results of operations in the periods prior to the change.

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23. COMMITMENTS AND CONTINGENCIES

The Company has been advised by its Chinese legal counsel that, except for liabilities constituting or arising out of or relating to the business assumed by the Company in the Reorganization (Note 1), no other liabilities were assumed by the Company, and the Company is not jointly and severally liable for other debts and obligations incurred by CSAHC prior to the Reorganization, except for certain loans from PRC banks which were fully repaid by CSAHC. There are not, however, any definitive PRC regulations or other pronouncements confirming such conclusion.

The Group leases from CSAHC certain land in Guangzhou and certain land and buildings in Wuhan, Haikou and Zhengzhou. The Group has a significant investment in buildings and other leasehold improvements located on such land. However, such land in Guangzhou and such land and buildings in Wuhan, Haikou and Zhengzhou lack adequate documentation evidencing CSAHC s rights thereto and the lease agreements between CSAHC and the Group may not be registered with the relevant authorities. Lack of registration may affect the validity of such lease agreements.

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

The Group is currently involved in a civil litigation (the Litigation). According to the writ of summons for the Litigation, the plaintiff, claimed against the Group for unspecified damages for breach of certain agreement. Given that the Litigation is still at its preliminary stage, it is pre-matured to predict the outcome. Based on the opinion given by the Company s instructing solicitors, the directors of the Company consider that the Group has a reasonable chance of success in its defense to the claim. Accordingly, the directors of the Company consider that a provision for such claim and/or the associated legal costs is not required.

As of December 31, 2003, the Group had on order two Boeing 757-200 aircraft, thirteen Boeing 737-700 aircraft, four Airbus 330-200 aircraft, six Embraer ERJ-145 aircraft and certain flight equipment, scheduled for deliveries in 2004 to 2005. Deposits of RMB2,494,853 have been made towards the purchase of these aircraft and related equipment. As of December 31, 2003, the aggregate future payments, including estimated amounts for price escalation through anticipated delivery dates for these aircraft and related equipment totaled approximately RMB10,615,079.

As of December 31, 2003, additional capital expenditures of approximately RMB3,012,607 have been authorized, of which approximately RMB849,847 have been committed, for the Group s principal facilities. Such expenditures comprised mainly RMB2,071,938 for facilities and equipment at the Guangzhou New Airport and RMB940,669 for other airport and office facilities and equipment, overhaul and maintenance bases and training centers.

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As of December 31, 2003, the Group was committed to make a capital contribution of approximately RMB446,000 to jointly controlled entities.

The Group has taken steps towards the purchase of the airline business of China Northern Airlines Company and Xinjiang Airlines Company. No contractual obligations existed as of December 31, 2003 and up to the date of approval of these consolidated financial statements. The purchase price has not yet been determined.

24. RETIREMENT AND POST-RETIREMENT MEDICAL BENEFITS

Employees of the Group participate in several defined contribution retirement schemes organized separately by PRC municipal governments in regions where the major operations of the Group are located. The Group is required to contribute to these schemes at the rates ranging from 14% to 17% for 2001, 14% to 19% for 2002 and 2003 of salary costs including certain allowances. A member of the retirement schemes is entitled to pension benefits equal to a fixed proportion of the salary at the retirement date. The retirement benefit obligations of all existing and future retired staff of the Group are assumed by these schemes. Contributions to the retirement schemes are charged to consolidated statements of operations as and when incurred. Contributions to the retirement schemes amounted to RMB62,833, RMB112,285 and RMB131,327, respectively, during 2001, 2002 and 2003.

In addition, the Group was selected as one of the pilot enterprises to establish a supplementary defined contribution retirement scheme for the benefit of employees. In this connection, employees of the Group participate in a supplementary defined contribution retirement scheme whereby the Group is required to make defined contributions at the rate of 4.5% of total salaries. The Group has no obligation for the payment of pension benefits beyond the contributions described above. Contributions to the retirement schemes are charged to consolidated statements of operations as and when incurred. Contributions to the retirement schemes amounted to RMB15,000, RMB19,337 and RMB19,120, respectively, during 2001, 2002 and 2003.

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

During 2001 and 2002, the Group provided additional quarters at its own expense to certain employees who are not eligible for quarters pursuant to the Services Agreement. These quarters were provided to the employees in accordance with the relevant PRC housing reform policy. In 2001 and 2002, the Group recognized a loss of RMB110,723 and RMB17,624, respectively, being the excess of the cost of these quarters over the considerations received by the Group from the employees, under the sub-item (Loss)/gain on sale of fixed assets under Non-operating income/(expenses) in the consolidated statements of operations.

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Subsequently, pursuant to an additional staff housing benefit scheme effective September 2002, the Group has agreed to pay lump sum housing allowances to certain employees who have not received quarters from CSAHC or the Group according to the relevant PRC housing reform policy, for subsidizing their purchases of housing. Such expenditure has been deferred and amortized on a straight line basis over a period of 10 years, which represents the vesting benefit period of the employees. An employee who quits prior to the end of the vesting benefit period is required to pay back a portion of the lump sum housing benefits determined on a pro-rata basis of the vesting benefit period remained. The Group has the right to effect a charge on the employee s house and to enforce repayment through selling the house in the event of default in repayment. Any shortfall in repayment would be charged against consolidated statements of operations. As of December 31, 2003, the Group already made payments totaling RMB130,479 under the scheme and recorded its remaining contractual liabilities totaling RMB129,521 as accrued liabilities on the consolidated balance sheets (Note 18).

25. RELATED PARTY TRANSACTIONS

The Group obtained various operational and financial services provided by CSAHC and its affiliates, and the Group s affiliated companies and jointly controlled entities during the normal course of its business. In the past, CSAHC was under the direct control of the CAAC. However, such control has been shifted to the State Assets Administration Committee since early 2003. Consequently, transactions with the CAAC and its affiliates beginning from 2003 are no longer presented as related party transactions of the Group. The principal related party transactions are described as follows:

Allocation of routes and air fares

Both domestic and international routes on which the Group and other PRC airlines offer scheduled services are allocated by the CAAC.

International air fares are subject to bilateral agreements between the CAAC, acting on behalf of the PRC government, and other governments. Domestic air fares are regulated jointly by the CAAC and the PRC Price Administrative Bureau.

Procurement of aircraft, flight equipment and other airline-related facilities

Certain PRC airlines, including the Group, were granted permission to acquire aircraft, flight equipment and other airline-related facilities directly from manufacturers subject to the approval of their fleet expansion plans by the relevant PRC government authorities.

The Group acquires aircraft, flight equipment and other airline-related facilities through Southern Airlines (Group) Import and Export Trading Company (SAIETC), a wholly-owned subsidiary of CSAHC. Total purchases amounted to RMB324,998, RMB583,548 and RMB1,154,553, respectively, for 2001, 2002 and 2003. Handling fees totaling RMB16,161, RMB 36,306 and RMB27,051, respectively, were paid to SAIETC for 2001, 2002 and 2003.

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Jet fuel supplies

Jet fuel is subject to allocation in the PRC. The Group is required to purchase jet fuel domestically from the China Aviation Oil Supply Company and Lan Tian Oil Supply Company, companies controlled by the CAAC, at prices set by such suppliers in conjunction with the CAAC and other PRC government authorities. During the periods presented, such prices exceeded the international market prices. The cost of jet fuel purchased by the Group in accordance with such allocation was RMB2,586,688 and RMB2,373,956, respectively, during 2001 and 2002. The remainder of the Group s jet fuel was purchased from domestic markets and, to a lesser extent, from international markets.

Aircraft insurance

Aviation insurance covering hull, war and passenger liability risk is arranged by the CAAC on behalf of all PRC airlines with the People s Insurance (Property) Company of China (PICC) under a master policy. PICC reinsures a substantial portion of its aircraft insurance business through the international reinsurance market. Insurance premiums are allocated to each individual PRC airline by the CAAC based on the value of the airline s aircraft and after taking into account the claims history of the airline. Insurance premiums totaling RMB123,439 and RMB256,238, respectively, were incurred by the Group during 2001 and 2002.

Financial arrangements

The Group s obligations under various lease and bank loan arrangements in connection with aircraft acquisitions are secured by guarantees provided by certain PRC financial institutions which obtained back-to-back guarantees from the CAAC. Guarantee fees totaling RMB1,490 and RMB1,025, respectively, were paid to these financial institutions during 2001 and 2002.

Interest income is received from short-term deposits with SA Finance. The applicable interest rate is determined in accordance with the savings rate published by the People s Bank of China. Interest income totaling RMB13,771, RMB10,530 and RMB3,100, respectively, was earned by the Group on such deposits during 2001, 2002 and 2003 (Note 11).

During 2003, CSAHC made short-term advances to the Group. These advances are unsecured, non-interest bearing and repayable on demand. As of 31 December, 2003, the advances amounted to RMB165,995.

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Airline-related services

The Group, jointly with other PRC airlines, participates in the CAAC s computer reservation system, under which the Group purchases computer reservation services from the CAAC at rates determined based on the utilization of the system. Service fees paid by the Group to the CAAC during 2001 and 2002 totaled RMB110,134 and RMB107,234, respectively.

The Group utilizes the passenger departure and cargo handling computer systems installed by the CAAC at certain PRC airports. Service fees are levied by the CAAC based on the utilization of these systems. Service fees totaling RMB57,424 and RMB62,111, respectively, were paid by the Group to the CAAC during 2001 and 2002.

The Group is required to pay landing and navigation fees to various PRC airports in respect of take-off and landing slots allocated to the Group and other ancillary services provided. Fees are payable by the Group based on the scale rates published by the CAAC. Landing and navigation fees totaling RMB1,527,600 and RMB1,667,706, respectively, were paid to various PRC airports during 2001 and 2002.

The Group purchases certain inflight meals and related services from Shenzhen Air Catering Company Limited, a cooperative joint venture established in the PRC, in respect of which CSAHC is entitled to 33% of its income after tax. Such purchases amounted to RMB22,707, RMB29,058 and RMB28,199, respectively, during 2001, 2002 and 2003.

Commission is earned by certain subsidiaries of CSAHC in connection with the air tickets sold by them on behalf of the Group. Commission is calculated based on a fixed rate ranging from 1.5% to 12% on the ticket value. Commission expenses incurred by the Group in respect of tickets sold by certain subsidiaries of CSAHC totaled RMB37,017, RMB16,725 and RMB4,896, respectively, during 2001, 2002 and 2003.

Commission is earned by the CAAC s sales offices and various PRC airlines in connection with the air tickets sold by them on behalf of the Group. Commission is calculated based on a fixed rate ranging from 1.5% to 12% on the ticket value. Commission expenses incurred by the Group in respect of tickets sold by the CAAC s sales offices and various PRC airlines totaled RMB510,169 and RMB464,721, respectively, during 2001 and 2002. Commission income received from other PRC airlines in connection with air tickets sold by the Group, calculated based on a fixed rate ranging from 3% to 9% on the ticket value, totaled RMB89,842 and RMB81,931, respectively, during 2001 and 2002.

Ground service fees are received from other PRC airlines in respect of ground services provided by the Group and Baiyun International Airport Group at Guangzhou Baiyun International Airport. The Group was entitled to 50% of the service fees. The Group s share of ground service fees received totaled RMB23,513 and RMB39,735, respectively, during 2001 and 2002.

The Group has a 50% equity interest in both Guangzhou Aircraft Maintenance Engineering Company Limited (GAMECO) and MTU Maintenance Zhuhai Co., Ltd (MTU Zhuhai), which provide comprehensive maintenance services to the Group. Maintenance fees totaling RMB534,828, RMB592,311 and RMB693,303, respectively, were incurred by the Group for services provided by GAMECO and MTU Zhuhai during 2001, 2002 and 2003.

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Certain aircraft sundry supplies are purchased from Southern Airlines (Group) Economic Development Company (SAGEDC), a subsidiary of CSAHC. Supplies totaling RMB86,386, RMB101,350 and RMB42,389, respectively, were purchased by the Group from SAGEDC during 2001, 2002 and 2003.

The Group has a 51% equity interest in Zhuhai Xiang Yi, which provides flight simulation services to the Group. Flight simulation service charges totaling RMB101,355 were incurred by the Group for services provided by Zhuhai Xiang Yi during 2003. In addition, the Group entered into operating lease agreements to lease certain flight training facilities and buildings to Zhuhai Xiang Yi. Rental income received by the Group amounted to RMB34,175 during 2003 (Note 13).

Advertising services

Advertising services are provided by Southern Airlines Advertising Company (SA Advertising). SA Advertising was a subsidiary of CSAHC up to July 2002. In August 2002, the Group acquired 90% equity interest in SA Advertising from CSAHC. Expenses totaling RMB9,940 and RMB3,275, respectively, were incurred by the Group for services provided by SA Advertising during 2001 and 2002.

Wet lease rentals

Pursuant to certain wet lease arrangements effected in August and November 2000, the Group incurred RMB300,000 during 2001 in respect of five Boeing 737-300/37K aircraft leased from Zhongyuan Airlines, a subsidiary of CSAHC. Such lease arrangements were terminated in January 2002.

During 2002 and 2003, wet lease rentals totaling RMB26,164 and RMB35,751, respectively, were paid to Xinjiang Airlines Company, a subsidiary of CSAHC, pursuant to a wet lease agreement in respect of a Boeing 757-200 aircraft effective October 2002. The wet lease agreement was terminated in April 2003.

During the period from August to October 2002, the Group received wet lease rentals totaling RMB27,599 from wet leasing of an Airbus 320-200 aircraft to Sichuan Airlines Corporation Limited, an affiliated company of the Group.

Refund of medical benefit payments

Prior to January 1, 2002, the Group paid a fixed annual fee to CSAHC in return for CSAHC providing medical benefit, transportation subsidies and other welfare facilities to the retirees of the Group. Such arrangement was terminated on January 1, 2002. During 2003, CSAHC refunded RMB58,120 to the Group which represented the difference between the aggregate fixed annual fees received from the Group and the aggregate cost of services incurred by CSAHC under the above arrangement.

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Acquisition of aircraft and related spare parts and vehicles

During 2002, the Group acquired five Boeing 737-300/37K aircraft and related spare parts and certain vehicles from Zhongyuan Airlines, a subsidiary of CSAHC, at a consideration of approximately RMB1,096,866. The consideration was satisfied by cash of approximately RMB132,130 together with an assumption by the Group of Zhongyuan Airlines debts of approximately RMB964,736. In addition, the Group received reimbursements of wet lease rentals totaling RMB150,000 which it paid to Zhongyuan Airlines during the period from July 1, 2001 to December 31, 2001. Such reimbursements have been applied to reduce the purchase costs of the acquired assets.

Acquisition of subsidiaries

In August 2002, the Group acquired 90% equity interest in each of Guangzhou Aviation Hotel, Southern Airlines Advertising Company and South China International Aviation & Travel Services Company from CSAHC at an aggregate cash consideration of approximately RMB107,846. Such consideration is determined by reference to the valuation reports prepared by GZAA Incorporated, a firm of independent valuers registered in the PRC. These acquisitions are not considered significant in the context of the Group.

Amounts due to related companies

Amounts due to related companies, which represent balance with CSAHC and its affiliates, and the Group s affiliated companies and jointly controlled entities, are unsecured, non-interest bearing and repayable within one year. The balance as of December 31, 2002 also included balances with the CAAC and its affiliates. Balances with other State-owned enterprises are excluded from this caption, as other State-owned enterprises are not considered related parties of the Group.

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

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

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26. FAIR VALUE OF FINANCIAL INSTRUMENTS AND CONCENTRATIONS OF RISK

Financial assets of the Group include cash and cash equivalents, investments, trade receivables and other receivables. Financial liabilities of the Group include notes payable, accounts payable, bills payable, sales in advance of carriage, amounts due to related companies, accrual expenses, other liabilities and obligations under capital leases.

Liquidity risk

As of December 31, 2002 and 2003, the Group s net current liabilities amounted to RMB7,015,998 and RMB10,792,050, respectively. For the years ended December 31, 2001, 2002 and 2003, the Group recorded a net cash inflow from operating activities of RMB2,223,943, RMB3,697,544 and RMB2,128,749, respectively, a net cash outflow from investing activities and financing activities of RMB3,603,535, RMB2,744,364 and RMB3,819,618, respectively, and a (decrease)/increase in cash and cash equivalents of RMB(1,379,592), RMB953,180 and RMB(1,690,869), respectively.

With regard to 2004 and thereafter, the liquidity of the Group is primarily dependent on its ability to maintain adequate cash inflow from operations to meet its debt obligations as they fall due, and on its ability to obtain adequate external finance to meet its committed future capital expenditures. With regard to its short-term notes payable outstanding as of December 31, 2003, the Group has obtained firm commitments from its principal bankers to renew relevant loans as they fall due during 2004. With regard to its future capital commitments and other financing requirements, the Group has already entered into loan financing agreements with several PRC banks to provide loan finance up to an approximate amount of RMB8,450,000 during 2004 and thereafter. The directors of the Company believe that such financing will be available to the Group.

The directors of the Company have carried out a detailed review of the cash flow forecast of the Group for the twelve months ending December 31, 2004. Based on such forecast, the directors have determined that adequate liquidity exists to finance the working capital and capital expenditure requirements of the Group during that period. In preparing the cash flow forecast, the directors have considered historical cash requirements of the Group as well as other key factors, including the availability of the above-mentioned loan finance which may impact the operations of the Group during the next twelve-month period. The directors are of the opinion that the assumptions and sensitivities which are included in the cash flow forecast are reasonable. However, as with all assumptions in regard to future events, these are subject to inherent limitations and uncertainties and some or all of these assumptions may not be realized.

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Business risk

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

Interest rate risk

The interest rates and terms of repayment of the notes payable and obligations under capital leases of the Group are disclosed in Notes 16 and 17, respectively.

Foreign currency risk

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

Credit risk

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

A significant portion of the Group s air tickets are sold by agents participating in the Billing and Settlement Plan (BSP), a clearing scheme between airlines and sales agents organized by International Air Transportation Association. As of December 31, 2002 and 2003, the balance due from BSP amounted to RMB353,246 and RMB446,399, respectively.

Self insurance risk

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

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Fair value

The carrying amounts and estimated fair values of significant financial assets and liabilities as of December 31, 2002 and 2003 are set out below.

	December 31,			
	2002		2003	
	Carrying amount	Fair value	Carrying amount	Fair value
	RMB	RMB	RMB	RMB
Cash and cash equivalents	3,771,043	3,771,043	2,080,174	2,080,174
Trade receivables	671,776	671,776	833,604	833,604
Other receivables	372,586	372,586	296,047	296,047
Notes payable, including current installments of long-term notes payable	5,240,726	5,326,511	7,096,846	7,164,216
Accounts payable	532,480	532,480	928,093	928,093
Bills payable	1,299,680	1,299,680	438,135	438,135
Sales in advance of carriage	390,531	390,531	466,087	466,087
Amounts due to related companies	525,090	525,090	929,003	929,003
Accrued expenses	2,341,454	2,341,454	2,527,794	2,527,794
Other liabilities	646,989	646,989	1,019,811	1,019,811
Notes payable, excluding current installments	5,835,434	6,111,052	4,521,735	4,743,128

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

(i) Cash and cash equivalents, trade receivables, other receivables, short-term notes payable, accounts payable, bills payable, sales in advance of carriage, amounts due to related companies, accrued expenses and other liabilities

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

(ii) Long-term notes payable

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

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

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

27. FOREIGN CURRENCY EXCHANGE

The Renminbi is not freely convertible into foreign currencies. All foreign exchange transactions involving Renminbi must take place either through the People s Bank of China or other institutions authorized to buy and sell foreign exchange or at a swap center.

The Group currently maintains bank accounts in currencies other than the Renminbi to engage in foreign exchange transactions. The amount of foreign exchange that can be retained by the Group under this system is determined by the SAFE based on the Group s expected payment obligations in foreign currencies for lease and debt payments and for dividends. Any amounts of foreign exchange that the Group receives in excess of such amount must be converted into Renminbi at the rate prevailing in the PRC inter-bank market. The Group will have access to foreign currency through the inter-bank system, subject to the approval of the SAFE, to satisfy its foreign exchange requirements where these exceed the amount of foreign exchange that the Group has retained.

The Articles of Association of the Company require cash dividends be declared in Renminbi and paid to holders of the H shares in Hong Kong dollars at the average closing exchange rate for Hong Kong dollars as announced by the People s Bank of China for the calendar week preceding the date of the dividend declaration. To the extent that the Company is unable to pay dividends in foreign currency out of its own resources, it will have to obtain foreign currency through the swap centers and PRC banks. Hong Kong dollar dividend payments will be converted by the depositary and distributed to holders of American Depositary Shares in United States dollars.

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28. RECONCILIATION AND SUPPLEMENTARY STATEMENTS OF CASH FLOWS INFORMATION

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

	Year ended December 31,		
	2001	**2002**	**2003**
	RMB	**RMB**	**RMB**
Income/(loss) before taxation and minority interests	795,256	1,139,099	(511,610)
Adjustments to reconcile income/(loss) before taxation and minority interests to cash inflows from operations:			
Depreciation and amortization of fixed assets	1,802,462	1,839,293	1,997,882
Other amortization	12,512	9,816	40,089
Amortization of deferred credits	(18,483)	(7,217)	(1,541)
Equity income of affiliated companies	(53,077)	(36,988)	(47,798)
Equity loss of jointly controlled entities	4,034	3,352	39,495
(Gain)/loss on sale of aircraft	(59,855)	(199,394)	20,405
Loss on sale of other fixed assets	115,744	28,654	1,812
Interest income	(49,878)	(52,618)	(13,061)
Interest expense	933,717	959,193	823,725
Non-cash exchange (gain)/loss, net	(292,630)	174,978	177,356
Decrease/(increase) in trade receivables	232,228	(110,749)	(161,828)
Decrease/(increase) in other receivables	42,938	(166,004)	76,539
(Increase)/decrease in inventories	(2,033)	(76,472)	1,923
(Increase)/decrease in prepaid expenses and other current assets	(136,600)	123,924	(6,045)
(Decrease)/increase in accounts payable	(167,599)	(61,843)	395,613
Increase/(decrease) in bills payable		1,299,680	(861,545)
Increase in sales in advance of carriage	31,036	19,985	75,556
Increase/(decrease) in amounts due to related companies	98,040	(193,175)	403,913
(Decrease)/increase in accrued expenses	(132,121)	86,215	203,439
Increase/(decrease) in other liabilities	70,254	(33,032)	372,822
(Decrease)/increase in provision for major overhauls	(40,422)	16,226	47,577
Cash inflows from operations	3,185,523	4,762,923	3,074,718

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

During 2002, the Group assumed from Zhongyuan Airlines debts totaling RMB964,736 in partial satisfaction of the consideration payable for acquisition of five Boeing 737-300/37K aircraft and other assets from Zhongyuan Airlines (Note 25).

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(c) Effect of acquisition of subsidiaries:

	Year ended December 31,		
	2001	**2002**	**2003**
	RMB	**RMB**	**RMB**
Net assets acquired:			
Fixed assets		96,636	
Cash and cash equivalents		17,355	
Trade receivables and other current assets		20,681	
		134,672	
Accounts payable		3,623	
Accrued expenses and other liabilities		11,220	
		14,843	
Net assets value		119,829	
Minority interests share of net assets value		11,983	
Net assets value acquired by the Group		107,846	
Consideration paid		107,846	
Cash and cash equivalents acquired		17,355	
Net cash outflow from acquisition of subsidiaries		90,491	

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29. PRINCIPAL SUBSIDIARIES, AFFILIATED COMPANIES AND JOINTLY CONTROLLED ENTITIES

Details of the Company s principal subsidiaries, affiliated companies and jointly controlled entities as of December 31, 2003 are as follows:

Name of company	Place of establishment /operation	Attributable equity interest Direct %	Attributable equity interest Indirect %	Principal activities
Subsidiaries				
Guangxi Airlines Company Limited	PRC	60		Airline
Southern Airlines Group Shantou Airlines Company Limited	PRC	60		Airline
Zhuhai Airlines Company Limited	PRC	60		Airline
Guizhou Airlines Company Limited	PRC	60		Airline
Xiamen Airlines Company Limited	PRC	60		Airline
Guangzhou Nanland Air Catering Company Limited	PRC	51		Air catering
Affiliated companies				
Southern Airlines Group Finance Company Limited	PRC	32	15.42	Provision of financial services
Sichuan Airlines Corporation Limited	PRC	39		Airline
Jointly controlled entities				
Guangzhou Aircraft Maintenance Engineering Company Limited (Note)	PRC	50		Provision of aircraft repair and maintenance services
MTU Maintenance Zhuhai Co. Ltd.	PRC	50		Provision of engine repair and maintenance services
China Postal Airlines Limited	PRC	49		Airline
Zhuhai Xiang Yi Aviation Technology Company Limited	PRC	51		Provision of flight simulation services

Note: Guangzhou Aircraft Maintenance Engineering Company Limited has been reclassified from an affiliated company to a jointly controlled entity since 2003 due to a change in the composition of its shareholders in 2003.

Certain of the Company s subsidiaries, affiliated companies and jointly controlled entities are PRC joint ventures which have limited lives pursuant to PRC law.

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30. SEGMENTAL INFORMATION

The Group operates primarily as a single business segment for the provision of air transportation services. Geographic information about the Group s operating revenue and income are as follows:

	Domestic	Hong Kong	International*	Total
	RMB	RMB	RMB	RMB
Year ended December 31, 2001				
Traffic revenue	12,924,892	1,182,492	2,354,148	16,461,532
Other revenue	359,895	58,231		418,126
	13,284,787	1,240,723	2,354,148	16,879,658
Operating income	1,090,154	219,686	90,833	1,400,673
Year ended December 31, 2002				
Traffic revenue	13,197,589	1,118,695	3,165,608	17,481,892
Other revenue	485,046		51,682	536,728
	13,682,635	1,118,695	3,217,290	18,018,620
Operating income	1,614,975	193,440	217,662	2,026,077
Year ended December 31, 2003				
Traffic revenue	13,086,939	807,677	3,070,184	16,964,800
Other revenue	436,122		69,201	505,323
	13,523,061	807,677	3,139,385	17,470,123
Operating income / (loss)	440,158	(29,210)	44,781	455,729

* Asian market accounted for approximately 75%, 70% and 70%, respectively, of the Group s total international traffic revenue for the years ended December 31, 2001, 2002 and 2003. The remaining portion was mainly derived from the Group s flights to/from European and North American regions.

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

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31. SUBSEQUENT EVENTS

In April 2004, the Company entered into a purchase agreement with Airbus SNC for the acquisition of fifteen Airbus 320-200 aircraft and six Airbus 319-100 aircraft, scheduled for deliveries in 2005 and 2006.

32. SUPPLEMENTARY INFORMATION

Movements in allowance for doubtful accounts comprise:

	Year ended December 31,		
	2001	**2002**	**2003**
	RMB	**RMB**	**RMB**
Balance at beginning of year	72,644	59,019	60,118
Provision for doubtful accounts (Note 9)	1,729	1,304	12,031
Doubtful accounts written-off	(15,354)	(205)	(2,152)
Balance at end of year (Note 12)	59,019	60,118	69,997

33. SIGNIFICANT DIFFERENCES BETWEEN IFRS AND U.S. GAAP

The Group s accounting policies conform with IFRS which differ in certain material respects from U.S. GAAP. Information relating to the nature and effect of such differences are set out below.

(a) Sale and leaseback accounting

Under IFRS, gains on sale and leaseback transactions where the subsequent lease is an operating lease are recognized as income immediately, if the transactions are established at fair value. Differences between the sale price and fair value are deferred and amortized over the period for which the assets are expected to be used. Under U.S. GAAP, such gains are deferred and amortized over the term of the lease.

(b) Lease arrangements

As disclosed in Note 13 to the consolidated financial statements, during 2002 and 2003, the Group entered into two separate arrangements with certain independent third parties under which the Group sold aircraft and then immediately leased back the aircraft for a pre-determined period. As a result of the arrangements, the Group received a net cash benefit of RMB51,682 and RMB69,121 in 2002 and 2003, respectively, which has been recognized as income under IFRS. Under U.S. GAAP, such benefits are deferred and amortized over the minimum lease period.

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CHINA SOUTHERN AIRLINES COMPANY LIMITED AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued) (Amounts in thousands, except share data)

In addition, under the lease arrangements, the commitments by the Group to make long-term lease payments have been defeased by the placement of security deposits. As such, under IFRS, such commitments and deposits are not recognized on the consolidated balance sheets. Under U.S. GAAP, such commitments and deposits amounting to RMB1,322,843 and RMB2,409,252 as of December 31, 2002 and 2003, respectively, would be recognized on the consolidated balance sheets, as such commitments are not deemed as extinguished by the placement of security deposits.

(c) Capitalized interest

Under IFRS, the Group capitalizes interest costs to the extent the related borrowings are directly attributable to the acquisition or construction of an asset.

Under U.S. GAAP, interest costs capitalized are determined based on specific borrowings related to the acquisition or construction of an asset, if an entity s financing plans associate a specific new borrowing with a qualifying asset. If average accumulated expenditures for the asset exceed the amounts of specific new borrowings associated with the asset, additional interest costs capitalized are based on the weighted average interest rate applicable to other borrowings of the entity.

(d) Revaluation of fixed assets

In connection with the Reorganization in 1996, the fixed assets of the Group were revalued as of December 31, 1996 (see Notes 1 and 13 to the consolidated financial statements). Such fixed asset revaluation resulted in an increase in shareholders equity with respect to the increase in carrying amount of certain fixed assets above their historical cost bases, while a charge to the consolidated statement of operations was recorded with respect to the reduction in carrying amount of certain fixed assets below their historical cost bases. In addition, the revalued fixed asset amounts serve as the tax bases of fixed assets for years beginning in 1997. Accordingly, the fixed asset revaluation eliminated certain of the temporary differences which gave rise to a deferred tax asset as of December 31, 1996. Such tax asset was offset against the revaluation surplus.

Under U.S. GAAP, fixed assets are stated at their historical cost unless an impairment loss has been recorded. An impairment loss on fixed assets is recorded under U.S. GAAP if the carrying amount of such asset exceeds its future undiscounted cash flows, excluding finance costs. The future undiscounted cash flows, excluding finance costs, of the Group s fixed assets whose carrying amount was reduced in connection with the Reorganization, exceed their historical cost carrying amount and, therefore, impairment of such assets is not appropriate under U.S. GAAP. Accordingly, the revaluation reserve recorded directly to shareholders equity and the charge recorded under IFRS in 1996 and the additional depreciation charges recorded in the seven years ended December 31, 2003, as a result of the Reorganization are reversed for U.S. GAAP purposes.

However, as a result of the tax deductibility of the net revaluation reserve, a deferred tax asset related to the reversal of the net revaluation reserve is created under U.S. GAAP with a corresponding increase in shareholders equity as of December 31, 1996. Such deferred tax asset will be reversed upon depreciation of the net revaluation surplus included in the fixed assets beginning 1997.

CHINA SOUTHERN AIRLINES COMPANY LIMITED AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued) (Amounts in thousands, except share data)

(e) Investments in affiliated company and jointly controlled entity

During 2002, the Group invested in an affiliated company and a jointly controlled entity, which were PRC state-owned enterprises. Under IFRS, such investments are initially recorded on a fair value basis at the cost of purchases borne by the Group. In the consolidated statements of operations, the equity share of results of the investees are measured based on the fair value of underlying net assets determined on the date of acquisitions.

Under U.S. GAAP, such transactions would be considered to be combinations of businesses under common control . Under U.S. GAAP, such investments are initially recorded at the Group s equity share of net assets of the investees determined on a historical cost basis. The differences between such amounts and the cost of purchases are reflected as movements in the shareholders equity. In the consolidated statements of operations, the equity share of results of the investees are measured based on the historical cost basis.

(f) Acquisition of subsidiaries from CSAHC

During 2002, the Group acquired 90% equity interest in certain subsidiaries from CSAHC. Under IFRS, the purchase method of accounting was applied to such business combination such that as from the date of combination, the results of the acquired subsidiaries and their assets and liabilities are included in the consolidated financial statements of the Group.

Under U.S. GAAP, such transaction would be considered to be a combination of entities under common control . Under U.S. GAAP, combination of entities under common control are accounted for under the as if pooling-of-interests method where assets and liabilities are accounted for at historical cost and financial statements of previously separate entities for periods prior to the combination generally are restated on a combined basis. The effect of this difference was not material to the years presented.

(g) Provision for major overhauls

As disclosed in Notes 2(r) and 6 to the consolidated financial statements prepared under IFRS, in respect of aircraft held under operating leases, a provision is made over the lease term for the estimated cost of scheduled overhauls required to be performed on the related aircraft prior to their return to the lessors.

Under U.S. GAAP, a liability would be recorded at the outset of the operating leases for the fair value of contractual obligations to perform the overhauls and a deferred asset would be recorded for the corresponding amount, which would be amortized over the term of the operating leases. The carrying amounts of such liability and asset would amount to approximately RMB486,660 and RMB292,773 respectively as of December 31, 2002 and RMB569,860 and RMB369,679 respectively as of December 31, 2003.

The effect of above difference on the net income/(loss) and shareholders equity reported under U.S. GAAP was not material to the years presented.

(h) Financial statements presentation and disclosure

In the consolidated statements of operations presented under IFRS, (loss)/gain on sale of fixed assets is classified under Non-operating income/(expenses) . Under U.S. GAAP, such (loss)/gain would be classified under Operating income/(expenses) General and administrative .

As disclosed in Note 20 to the consolidated financial statements, deferred tax assets are presented on a net basis under IFRS. Under U.S. GAAP, the gross amounts of such deferred tax assets and any applicable valuation allowances would be separately disclosed. As of December 31, 2002 and 2003, the amount of valuation allowances which have been netted off with deferred tax assets amounted to approximately RMB48,480 and RMB53,000, respectively.

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**CHINA SOUTHERN AIRLINES COMPANY LIMITED
AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)
(Amounts in thousands, except share data)**

(i) New accounting pronouncements

FIN 46R

In December 2003, the FASB issued FASB Interpretation No. 46 (revised December 2003) Consolidation of Variable Interest Entities which addresses how a business enterprise should evaluate whether it has a controlling financial interest in an entity through means other than voting rights and accordingly should consolidate the entity. FIN 46R replaces FASB Interpretation No. 46 Consolidation of Variable Interest Entities which was issued in January 2003. The Group will be required to apply FIN 46R to variable interests in VIEs created after December 31, 2003. For variable interests in VIEs created before January 1, 2004, the Interpretation will be applied beginning on January 1, 2005. For any VIEs that must be consolidated under FIN 46R that were created before January 1, 2004, the assets, liabilities and noncontrolling interests of the VIE initially would be measured at their carrying amounts with any difference between the net amount added to the consolidated balance sheets and any previously recognized interest being recognized as the cumulative effect of an accounting change. If determining the carrying amounts is not practicable, fair value at the date FIN 46R first applies may be used to measure the assets, liabilities and noncontrolling interest of the VIE. The Group is evaluating the impact of applying FIN 46R to existing VIEs in which it has variable interests and has not yet completed this evaluation.

FASB No. 150

FASB Statement No. 150 Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity was issued in May 2003. This Statement establishes standards for the classification and measurement of certain financial instruments with characteristics of both liabilities and equity. The Statement also includes required disclosures for financial instruments within its scope. For the Group, the Statement was effective for instruments entered into or modified after May 31, 2003 and otherwise will be effective as of January 1, 2004, except for mandatorily redeemable financial instruments. For certain mandatorily redeemable financial instruments, the Statement will be effective for the Group on January 1, 2005. The effective date has been deferred indefinitely for certain other types of mandatorily redeemable financial instruments. The Group currently does not have any financial instruments that are within the scope of this Statement.

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CHINA SOUTHERN AIRLINES COMPANY LIMITED AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)
(Amounts in thousands, except share data)

Effect on net income/(loss) of significant differences between IFRS and U.S. GAAP is as follows:

	Reference in Note above	Year ended December 31, 2001	2002	2003	2003
		RMB	RMB	RMB	U.S. dollars
Net income/(loss) under IFRS		340,225	575,761	(358,267)	(43,286)
U.S. GAAP adjustments:					
Sale and leaseback accounting	(a)	54,254	(100,664)	114,635	13,850
Lease arrangements	(b)		(49,960)	(64,140)	(7,749)
Capitalized interest	(c)	18,000	(31,473)	(32,961)	(3,982)
Reversal of additional depreciation arising from revaluation of fixed assets	(d)	65,000	33,000	33,000	3,987
Investments in affiliated company and jointly controlled entity	(e)	3,546	(541)	7,044	851
Deferred tax effects					
- current year		(50,369)	47,849	(7,580)	(916)
- effect on change in income tax rate on deferred taxation				(51,368)	(6,206)
Net income/(loss) under U.S. GAAP		430,656	473,972	(359,637)	(43,451)
Basic earnings/(loss) per share under U.S. GAAP		0.13	0.14	(0.09)	(0.01)
Basic earnings/(loss) per ADS under U.S. GAAP*		6.38	7.02	(4.69)	(0.57)

*Basic earnings/(loss) per ADS is calculated on the basis that one ADS is equivalent to 50 H shares.

Effect on shareholders equity of significant differences between IFRS and U.S. GAAP is as follows:

	Reference in Note above	December 31, 2002	2003	2003
		RMB	RMB	U.S. Dollars
Shareholders equity under IFRS		9,613,207	11,895,707	1,437,252
U.S. GAAP adjustments:				
Sale and leaseback accounting	(a)	(586,989)	(472,354)	(57,070)
Lease arrangements	(b)	(49,960)	(114,100)	(13,786)
Capitalized interest	(c)	381,021	348,060	42,053
Revaluation of fixed assets, net of depreciation	(d)	(46,120)	(13,120)	(1,585)
Investments in affiliated company and jointly controlled entity	(e)	(118,003)	(110,959)	(13,406)
Deferred tax effects		94,175	35,227	4,256
Shareholders equity under U.S. GAAP		9,287,331	11,568,461	1,397,714

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SIGNATURES

The registrant hereby certifies that it meets all of the requirements for filing on Form 20-F and that it has duly caused and authorized the undersigned to sign this annual report on its behalf.

CHINA SOUTHERN AIRLINES COMPANY LIMITED

(Registrant)

/s/ Yan Zhi Qing

Name: Yan Zhi Qing
Title: Chairman of the Board of Directors

Date: June 30, 2004

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EXHIBIT INDEX

Exhibit No.	Description of Exhibit
1	Articles of Association
4.1	Form of Director s Service Agreement
4.2	Form of Non-Executive Director s Service Agreement
8	Subsidiaries of the Company
12.1	Section 302 Certification of Chairman
12.2	Section 302 Certification of President
12.3	Section 302 Certification of Chief Financial Officer
13.1	Section 906 Certification of Chairman
13.2	Section 906 Certification of President
13.3	Section 906 Certification of Chief Financial Officer