CHINA SOUTHERN AIRLINES CO LTD
Form 20-F
April 26, 2019
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 20-F

REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR (g) OF THE SECURITIES EXCHANGE ACT OF 1934

OR

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2018

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from __________ to

OR

SHELL COMPANY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

Date of event requiring this shell company report __________

Commission file number 1-14660

(Exact name of Registrant as specified in its charter)

CHINA SOUTHERN AIRLINES COMPANY LIMITED

(Translation of Registrant s name into English)

THE PEOPLE S REPUBLIC OF CHINA

(Jurisdiction of incorporation or organization)

68 QI XIN ROAD

GUANGZHOU, 510403

PEOPLE S REPUBLIC OF CHINA

(Address of principal executive offices)

Mr. Xie Bing

Telephone: +86 20 86124462

E-mail: ir@csair.com

Fax: +86 20 86659040

Address: 68 QI XIN ROAD

GUANGZHOU, 510403

PEOPLE S REPUBLIC OF CHINA

(Name, Telephone, E-mail and/or Facsimile number and Address of Company Contact Person)

Securities registered or to be registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Ordinary H Shares of par value RMB1.00 per share represented by American Depositary Shares	**New York Stock Exchange**

Securities registered or to be registered pursuant to Section 12(g) of the Act:

None

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act.

None

Indicate the number of outstanding shares of each of the issuer s classes of capital or common stock as of the close of the period covered by the annual report: 8,600,723,089 A Shares of par value RMB1.00 per share and 3,666,449,197 H Shares of par value RMB1.00 per share.

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934. Yes No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer	Accelerated filer
Non-accelerated filer	Emerging growth company

If an emerging growth company that prepares its financial statements in accordance with U.S. GAAP, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

The term new or revised financial accounting standard refers to any update issued by the Financial Accounting Standards Board to its Accounting Standards Codification after April 5, 2012.

Indicate by check mark which basis of accounting the registrant has used to prepare the financial statements included in this filing:

U.S. GAAP	International Financial Reporting Standards as issued by the International Accounting Standards Board	Other

If Other has been checked in response to the previous question, indicate by check mark which financial statement Item the registrant has elected to follow. Item 17 Item 18

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

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FORWARD-LOOKING STATEMENTS

This Annual Report includes forward-looking statements for the purpose of the safe harbor provided by Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. These statements appear in a number of different places in this Annual Report. A forward-looking statement is usually identified by the use in this Annual Report of certain terminology such as estimate , project , expect , intend , believe , plan , anticipate , negatives or other comparable words. Also look for discussions of strategy that involve risks and uncertainties. Forward-looking statements include statements regarding the outlook for our future operations, forecasts of future costs and expenditures, evaluation of market conditions, the outcome of legal proceedings (if any), the adequacy of reserves, and other business plans. Forward-looking statements are, by their nature, subject to inherent risks and uncertainties, some of which are beyond our control, and are based on assumptions and analyses made by us in light of our experience and our perception of historical trends, current conditions and expected future developments, as well as other factors we believe are appropriate in particular circumstances. We caution you that a number of risks and assumptions could cause actual outcomes to differ, or differ materially, from those expressed in any forward-looking statements.

These risks and assumptions, in addition to those identified under Item 3, Key Information - Risk Factors, include:

- general economic and business conditions in markets where our Company operates, including changes in interest rates;
- the effects of competition on the demand for and price of our services;
- natural phenomena;
- the impact of unusual events on our business and operations;
- actions by government authorities, including changes in government regulations, and changes in CAAC s regulatory policies;
- our relationship with China Southern Air Holding Limited Company (CSAH);
- uncertainties associated with legal proceedings;
- technological development;
- our ability to attract key personnel and attract new talent;

- future decisions by management in response to changing conditions;
- the Company s ability to execute prospective business plans;
- the availability of qualified flight personnel and airport facilities; and
- misjudgments in the course of preparing forward-looking statements.

Our Company advises you that these cautionary remarks expressly qualify in their entirety all forward-looking statements attributable to our Company, our Group and persons acting on their behalf.

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INTRODUCTORY NOTE

In this Annual Report, unless the context indicates otherwise, we , us , our , the Company and our Company refer China Southern Airlines Company Limited, a joint stock company incorporated in China on March 25, 1995, our Group means our Company and our consolidated subsidiaries, and CSAH means China Southern Air Holding Limited Company, our Company s parent company which directly and indirectly holds a 50.54% interest in our Company as of April 26, 2019.

References to China or the PRC are to the People s Republic of China, excluding Hong Kong, Macau and Taiwan. References to Renminbi or RMB are to the currency of China, references to U.S. dollars , $ or US$ are to the cur of the United States of America (the U.S. or United States), and references to HK$ are to the currency of Hong Kong. References to the Chinese government are to the national government of China. References to Hong Kong or Hong Kong SAR are to the Hong Kong Special Administrative Region of the PRC. References to Macau or Macau SAR are to the Macau Special Administrative Region of the PRC.

Our Group presents our consolidated financial statements in Renminbi. The consolidated financial statements of our Group have been prepared in accordance with all applicable International Financial Reporting Standards (IFRSs), which collective term include all applicable individual IFRSs, International Accounting Standards (IASs) and Interpretations issued by the International Accounting Standards Board (the IASB).

Solely for the convenience of the readers, this Annual Report contains conversions of certain Renminbi into U.S. dollars at the rate of US$1.00 = RMB6.8632, which is the average of the buying and selling rates as quoted by the People s Bank of China at the close of business on December 28, 2018. No representation is made that the Renminbi amounts or U.S. dollar amounts included in this Annual Report could have been or could be converted into U.S. dollars or Renminbi, as the case may be, at any particular rate or at all. Any discrepancies in the tables included herein between the amounts listed and the totals are due to rounding.

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GLOSSARY OF AIRLINE INDUSTRY TERMS

In this Annual Report, unless the context indicates otherwise, the following terms have the respective meanings set forth below.

Capacity	
available seat kilometers or ASK	the number of seats made available for sale multiplied by the kilometers flown
available tonne kilometers or ATK	the tonnes of capacity available for the transportation of revenue load (passengers and cargo) multiplied by the kilometers flown
Traffic	
revenue passenger kilometers or RPK	i.e. passenger traffic volume, the number of passengers carried multiplied by the kilometers flown
revenue tonne kilometers or RTK	i.e. total traffic volume, the load (passenger and cargo) in tonnes multiplied by the kilometers flown
revenue tonne kilometers-cargo or RFTK	i.e. cargo and mail traffic volume, the load for cargo and mail in tonnes multiplied by the kilometers flown
revenue tonne kilometers-passenger	the load for passenger in tonnes multiplied by the kilometers flown
tonne	a metric ton, equivalent to 1,000 kilograms
Yield	
yield per RFTK	revenue from cargo operations divided by RFTK
yield per RPK	revenue from passenger operations divided by RPK
yield per RTK	revenue from airline operations (passenger and cargo) divided by RTK
Cost	
operating cost per ATK	operating expenses divided by ATK
Load Factors	
overall load factor	RTK expressed as a percentage of ATK
passenger load factor	RPK expressed as a percentage of ASK
Utilization	
utilization rates	flight hours that aircraft can service during specified time
Equipment	
expendables	aircraft parts that are ordinarily used up and replaced with new parts
rotables	aircraft parts that are ordinarily repaired and reused

Others

ADS	American Depositary Share
A Shares	Shares issued by our Company to investors in the PRC for subscription in RMB, with par value of RMB1.00 each
CAAC	Civil Aviation Administration of China
CAOSC	China Aviation Oil Supplies Company
CSAH	China Southern Air Holding Limited Company
CSRC	China Securities Regulatory Commission

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Hong Kong Stock Exchange	Stock Exchange of Hong Kong Limited
H Shares	Shares issued by our Company, listed on The Stock Exchange of Hong Kong Limited and subscribed for and traded in Hong Kong dollars, with par value of RMB1.00 each
Nan Lung	Nan Lung Holding Limited (a wholly-owned subsidiary of CSAH)
NDRC	National Development and Reform Commission of China
SAFE	State Administration of Foreign Exchange of China
SA Finance	Southern Airlines Group Finance Company Limited
SASAC	State-owned Assets Supervision and Administration Commission of the State Council
SEC	United States Securities and Exchange Commission
SPVs	special purpose vehicles exclusively set up by China Southern Airlines and its subsidiaries for leased aircraft
ton	a metric ton, equivalent to 2,204.6 pounds

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PART I

ITEM 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISERS
Not applicable.

ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE
Not applicable.

ITEM 3. KEY INFORMATION

A. SELECTED FINANCIAL DATA.
The following tables present selected financial data for the five-year period ended December 31, 2018. The selected consolidated income statement data (other than ADS data) for the three-year period ended December 31, 2016, 2017 and 2018 and selected consolidated statement of financial position data as of December 31, 2017 and 2018 are derived from the audited consolidated financial statements of us, included elsewhere in this Annual Report. The selected consolidated income statement data (other than ADS data) for the years ended December 31, 2014 and 2015 and selected consolidated statement of financial position data as of December 31, 2014, 2015 and 2016 are derived from our audited consolidated financial statements that are not included in this Annual Report.

Moreover, the selected financial data should be read in conjunction with our consolidated financial statements together with accompanying notes and Item 5. Operating and Financial Review and Prospects which are included elsewhere in this Annual Report. Our consolidated financial statements are prepared and presented in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board, or IFRSs.

	Year ended December 31,					
	2018	2018	2017	2016	2015	2014
	US$	RMB	RMB	RMB	RMB	RMB
	(in million, except per share and per ADS data)					
Consolidated Income Statement Data						
Operating revenue	20,927	143,623	127,806	114,981	111,652	108,584
Operating expenses	(20,434)	(140,242)	(123,098)	(106,204)	(101,492)	(106,026)
Operating profit	1,285	8,819	9,156	12,612	13,438	4,748
Profit before income tax	636	4,364	8,874	7,661	6,118	3,066
Profit for the year	490	3,364	6,898	5,898	4,818	2,398
Profit attributable to:						
Equity shareholders of our Company	422	2,895	5,961	5,044	3,736	1,777
Non-controlling interests	68	469	937	854	1,082	621

Basic and diluted earnings per share	0.04	0.27	0.60	0.51	0.38	0.18
Basic and diluted earnings per ADS[1]	2.00	13.50	30.03	25.69	19.03	9.05
Other Financial Data						
Cash dividends declared per share	0.01	0.05	0.10	0.10	0.08	0.04

(1) Basic and diluted earnings per share have been computed by dividing profit attributable to our equity shareholders by the weighted average number of shares in issue. Basic and diluted earnings per ADS have been computed as if all of our issued or potential ordinary shares, including domestic shares and H shares, are represented by ADSs during each of the years presented. Each ADS represents 50 H shares.

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	Year ended December 31,					
	2018 US$	**2018 RMB**	**2017 RMB**	**2016 RMB**	**2015 RMB**	**2014 RMB**
	(in million, except per share and per ADS data)					
Consolidated Statement of Financial Position Data:						
Cash and cash equivalents	1,009	6,928	6,826	4,152	4,560	15,414
Total current assets, excluding cash and cash equivalents	2,498	17,144	11,058	9,612	9,553	12,127
Property, plant and equipment, net	24,871	170,692	158,926	146,746	142,870	134,453
Total assets	35,982	246,949	218,718	200,442	185,989	189,688
Current borrowings	5,645	38,741	27,568	26,746	30,002	20,979
Current portion of obligations under finance leases	1,392	9,555	8,341	8,695	6,416	5,992
Non-current borrowings	2,284	15,676	20,719	18,758	15,884	42,066
Obligations under finance leases, excluding current portion	9,131	62,666	59,583	53,527	49,408	43,919
Total equity	11,433	78,469	62,543	54,976	49,624	44,493
Number of shares (in million)	12,267	12,267	10,088	9,818	9,818	9,818

Selected Operating Data

The operating data and comparison below is calculated and disclosed in accordance with the statistical standards, which have been implemented by our Group since January 1, 2001. See Glossary of Airline Industry Terms at the front of this Annual Report for definitions of certain terms used herein.

	Year ended December 31,				
	2018	**2017**	**2016**	**2015**	**2014**
Capacity					
ASK (million)	314,421	280,646	255,992	235,616	209,807
ATK (million)	42,728	38,332	34,980	32,205	28,454
Kilometers flown (thousand)	1,762,920	1,623,014	1,504,310	1,408,500	1,275,570
Hours flown (thousand)	2,773	2,567	2,375	2,238	2,026
Number of landing and take-offs	1,069,430	1,010,460	959,110	936,750	884,070
Traffic					
RPK (million)	259,194	230,697	206,106	189,588	166,629
RTK (million)	30,334	27,321	24,387	22,388	19,780
Passengers carried (thousand)	139,885	126,299	114,619	109,422	100,919
Cargo and mail carried (tons)	1,732,280	1,672,162	1,612,550	1,511,550	1,433,250
Load Factors					
Passenger load factor (RPK/ASK) (%)	82.4	82.2	80.5	80.5	79.4
Overall load factor (RTK/ATK) (%)	71.0	71.3	69.7	69.5	69.5
Yield					
Yield per RPK (RMB)	0.49	0.49	0.50	0.53	0.58
Yield per RFTK (RMB)	1.33	1.30	1.16	1.21	1.42
Yield per RTK (RMB)	4.55	4.46	4.50	4.78	5.27
Fleet					

- Boeing	460	407	372	351	311
- Airbus	354	321	304	290	276
- Others	26	26	26	26	25
Total aircraft in service at period end	840	754	702	667	612
Average daily utilization rate (hours per day)	9.73	9.79	9.53	9.6	9.6

Exchange Rate Information

The following table sets forth certain information concerning exchange rates, based on the noon buying rates in New York City for cable transfers in foreign currencies, as certified for customs purposes by the Federal Reserve Bank of New York (the Noon Buying Rate), between Renminbi and U.S. dollars for the five most recent financial years.

	Renminbi per U.S. Exchange Rate (1)			
Period	**Average(2)**	**Low**	**High**	**Period-end**
Exchange Rate				
2014	6.1704	6.0402	6.2591	6.2046
2015	6.2869	6.1870	6.4896	6.4778
2016	6.6400	6.4480	6.9580	6.9430
2017	6.7569	6.4773	6.9575	6.5063
2018	6.6090	6.2649	6.9558	6.8755
October	6.9191	6.8680	6.9737	6.9737
November	6.9367	6.8894	6.9558	6.9558
December	6.8837	6.8343	6.9077	6.8755
2019				
January	6.7863	6.6958	6.8708	6.6958
February	6.7367	6.6822	6.7907	6.6912
March	6.7119	6.6916	6.7381	6.7112
April (through 19, 2019)		6.6870	6.7223	6.7032

(1) Source: The source of the exchange rate is the H.10 statistical release of the Federal Reserve Board.

(2) The source of annual averages is the G.5A statistical release of the Federal Reserve Board. The source of monthly averages is the G.5 statistical release of the Federal Reserve Board.

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B. CAPITALIZATION AND INDEBTEDNESS

Not applicable.

C. REASONS FOR THE OFFER AND USE OF PROCEEDS

Not applicable.

D. RISK FACTORS

Risks Relating to our Business

We are indirectly majority owned by the Chinese government, which may exert influence in a manner that may conflict with the interests of holders of ADSs, H Shares and A Shares.

Major Chinese airlines are wholly or majority owned by either the Chinese government or provincial or municipal governments in China. CSAH, an entity wholly-owned by the Chinese government, directly and indirectly holds and exercises the rights of ownership of 50.54 % of our equity stake. The interests of the Chinese government in us and in other Chinese airlines could conflict with the interests of the holders of the ADSs, H Shares and A Shares. The public policy considerations of the Chinese government in regulating the Chinese commercial aviation industry could also conflict with its indirect ownership interest in us. In addition, we may accept further capital injections from CSAH through non-public subscriptions, which may dilute the stakes of other holders of ADSs, H Shares and A Shares.

Due to a high degree of operating leverage and high fixed costs, a decrease in our revenue could result in a disproportionately higher decrease in our profit. The results of our operations are also significantly exposed to fluctuations in foreign exchange rates.

The airline industry is generally characterized by a high degree of operating leverage. In addition, due to high fixed costs, the expenses relating to the operation of any flight do not vary proportionately with the number of passengers carried, while revenues generated from a flight are directly related to the number of passengers carried and the fare structure of such flight. Accordingly, a decrease in revenue could result in a disproportionately higher decrease in our profit. Moreover, as we have substantial obligations denominated in foreign currencies, our results of operations are significantly affected by fluctuations in foreign exchange rates, particularly fluctuations in the Renminbi-U.S. dollar exchange rate. Our net foreign exchange gains were RMB1,801 million in 2017, whereas our net foreign exchange losses were RMB1,853 million in 2018, primarily due to the translation of balances of borrowings and obligations under finance leases which are denominated in USD.

We have significant committed capital expenditures in the next three years, and may face challenges and difficulties in maintaining our liquidity.

We have, and will continue to have a substantial amount of debt, lease and other obligations in the future. As of December 31, 2018, our current liabilities exceeded our current assets by RMB59,615 million. We generated net cash inflow from operating activities of RMB17,732 million and RMB15,388 million for the years ended December 31, 2017 and 2018, respectively. However, our substantial indebtedness and other obligations may negatively impact our liquidity in the future. In addition, we have significant committed capital expenditures in the next three years, mainly due to aircraft acquisition. In 2018 and thereafter, our liquidity is primarily dependent on our ability to maintain adequate cash inflow from operations to meet our debt obligations as they fall due, and our ability to obtain adequate external financing to meet our committed future capital expenditures. If our operating cash flow is materially and adversely affected by factors, such as increased competition, significantly reduced demand for our services, or significantly increased jet fuel prices, our liquidity would be materially and adversely affected. Moreover, we may not be able to meet our debt obligations as they fall due and commit further capital expenditures if certain assumptions about the availability of external financing on acceptable terms are inaccurate. If we are unable to obtain adequate financing for our capital requirements, our liquidity and operations would be materially and adversely affected.

As of December 31, 2018, we had committed banking facilities with several PRC commercial banks for providing loan financing up to approximately RMB243,910 million, of which approximately RMB193,871 million was unutilized. Our directors believe that sufficient financing will be available to our Group in 2019. However there can be no assurance that such loan financing will be available on terms acceptable to our Group or at all.

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CSAH will continue to be our controlling shareholder, and our interests may conflict with those of CSAH. CSAH and certain of its affiliates will continue to provide certain important services to our Group. Any disruption of the provision of services by CSAH or its affiliates could affect our operations and financial condition.

CSAH will continue to be our controlling shareholder. CSAH and certain of its affiliates will continue to provide certain important services to us, including advertising services, provision of air ticket sales services, property management services, leasing of properties and financial services. The interests of CSAH may conflict with those of our Group. In addition, any disruption of the provision of services by CSAH s affiliates or a default of CSAH on its obligations owed to our Group could affect our operations and financial condition. In particular, as part of our cash management system, we periodically place certain amount of demand deposits after independent shareholders approval with SA Finance, a PRC authorized financial institution controlled by CSAH and one of our associates. We have taken certain measures to monitor the fund flows between us and SA Finance and the placement of funds by SA Finance. Such monitoring measures may help to keep our deposits with SA Finance safe. In addition, we have received a letter of undertakings from CSAH dated March 31, 2009, in which, among other things, CSAH warranted that our deposits and loans with SA Finance were secure and that SA Finance would continue to operate in strict compliance with the relevant rules and regulations. However, the deposits may be exposed to risks associated with SA Finance s business over which we do not have control. As of December 31, 2017 and 2018, we had deposits of RMB6,095 million and RMB5,583 million, respectively, with SA Finance.

Unfavorable economic conditions, in China and globally, could affect the demand for air travel.

The airline industry is highly cyclical, and the level of demand for air travel is correlated to the strength of domestic and global economies. During periods of unfavorable or volatile economic conditions, demand for air travel can be impacted as business and leisure travelers choose not to travel, seek alternative forms of transportation for short trips or conduct business through videoconferencing. If unfavorable economic conditions occur, particularly for an extended period, our business, financial condition and results of operations may be adversely affected.

Following a referendum in June 2016 in which voters in the U.K. approved an exit from the EU, the U.K. government has initiated a process to leave the EU (often referred to as Brexit) and begun negotiating the terms of the U.K. s future relationship with the EU. Currently, the new deadline for the proposed exit is October 31, 2019. The airline industry faces substantial uncertainty regarding the impact of the exit of the U.K. from the EU. Adverse consequences such as deterioration in economic conditions, volatility in currency exchange rates, or adverse changes in regulation of the airline industry or bilateral agreements governing air travel could have a negative impact on our operations, financial condition and results of operations.

Chinese macroeconomic controls, such as financing adjustments, credit adjustments, taxation policies, price controls and exchange rate policies would also present unexpected changes to the aviation industry. As a result, our business and results of our operations may be adversely affected by the changing economic situations and Chinese macroeconomic controls.

We could be adversely affected by an outbreak of a disease, a similar public health threat or a large-scale natural disaster.

An outbreak of a disease, a similar public health threat or a large-scale natural disaster that affects travel demand, travel behavior, or travel restrictions could have a material adverse impact on our business, financial condition and operating results.

The outbreak of the H1N1 swine flu in March 2009 had an adverse impact on the aviation industry globally and our international routes operations in 2009 were adversely affected by the spread of the swine flu. In 2011, a number of large-scale natural disasters occurred, such as the nuclear meltdown in Japan caused by earthquakes and subsequent tsunami, the hurricane on the East Coast of the United States, the flooding in Thailand and the typhoon in the Philippines, materially and adversely affected the aviation industry.

Lack of adequate documentation for land use rights and ownership of buildings may subject us to challenges and claims by third parties.

We leased certain properties and buildings, which are located in Guangzhou, Haikou and other PRC cities from CSAH. However, CSAH lacks adequate documentation evidencing CSAH s rights to such land and buildings, and, as a result, the lease agreements between CSAH and us for such land have not been registered with the relevant authorities. As a result, such lease agreements may not be enforceable. Lack of adequate documentation for land use rights and ownership of buildings may subject us to challenges and claims by third parties with respect to our use of such land and buildings.

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As of the date of this Annual Report, we had occupied all of the land and buildings mentioned above without any challenge or claim by third parties. However, we cannot assure you that we would not be subject to any challenges in the future. If any challenges to the property ownership or other claims are successful, our operation and business may be materially adversely affected. CSAH has agreed to indemnify us against any loss or damage caused by or arising from any challenge of, or interference with, our right to use such land and buildings.

Any discontinuity or disruption in the direct flight arrangement between Taiwan and Mainland China may negatively affect our results of operations.

The restrictions on direct flights between Taiwan and Mainland China has been further loosened in the past few years, but there has been no further negotiations on the expansion of such arrangement between Taiwan and Mainland China since mid-2016. As of April 26, 2019, there were 80 cross-Strait direct passenger flights per week. We were the first Chinese carrier to operate non-stop flights between Mainland China and Taiwan and have benefited from the operation of such flights. However, given the cross-Strait flight arrangement is subject to the political relationship between Taiwan and Mainland China, any deterioration in such political relationship may cause the discontinuity or disruption in the flight arrangement, and lead to a material adverse impact on our results of operations.

Terrorist attacks or the fear of such attacks, even if not made directly on the airline industry, could adversely affect us and the airline industry. The travel industry continues to face on-going security concerns and cost burdens.

The aviation industry has been beset with high-profile terrorist attacks, most notably the terrorist attack on September 11, 2001 in the United States. Terrorist attacks could also affect the aviation industry in China. Airlines in China have experienced several incidents of terrorist attacks or threats. For example, on March 7, 2008, on a China Southern Airlines flight boarding in Urumqi, crew members discovered a terrorist suspect. On July 14, 2010, a passenger jet en route from Urumqi to Guangzhou was forced to make an emergency landing after receiving an anonymous call claiming there was a bomb on the aircraft. On June 29, 2012, there was an attempted hijacking on a passenger flight operated by Tianjin Airlines between Hotan and Urumqi in China s Xinjiang region. CAAC has enhanced security measures to prevent potential threats of terrorist attacks. Terrorist attacks, even if not made on or targeted directly at the airline industry, or the fear of or the precautions taken in anticipation of such attacks (including elevated threat warnings, travel restrictions, or selective cancellation or redirection of flights) could materially and adversely affect us and the aviation industry. Terrorist attacks may result in substantial flight disruption costs caused by grounding of fleet, significant increase in security costs and associated passenger inconvenience, increased insurance costs, substantially higher ticket refunds and significant decrease in traffic measured in revenue passenger kilometers. Additionally, increasingly strict security measures may cause inconvenience to passengers. These factors can have an uncertain impact on the development of the aviation industry.

We may suffer losses in the event of an accident involving our aircraft or the aircraft of any other airline.

An accident involving an aircraft that we operate could expose us to additional repair or replacement expenses, temporary or permanent losses from disruption of services and significant tort liabilities. Although we believe that we currently maintain liability insurance in amounts and of the types generally consistent with industry practice, the amounts of such coverage may not be adequate to fully cover the costs related to the accident or incident, which could result in harm to our results of operations and financial condition. In addition, such an aircraft accident could create a public perception that our operations are not as safe or reliable as those of other airlines, which could harm our competitive position and cause a decrease in our operating revenue. Moreover, a major accident involving the aircraft of any of our competitors may reduce demand for air travel in general, which would adversely affect our results of operations and financial condition.

On March 11, 2019, the CAAC issued the notice CAAC Request Domestic Transportation Airlines to Suspend the Commercial Operation of the Boeing 737-8 Aircraft , requiring domestic transportation airlines to suspend the commercial operation of the Boeing 737-8 aircraft. As of December 31, 2018, we owned some Boeing 737-8 aircraft and currently suspend commercial operations in accordance with the requirements of the CAAC. At this point, the effects of such suspension on us still remain unclear, and our operations may be affected.

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We could be adversely affected by a failure or disruption of our computer, communications or other technology systems.

We are increasingly dependent on technology to operate our business. In particular, to enhance our management of flight operations, we launched the computerized flight operations control system in May 1999. The system utilizes advanced computer and telecommunications technology to manage our flights on a centralized, real-time basis. We believe that the system will enhance the efficiency of flight schedule, increase the utilization of aircraft and improve the coordination of our aircraft maintenance and ground servicing functions. However, the computer and communications systems on which we rely could suffer substantial or repeated disruptions due to various factors, some of which are beyond our control, including natural disasters, power failures, terrorist attacks, equipment or software failures and computer viruses and hackers. We cannot assure you that the measures we have taken to reduce the risk of some of these potential disruptions are adequate to prevent disruptions to or failures of these systems. Any substantial or repeated failure of those systems could adversely affect our operations and customer services, and result in the loss of important data, loss of revenue, and increased costs. Moreover, a failure of our vital systems could limit our ability to operate our flights for an extended period of time, which could have a material adverse effect on our operations and business.

We may lose investor confidence in the reliability of our financial statements if we fail to achieve and maintain effective internal control over financial reporting, which in turn could harm our business and negatively impact the trading prices of our ADSs, H Shares or A Shares.

The United States Securities and Exchange Commission, or the SEC, as required by Section 404 of the Sarbanes-Oxley Act of 2002, adopted rules requiring every public company, including us, in the United States to include a management report on such company s internal control over financial reporting in its annual report, which contains management s assessment of the effectiveness of the company s internal control over financial reporting. In addition, our independent registered public accounting firm is required to report on the effectiveness of our internal control over financial reporting.

Since 2011, in accordance with the Basic Standard for Enterprise Internal Control jointly issued by the Ministry of Finance, China Securities Regulatory Commission (CSRC) and other three PRC authorities on May 22, 2008, and its application guidelines and other relevant regulations issued subsequently (collectively, PRC internal control requirements) , we have carried out a self-assessment of the effectiveness of its internal control and issued a self-assessment report annually in accordance with the PRC internal control requirements, and our auditor for our PRC GAAP financial statements (the PRC Auditor) is required to report on the effectiveness of our internal control over financial reporting.

However, our independent registered public accounting firm or PRC Auditor may not be satisfied with our internal controls, the level at which our controls are documented, designed, operated and reviewed. Our independent registered public accounting firm or PRC Auditor may also interpret the requirements, rules and regulations differently, and reach a different conclusion regarding the effectiveness of our internal control over financial reporting. Although our management have concluded that our internal control over financial reporting as of December 31, 2018 was effective, we may discover deficiencies in the course of our future evaluation of our internal control over financial reporting and may be unable to remediate such deficiencies in a timely manner. If we fail to maintain the adequacy of our internal control over financial reporting, we may not be able to conclude that we have effective internal control over financial reporting on an ongoing basis, as required under the above mentioned rules and regulations. Moreover, effective internal control is necessary for us to produce reliable financial reports and is important to prevent fraud. As a result, our failure to achieve and maintain effective internal control over financial reporting could result in the loss of investor confidence in the reliability of our financial statements, which in turn could harm our business and negatively impact the trading prices of our ADSs, H Shares or A Shares.

We could be classified as a passive foreign investment company by the United States Internal Revenue Service and may therefore be subject to adverse tax impact.

Depending upon the relative values of our passive assets and income as compared to our total assets and income each taxable year, we could be classified as a passive foreign investment company, or PFIC, by the United States Internal Revenue Service, or IRS, for U.S. federal income tax purposes. We believe that we were not a PFIC for the taxable year 2018. However, there can be no assurance that we will not be a PFIC for the taxable year 2019 and/or later taxable years, as PFIC status is re-tested each year and depends on the facts in such year.

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We will be classified as a PFIC in any taxable year if either: (1) the average value during the taxable year of our assets that produce passive income, or are held for the production of passive income, is at least 50% of the average value of our total assets for such taxable year (the Asset Test) or (2) 75% or more of our gross income for the taxable year is passive income (such as certain dividends, interest or royalties) (the Income Test). For purposes of the Asset Test: (1) any cash, cash equivalents, and cash invested in short-term, interest bearing, debt instruments, or bank deposits that is readily convertible into cash, will generally count as producing passive income or as being held for the production of passive income and (2) the average values of our passive and total assets is calculated based on our market capitalization.

If we were a PFIC, we would generally be subject to additional taxes and interest charges on certain excess distributions our Company makes regardless of whether we continue to be a PFIC in the year in which you receive an excess distribution . An excess distribution would be either (1) the excess amount of a distribution with respect to ADSs during a taxable year in which distributions to you exceed 125% of the average annual distributions to you over the preceding three taxable years or, if shorter, your holding period for the ADSs, or (2) 100% of the gain from the disposition of ADSs. For more information on the United States federal income tax consequences to you that would result from our classification as a PFIC, please see Item 10, Taxation - United States Federal Income Taxation - U.S. Holders - Passive Foreign Investment Company .

We may be unable to retain senior management team or other key employees.

We are dependent on the experience and industry knowledge of our senior management team and other key employees, and we cannot assure you that we will be able to retain them. Any inability to attract and retain talented and highly qualified senior management team or other key employees, could have a negative impact on us.

Our exit from Sky Team Alliance may result in claims against us during the transition period, due to lack of detailed implementation rules regarding member passenger s rights and interests .

During the reporting period, given the requirements from our own development strategy and the new trend of cooperation model in the global air transport industry, we decided not to renew the Sky Team Alliance Agreement from January 1, 2019. We and Sky Team Alliance will continue to work closely during the transition period (January 1, 2019 - December 31, 2019) to ensure a smooth transition for passengers and partners. At this point, we and Sky Team Alliance have reached some agreements on the member passenger s rights and interests during the transition period. However, due to lack of detailed implementation rules regarding member passenger s rights and interests, claims may arise against us during the transition period.

Risks Relating to the Chinese Commercial Aviation Industry

Our business is subject to extensive government regulations.

The Chinese commercial aviation industry is subject to extensive regulatory and legal oversight. The CAAC issues and implements several regulations and polices, which encompass substantially all aspects of the Chinese commercial aviation industry, such as the approval of route allocation, the administration of certain airport operations and air traffic control. As a result, we may face significant constraints on our flexibility and ability to conduct our business or maximize our profitability.

Our results of operations may be negatively impacted by any jet fuel shortages or any fluctuation in domestic prices for jet fuel.

The availability and cost of jet fuel have a significant impact on our financial condition and results of operations. Prior to 1993, jet fuel shortages occurred in China, as a result of which we had to cancel or delay flights. We cannot assure you that such shortages would not occur again, and if such a shortage occurs and causes us to delay or cancel flights, our reputation among passengers as well as our operations may suffer.

Domestic price for jet fuel has experienced fluctuations in the past few years and may continue to fluctuate in the future due to various factors including changes of fuel surcharge. In 2018, our jet fuel cost for 2018 accounted for 56.32% of our flight operation expenses. Therefore, any foregoing fluctuation in the fuel price may affect our financial performance due to our sensitivity to fuel prices. For more information on the jet fuel prices, please see Item 4, Information on the Company - Business Overview - Jet Fuel section below for further discussion.

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In 2018, a reasonable possible increase or decrease of 10% in average jet fuel price with volume of fuel consumed and all other variables held constant, would have increased or decreased our annual fuel costs by approximately RMB4,292 million. Accordingly, even if the jet fuel supply remains stable, increases in jet fuel prices will nevertheless adversely impact our financial results.

Our profit for the year may suffer from unexpected volatility caused by any fluctuation in the level of fuel surcharges.

The level of fuel surcharges, which is regulated by Chinese government, affects domestic customers air travel demands as well as our ability to generate profits. On January 14, 2009, the NDRC and the CAAC jointly announced that the collection of passenger fuel surcharge for domestic routes should be suspended from January 15, 2009 onwards. Subsequently, in response to the increase in international fuel prices, the NDRC and CAAC issued a notice on November 11, 2009 to introduce a new pricing mechanism of fuel surcharge that links it with airlines jet fuel costs, which was further adjusted subsequently. On October 14, 2011, the NDRC and the CAAC issued a notice to adjust such pricing mechanism. As a result of this adjustment, the maximum rates for fuel surcharge can be adjusted according to the pricing mechanism of fuel surcharge, if the aggregated change in jet fuel costs exceeds RMB250 per ton. Due to the decrease in the jet fuel cost, the fuel surcharge has been suspended since February 5, 2015. In March 2015, the NDRC and the CAAC issued the Notice on Adjusting the Base Oil Price of the Passenger Transportation Fuel Addition and Aviation Kerosene Price Linkage Mechanism of Civil Aviation Domestic Routes , pursuant to which, when the domestic aviation kerosene comprehensive procurement cost exceeds RMB5,000 per ton, an air transport enterprise can collect fuel surcharge according to the linkage mechanism. In accordance with the above regulations, we adjusted the fuel surcharges for domestic routes from June 5, 2018 (the date of issue), and, as a result, each passenger is charged RMB10 for domestic flight segments (including domestic segments of international routes) under 800 kilometers, 800 kilometers and above 800 kilometers. We cannot guarantee that fuel surcharges would not be adjusted further in the future or adjusted in our favor. If fuel surcharges are not adjusted in correspondence to the increase in jet fuel, our profit for the year may be materially adversely affected.

Our results of operations tend to be volatile and fluctuate due to seasonality.

The aviation industry is characterized by annual high and low travel seasons. Our operating revenue is substantially dependent on the passenger and cargo traffic volume carried, which is subject to seasonal and other changes in traffic patterns, the availability of appropriate time slots for our flights and alternative routes, the degree of competition from other airlines and alternate means of transportation, as well as other factors that may influence passenger travel demand and cargo and mail volume. In particular, our airline revenue is generally higher in the second half of the year than in the first half of the year due to the greater demand for air travel during the summer months. As a result, our results tend to be volatile and subject to rapid and unexpected change.

Our operations may be adversely affected by insufficient aviation infrastructure in Chinese commercial aviation industry.

The rapid increase in air traffic volume in China in recent years has put pressure on many components of the Chinese commercial aviation industry, including China s air traffic control system, the availability of qualified flight personnel and airport facilities. Airlines, such as our Company, which have route networks that emphasize short- to medium-haul routes, are generally more affected by insufficient aviation infrastructure in terms of on-time performance and high operating costs due to fuel inefficiencies resulting from the relatively short segments flown, as well as the relatively high proportion of time on the ground during turnaround. All of these factors may adversely affect the perception of the service provided by an airline and, consequently, the airline s operating results. In recent years, the CAAC placed increasingly emphasis on the safety of Chinese airline operations and implemented measures aimed at improving the safety record of the industry. The ability of us to increase utilization rates and to provide safe and efficient air transportation in the future will depend in part on factors, such as the improvement of national air traffic control, navigation systems and ground control operations at Chinese airports, which are beyond our control.

We face increasingly intense competition in both domestic and international market, as well as from alternative means of transportation.

Competition has become increasingly intense in recent years in domestic market, due to relaxation of certain regulations by the CAAC, increase in the capacity, routes and flights of Chinese airlines, etc. Such intense competition has led to widespread price-cutting practices, which do not comply with applicable regulations in all respects . Until CAAC finalizes and strictly enforces the interpretation of relevant regulations limiting such price-cutting, discounted tickets from competitors will continue to have an adverse effect on our sales.

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We face varying degrees of competition on regional routes from certain Chinese airlines and Cathay Pacific, Cathay Dragon and Air Macau, and on our international routes, primarily from non-Chinese airlines, most of which have significantly longer operating histories, substantially greater financial and technological resources and greater name recognition than us. In addition, the public s perception of the safety and service records of Chinese airlines could adversely affect our ability to compete against our regional and international competitors. Many of our international competitors have larger sales networks, participate in more comprehensive and convenient reservation systems, or engage in more promotional activities, which may enhance their ability to attract international passengers.

Furthermore, for short-distance transportation, airplanes, trains and buses are alternatives to each other. Given the recent development of high-speed trains (as discussed below), the construction of nationwide high-speed railway network and the improvement of inter-city expressway network, the commercial aviation sector as a whole faces increasingly competition from alternative means of transportation aforementioned.

We expect to face substantial competition from the rapid development of the Chinese rail network.

The PRC government is aggressively expanding its high-speed rail network. The mileage of new railway lines put into operation in 2018 reached 4,600 kilometers. In 2018, the Harbin-Jiamusi Rapid Railway, Jianmeng-Zhanjiang, and Kunming Chuxiong Dali Intercity Railway commenced operation. As of December 31, 2018, China s railway traffic mileage reached 131,000 kilometers, among which 29,000 kilometers are covered by high-speed railway, accounting for more than 60% of the world s total high-speed railway traffic mileage. According to the latest development goal of the China Railway, China s railway traffic mileage will reach 175,000 kilometers by 2025, among which 38,000 kilometers are covered by high-speed railway. The operating results of our air routes, which overlap with the high-speed railway corridors (especially air routes with a distance of less than 800 kilometers), will be affected in the future.

Limitations on foreign ownership of Chinese airlines may affect our access to funding in the international equity capital markets.

The current Chinese government policies limit foreign ownership of Chinese airlines. Under these policies, non-PRC, Hong Kong, Macau, Taiwan residents can only hold up to 49% of equity interest in a Chinese airline. As of December 31, 2018, we estimate that 29.89% of our total outstanding ordinary shares were held by non-PRC, Hong Kong, Macau, Taiwan residents. According to The Provisions on Domestic Investment in Civil Aviation Industry, effective on January 19, 2018, Chinese government has loosen up restrictions on state ownership of our total outstanding ordinary shares, which allows the percentage of state-owned shares to be under 50%. However, for so long as the limitation on foreign ownership is in force, we will have limited access to funding in the international equity capital markets.

The European Emissions Trading Scheme may increase our operational cost.

Starting on January 1, 2012, aviation sector has been included in the European Emissions Trading Scheme (ETS), EU s mandatory cap-and-trade system for reduction of greenhouse gas emissions. Airline operators in the EU will receive tradable emission permits (aviation allowances) covering a certain level of their CO2 emissions per year for their flights operating to and from EU airports. If an airline fails to obtain free-of-charge emission permits from the EU, it will have to buy around EUR10 million (RMB100 million) worth of CO2 emissions allowances from other greener industries. Pursuant to this policy, the Chinese airlines having flight points in Europe undertake the same carbon emission reductions obligation as the European local airlines, which will result in a significant increase in the operating cost of Chinese airlines in Europe, including our Company, and further have an adverse impact on the results of operations and financial condition. In March 2011, a group representing China s largest airlines sent a formal notice to the EU expressing strong opposition to non-member-state airlines inclusion in the EU s Emissions Trading Scheme. Also, in early February 2012, the CAAC issued instructions to various airlines announcing that without approval from the relevant government authorities, the major airlines are prohibited from joining the ETS and the transport airlines are also prohibited from raising the freight price or increasing fee items by adducing this reason. On November 12, 2012, EU announced to temporarily suspend the implementation of the ETS in the aviation sector in 2013 in order to forge a positive negotiation environment for all parties. In 2016, our Company had finished 2015 compliance cycle and in 2017, our Company had finished 2016 compliance cycle. In March 2018, the CAAC issued another notification on the ETS. The notification provided that the CAAC would not prohibit Chinese airlines to take part in the ETS if the relevant flights take off and land between the airports within the EU during 2017 and 2018. By the end of reporting period, our Company has finished 2017 compliance cycle and now is performing 2018 compliance cycle. On 2019-2020 compliance cycle, our Company will be subject to the requirements of relevant PRC laws and the ETS. There can be no assurance that the new implementation proposal will not have negative impact on our financial condition and results of operations.

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We may utilize fuel hedging arrangements which may result in losses.

While we have not entered into any fuel hedging transactions since the fourth quarter of 2008, we may in the future consider to hedge a portion of our future fuel requirements through various financial derivative instruments linked to certain fuel commodities to lock in fuel costs within a hedged price range. However, these hedging strategies may not always be effective and high fluctuations in aviation fuel prices exceeding the locked-in price ranges may result in losses. Significant declines in fuel prices may substantially increase the costs associated with our fuel hedging arrangements. In addition, while we seek to manage the risk of fuel price increases by using derivative contracts, we cannot assure you that, at any given point in time, our fuel hedging transactions will provide any particular level of protection against increased fuel costs.

Risks Relating to the PRC

We have significant exposure to foreign currency risk as part of our lease obligations and certain bank and other loans are denominated in foreign currencies. Due to rigid foreign exchange control by Chinese government, we may face difficulties in obtaining sufficient foreign exchange to pay dividends or satisfy our foreign exchange liabilities.

Under current Chinese foreign exchange regulations, the Renminbi is fully convertible for current account transactions, but is not freely convertible for capital account transactions. 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.

We have significant exposure to foreign currency risk as substantially all of our obligations under leases, certain bank and other loans and operating lease commitment are denominated in foreign currencies, principally U.S. dollars, Euros and Japanese Yen. Depreciation or appreciation of the Renminbi against foreign currencies affects our results significantly because our foreign currency liabilities generally exceed our foreign currency assets. We are not able to hedge our foreign currency exposure effectively other than by retaining our foreign currency denominated earnings and receipts to the extent permitted by SAFE, or subject to certain restrictive conditions, entering into foreign exchange forward option contracts with authorized banks. However, SAFE may limit or eliminate our ability to purchase and retain foreign currencies in the future. In addition, foreign currency transactions under the capital account are still subject to limitations and require approvals from SAFE. This may affect our ability to obtain foreign exchange through debt or equity financing, including by means of loans or capital contributions. No assurance can be given that we will be able to obtain sufficient foreign exchange to pay dividends or satisfy our foreign exchange liabilities.

Our operations are subject to immature development of legal system in China. Lack of uniform interpretation and effective enforcement of laws and regulations may cause significant uncertainties to our operations.

Our Company and the major subsidiaries of us are organized under the laws of China. The Chinese legal system is based on written statutes and is a system, unlike common law systems, in which decided legal cases have little precedential value. Since 1979, the Chinese government has been developing a comprehensive system of commercial laws and considerable progress has been made in the promulgation of laws and regulations dealing with economic matters, such as corporate organization and governance, foreign investments, commerce, taxation and trade. These laws, regulations and legal requirements are relatively recent, and, like other laws, regulations and legal requirements in China (including with respect to the commercial aviation industry), their interpretation and enforcement involve significant uncertainties.

The PRC tax law may have negative tax impact on holders of our H Shares or ADSs, by requiring the imposition of a withholding tax on dividends paid by a Chinese company to a non-resident enterprise.

The current tax law generally provides for a withholding tax on dividends paid by a Chinese company to a non-resident enterprise at a rate of 10%.

Caishui Notice [2014] No. 81 provides that, for dividends derived by Mainland individual investors from investing in H Shares listed on the Hong Kong Stock Exchange through Shanghai Hong Kong Stock Connect, H-Share companies shall apply to the China Securities Depository and Clearing Corporation Limited (CSDC). CSDC shall provide the list of Mainland individual investors to H-Share companies who shall withhold individual income tax at a tax rate of 20%. For Mainland securities investment funds investing in shares listed on the Hong Kong Stock Exchange through Shanghai Hong Kong Stock Connect, the above rules shall also apply and individual income tax shall be levied on dividends derived therefrom.

Caishui Notice [2014] No. 81 further provides that, dividends derived by Mainland enterprise investors from investing in shares listed on the Hong Kong Stock Exchange through Shanghai Hong Kong Stock Connect shall be included in their gross income and subject to enterprise income tax. For dividends derived by Mainland enterprises where the relevant H Shares have been continuously held for no less than 12 months, enterprise income tax may be exempt according to the tax law. H-Share companies listed on the Hong Kong Stock Exchange shall apply to CSDC to obtain the list of Mainland enterprise investors from CSDC. H-Share companies are not required to withhold income tax on dividends to Mainland enterprise investors which shall report the income and make the tax payment by themselves.

In addition, to date, relevant tax authorities have not collected capital gains tax on the gains realized upon the sale or other disposition of overseas shares in Chinese enterprise held by foreign individuals. If relevant tax authorities promulgate implementation rules on the taxation of capital gains realized by individuals upon the sale or other disposition of the shares, individual holders of the shares may be required to pay capital gains tax.

Our investors in the U.S. who rely on our auditor s audit reports currently do not have the benefit of PCAOB oversight.

Auditors of companies that are registered with the SEC and traded publicly in the United States, including our independent registered public accounting firm, must be registered with the Public Company Accounting Oversight Board, or the PCAOB, and are required by the laws of the United States to undergo regular inspections by the PCAOB to assess their compliance with the laws of the United States and professional standards. The PCAOB, however, is currently unable to inspect a registered public accounting firm s audit work relating to a company s operations in China where the documentation of such audit work is located in China. Accordingly, our independent registered public accounting firm s audit of our operations in China is not subject to the PCAOB inspection.

The PCAOB has conducted inspections of independent registered public accounting firms outside of China and has at times identified deficiencies in the audit procedures and quality control procedures of those accounting firms. Such deficiencies may be addressed in those accounting firms future inspection process to improve their audit quality. Due to the lack of PCAOB inspections of audit work undertaken in China, our investors do not have the benefit of the regular evaluation by PCAOB of the audit works, audit procedures and quality control procedures of our independent registered public accounting firm.

If additional remedial measures are imposed against four PRC-based accounting firms, including our independent registered public accounting firm, in administrative proceedings brought by the SEC, it could result in our financial statements being determined to not be in compliance with the requirements of the Securities Exchange Act of 1934.

In December 2012, the SEC instituted administrative proceedings against four PRC-based accounting firms, including our independent registered public accounting firm, alleging that they had refused to produce audit work papers related to their audit of certain PRC-based companies that are publicly traded in the United States. On January 22, 2014, an initial administrative law decision was issued, which determined that the four PRC-based accounting firms should be censured and barred from practicing before the SEC for a period of six months. The four PRC-based accounting firms appealed the initial administrative law decision to the SEC. The initial law decision is neither final nor legally effective unless and until it is endorsed by the full SEC. In February 2015, each of the four PRC-based accounting firms agreed to a censure and to pay a fine to the SEC to settle the dispute and avoid suspension of their ability to practice before the SEC. The settlement requires the firms to follow detailed procedures to provide the SEC with access to PRC-based firms audit documents via the CSRC.

We were not and are not the subject of any SEC investigations nor are we involved in the proceedings brought by the SEC against the accounting firms. If the firms do not follow these procedures or if there is a failure in the process between the SEC and the CSRC, the SEC could impose penalties such as suspensions, or it could restart the administrative proceedings. If the accounting firms including our independent registered public accounting firm were denied, temporarily or permanently, the ability to practice before the SEC, and we were unable to find another registered public accounting firm in a timely manner to audit and issue a report on our financial statements, our financial statements could be determined to not be in compliance with the requirements of the Exchange Act. Such a determination could ultimately lead to our delisting from the NYSE or deregistration from the SEC, or both, which would substantially reduce or effectively terminate the trading of our ADSs in the United States.

Recent international trade tensions could materially and adversely affect our business, financial condition, and results of operations.

Economic conditions in China are sensitive to global economic conditions. The global financial markets have experienced significant disruptions in the past, including the recent international trade disputes and tariff actions announced by the United States, the PRC and certain other countries. The U.S. administration has imposed significant amount of tariffs on Chinese goods, and the PRC government has imposed tariffs on certain goods manufactured in the United States. There is no assurance that the list of goods impacted by additional tariffs will not be expanded or the tariffs will not be increased materially. It is difficult to predict how PRC or U.S. government policy, in particular, the outbreak of a trade war between the PRC and the United States and the imposition in 2018 of additional tariffs on bilateral imports, may continue to impact the PRC. If the list of goods is further expanded or the tariff is further increased, the volume of China-U.S. import and export trade would drop significantly, which will lead to deterioration in economic conditions of both countries and decrease of business and official activities between both countries. Demand for air travel as well as cargo and mail volume may also be impacted.

ITEM 4. INFORMATION ON THE COMPANY

A. HISTORY AND DEVELOPMENT OF OUR COMPANY

We were incorporated under the PRC laws on March 25, 1995 as a joint stock company with limited liability under the name of China Southern Airlines Company Limited. The address of our principal place of business is 68 Qi Xin Road, Guangzhou 510403, People s Republic of China. Our telephone number is +86 20 8612 4462 and our website is www.csair.com.

In July 1997, we issued 1,174,178,000 H Shares, par value RMB1.00 per share, and completed the listing of our H Shares on the Hong Kong Stock Exchange and the ADSs representing our H shares on the New York Stock Exchange.

On March 13, 2003, we obtained an approval certificate from the Ministry of Commerce to change to a permanent limited company with foreign investments, and on October 17, 2003, we obtained a business license for our new status, as a permanent limited company with foreign investments issued by the State Administration of Industry and Commerce of the People s Republic of China.

In July 2003, we issued 1,000,000,000 A Shares, par value RMB1.00 per share, and completed the listing of our A shares on the Shanghai Stock Exchange.

Pursuant to a sale and purchase agreement dated November 12, 2004 between our Company, CSAH, China Northern Airlines (CNA) and Xinjiang Airlines (XJA), which was approved by our shareholders in an extraordinary general meeting held on December 31, 2004, we acquired the airline operations and certain related assets of CNA and XJA with effect from December 31, 2004 at a total consideration of RMB1,959 million.

On May 30, 2007, we, together with an independent third party, established Chongqing Airlines Company Limited (Chongqing Airlines). As of December 31, 2012, four aircraft were transferred to Chongqing Airlines by us as a capital contribution. We own a total of 60% equity interest in Chongqing Airlines.

On August 14, 2007, we acquired a 51% equity interest in Nan Lung International Freight Limited beneficially owned by and registered in the name of Nan Lung Travel & Express (Hong Kong) Limited, and a 100% equity interest in

China Southern Airlines Group Air Catering Company Limited, both a wholly-owned subsidiary of CSAH, for a total consideration of RMB112 million.

In December 2008, we acquired a 26% equity interest in China Southern West Australian Flying College Pty Ltd. (Flying College) from CSAH, and Flying College became a 91% owned subsidiary of our Company.

In June 2009, we acquired a 50% equity interest in Beijing Southern Airlines Ground Services Company Limited (Beijing Ground Service) from the other shareholder, and Beijing Ground Service became a wholly-owned subsidiary of our Company.

On September 28, 2009, we entered into an agreement with CSAH to sell our 50% equity interest in MTU Maintenance Zhuhai Co., Ltd (Zhuhai MTU), a jointly controlled entity of our Company, to CSAH at a consideration of RMB 1,607,850,000. The transfer was completed in February 2010.

On June 2, 2010, a third party company injected capital to Flying College, which diluted our interest in Flying College from 91% to 48.12%. Flying College became a jointly controlled entity of our Company since then. The retained non-controlling equity interest in Flying College is re-measured to the fair value at the date when control was lost and a gain on deemed disposal of a subsidiary of RMB17 million was recorded in 2010.

In December 2010, we entered into an agreement with Xiamen Jianfa Group Co., Ltd. and Hebei Aviation Investment Group Corporation Limited (Hebei Investment), pursuant to which Hebei Investment agreed to inject a cash capital of RMB1,460 million into Xiamen Airlines Company Limited (Xiamen Airlines). In March 2011, the capital injection was received in full and our equity interest in Xiamen Airlines was diluted from 60% to 51%. Xiamen Airlines remains a subsidiary of our Company.

On June 29, 2012, Xiamen Airlines, a subsidiary of our Company and Southern Airlines Culture and Media Co., Ltd. (SACM) entered into an agreement, pursuant to which Xiamen Airlines agreed to sell and SACM agreed to purchase a 51% equity interest in Xiamen Airlines Media Co., Ltd.(XAMC), at a consideration of approximately RMB43.12 million. Immediate prior to the transaction, XAMC was wholly owned by Xiamen Airlines and primarily engaged in providing advertising, corporate branding, publicity and exhibition services and was responsible for the overall brand building and publicity of Xiamen Airlines.

On September 24, 2012, we entered into a joint venture agreement with Henan Civil Aviation Development and Investment Co., Ltd. (Henan Aviation Investment) for the establishment of China Southern Airlines Henan Airlines Company Limited (Henan Airlines), a joint venture company with a total registered capital of RMB6 billion, which is owned as to 60% and 40% by us and Henan Aviation Investment, respectively. On September 28, 2013, Henan Airlines was established.

On October 13, 2014, Xiamen Airlines and Hebei Airlines Investment Group Company Limited (the Hebei Airlines Investment) entered into an agreement, pursuant to which Hebei Airlines Investment agreed to sell and Xiamen Airlines agreed to purchase a 95.4% equity interest in Hebei Airlines at the consideration of RMB680 million. The acquisition was completed in December 2014.

On July 14, 2015, we and Xiamen Jianfa entered into an agreement, pursuant to which Xiamen Jianfa agreed to sell and we agreed to purchase a 4% equity interest in Xiamen Airlines at the consideration of RMB586,666,670. The acquisition was completed in December 2015.

On February 2, 2016, we and CSAH entered into an agreement, pursuant to which CSAH agreed to sell and we agreed to purchase a 100% equity interest in Southern Airlines (Group) Import And Export Trading Co. Ltd. at the consideration of RMB400,570,400. The acquisition was completed in August 2016.

On March 27, 2017, according to the authorization under the general mandate approved by the 2015 annual general meeting and as approved by the Board, we entered into a share subscription agreement with American Airlines, pursuant to which American Airlines agreed to subscribe for 270,606,272 new H Shares of us, at the consideration of HK$1,553.28 million, representing a subscription price of HK$5.74 per share. The closing price of the H Shares as at the date of the share subscription agreement was HK$5.49. The subscription was completed on August 10, 2017.

On May 18, 2017, we entered into a joint venture agreement regarding Guangzhou Nanland Air Catering Company Limited with Hong Kong Sharpland Investments Ltd., Servair S.A and Hong Kong Ginkgo Group Company Limited, pursuant to which we contributed RMB76,206,300 cash and the equity interests in a subsidiary with a valuation of RMB513,727,300 into Guangzhou Nanland Air Catering Co., Ltd.. After the capital contribution, we held 70.5% equity interest in Guangzhou Nanland Air Catering Co., Ltd..

On July 10, 2017, we entered into a share transfer agreement with CAE International Holdings Limited for an acquisition of 49% equity interest in Zhuhai Xiang Yi Aviation Technology Company Limited held by CAE with an amount of US$99.52 million (equivalent to approximately RMB678 million). After the completion of this acquisition, Zhuhai Xiang Yi Aviation Technology Company Limited became our wholly-owned subsidiary.

On October 13, 2017, Xiamen Airlines entered into a share transfer agreement with SACM for an acquisition of 51% equity interest in Xiamen Airlines Media Co., Ltd. held by SACM with an amount of RMB47 million. After the completion of this acquisition, Xiamen Airlines Media Co., Ltd. became a wholly-owned subsidiary of Xiamen Airlines.

On June 29, 2018, we established a wholly-owned subsidiary, Xiongan Airlines in Xiong an New Area. We intend to make a total contribution of RMB10 billion by stages, among which RMB2.5 billion will be made in cash, and RMB7.5 billion will be made in kind. This investment is conducive to promoting the development of the Company s main aviation industry and enhancing our competitiveness in the aviation market.

On September 29, 2018, we completed the non-public issuance of A shares, and CSAH participated in the non-public issuance of A shares subscription with its 50.00% equity interest in Zhuhai MTU and part of cash. The appraisal value of 50% equity interest in Zhuhai MTU assessed and filed by the SASAC is the benchmark, and the asset consideration is determined to be RMB1,741,080,000 after the adjustment of 2016 annual dividend of Zhuhai MTU. As of the end of the reporting period, transfer of all 50.00% of equity interest of Zhuhai MTU and the procedures and the registration with Administration for Industry and Commerce had been completed, and we hold 50.00% of equity interest in Zhuhai MTU.

On September 11, 2018, we issued 600,925,925 H shares to Nan Lung with the proceeds of approximately HK$3.626 billion. On September 27, 2018, we, by way of non-public issuance, issued 1,578,073,089 A shares to seven investors including CSAH. The proceeds is approximately RMB9.5 billion. After the completion of our non-public issuance, our total share capital increased to 12,267,172,286 shares.

Aircraft Acquisitions

Pursuant to an A320 series aircraft purchase agreement dated January 20, 2010 between our Company and Airbus SNC, we will acquire 20 Airbus 320 series aircraft from Airbus SNC. According to the information provided by Airbus SNC, the catalogue price of an Airbus 320 aircraft, including airframe and engines, is around US$76.9 million. The aggregate consideration for the acquisition was partly paid in cash and partly through financing arrangements with banking institutions. The Airbus aircraft were delivered in stages to our Company during the period from 2011 to 2013.

On September 30, 2010, Xiamen Airlines entered into a supplemental agreement with Boeing to purchase additional 10 Boeing B737 series aircraft. The aggregate catalogue price for those aircraft, including airframe and engines, is around US$699 million. According to the information provided by Boeing, the aggregate consideration for the acquisition was partly paid in cash by Xiamen Airlines, and partly through financing arrangements with banking institutions. The Boeing aircraft were delivered in stages to Xiamen Airlines during the period from 2015 to October 2016.

On November 4, 2010, we entered into an A320 series aircraft purchase agreement and an A330-300 aircraft purchase agreement with Airbus S.A.S. to purchase 30 Airbus A320 series aircraft and six Airbus A330 series aircraft. According to the information provided by Airbus S.A.S., the catalogue price of six Airbus A330 series aircraft and 30 Airbus A320 series aircraft, including airframe and engines, is US$1.205 billion and US$2.575 billion, respectively. The aggregate consideration for the acquisition was partly paid in cash and partly through financing arrangements with banking institutions. The six Airbus A330 aircraft were delivered in stages to our Company during the period from 2013 to 2014 and the 30 Airbus A320 series aircraft were delivered in stages to our Company during the period from 2012 to 2015.

On May 31, 2011, we entered into an aircraft acquisition agreement with Boeing to purchase six Boeing B777F freighters. According to the information provided by Boeing, the catalogue price of six Boeing B777F aircraft, including airframe and engines, is US$1,584 million. The aggregate consideration for the Acquisition was partly paid in cash and partly through financing arrangements with banking institutions. The six Boeing B777F freighters were delivered in stages to us during the period from 2013 to 2015.

On May 9, 2011, Xiamen Airlines entered into an aircraft acquisition agreement to purchase six Boeing B787 series aircraft. According to the information provided by Boeing, the aggregate catalogue price, including airframe and engines, for the six Boeing B787 series aircraft is US$1,098 million. The aggregate consideration for the acquisition was partly paid in cash and partly through financing arrangements with banking institutions. The Boeing aircraft were delivered in stages to Xiamen Airlines during the period from 2014 to 2015.

On February 28, 2012, we entered into an agreement with the Boeing Company to purchase 10 Boeing 777-300ER aircraft. According to the information provided by Boeing, the catalogue price of one Boeing B777-300ER aircraft, including airframe and engines, is around US$298 million. The aggregate consideration for the acquisition was partly paid in cash and partly through financing arrangements with banking institutions. The Boeing aircraft were delivered in stages to our Company during the period from 2014 to 2016.

On August 3, 2012, Xiamen Airlines entered into an agreement with Boeing to purchase 40 Boeing B737 series aircraft from Boeing. The aggregate catalogue price of the 40 Boeing B737 series aircraft is US$3.36 billion. The aggregate consideration for the acquisition was partly paid in cash and partly through financing arrangements with banking institutions. The 27 Boeing737 series aircraft were delivered in stages to Xiamen Airlines during the period from 2016 to 2017 and the 13 Boeing737 series aircraft will be delivered in stages to Xiamen Airlines during the period from 2018 to 2019.

On December 5, 2012, we entered into the Airbus aircraft acquisition agreement with Airbus S.A.S. to purchase 10 Airbus A330-300 aircraft. The catalogue price of one Airbus A330-300 aircraft is US$188 million. The aggregate consideration for the acquisition was partly paid in cash and partly through financing arrangements with banking institutions. The Airbus aircraft were delivered in stages to our Company during the period from 2014 to 2016.

On May 16, 2014, we entered into the aircraft acquisition agreement with Airbus S.A.S to purchase 30 Airbus A320 series aircraft and 50 A320 NEO series aircraft. The catalogue price of one Airbus A320 series aircraft and one A320 NEO series aircraft differs, ranging from US$85.8 million to US$110.1 million and US$94.4 million to US$120.5 million, respectively. The aggregate consideration for the acquisition will be funded partly by internal resources of our Company and partly through commercial loans by commercial banks. The 30 Airbus320 aircraft were delivered in stages to our Company during the period from 2016 to 2017 and the 50 Airbus320 NEO aircraft will be delivered in stages to our Company during the period from 2018 to 2020.

On December 17, 2015, we entered into the aircraft acquisition agreement with Boeing to purchase 30 B737NG series aircraft and 50 B737 MAX series aircraft. The catalogue price of each B737NG series aircraft and B737 MAX series aircraft is about US$81.2 million and US$96.1 million, respectively. The aggregate consideration for the acquisition will be funded partly payable in cash and partly through financing arrangements with banking institutions. The 30 Boeing737NG aircraft were delivered in stages to our Company in 2017 and the 50 Boeing737 MAX aircraft will be delivered in stages to our Company during the period from 2018 to 2021.

On December 23, 2015, we entered into the aircraft acquisition agreement with Airbus S.A.S to purchase 10 Airbus A330-300 series aircraft. The catalogue price of one Airbus A330-300 series aircraft is about US$227.4 million. The aggregate consideration for the acquisition will be funded partly payable in cash and partly through financing arrangements with banking institutions. The Airbus aircraft will be delivered in stages to our Company during the period from 2017 to 2019. The 3 Airbus A330-300 aircraft were delivered in stages to our Company in 2017 and the 7 Airbus A330-300 aircraft will be delivered in stages to our Company during the period from 2018 to 2019.

On April 26, 2016, Xiamen Airlines entered into the aircraft acquisition agreement with Boeing to purchase 10 B737-800 series aircraft. The catalogue price of one B737-800 series aircraft is about US$85.06 million. The aggregate consideration for the acquisition will be funded partly by internal sources of our Company and partly through commercial loans by commercial banks. The four Boeing787-800 series aircraft were delivered in stages to Xiamen Airlines g in 2017 and the six Boeing787-800 series aircraft were delivered in stages to Xiamen Airlines in 2018.

On July 27, 2016, Xiamen Airlines entered into the aircraft acquisition agreement with Boeing to purchase six B787-9 series aircraft. The catalogue price of one is about US$230 million. The aggregate consideration for the acquisition will be funded partly by internal sources of our Company and partly through commercial loans by commercial banks. The Boeing 787-9 series aircraft were delivered in stages to Xiamen Airlines during the period from 2016 to 2018.

On October 12, 2016, we entered into the aircraft acquisition agreement with Boeing to purchase 12 B787-9 series aircraft. The catalogue price of one is about US$271 million. The aggregate consideration for the acquisition will be funded partly by internal sources of our Company and partly through commercial loans by commercial banks. The Boeing aircraft will be delivered in stages to our Company during the period from 2018 to 2020.

On April 26, 2017, we entered into the aircraft acquisition agreement with Airbus S.A.S to purchase 20 A350-900 series aircraft. The catalogue price of one A350 series aircraft is about US$299 million. The aggregate consideration for the acquisition will be funded partly by internal sources of our Company and partly through commercial loans by commercial banks. The Airbus aircraft will be delivered in stages to us during the period from 2019 to 2022.

On October 20, 2017, we entered into the aircraft acquisition agreement with Boeing to purchase 8 B777-300ER and 30 B737-8 series aircraft. The catalogue price of each B777-300ER series aircraft and B737-8 series aircraft is about US$318 million and US$104 million, respectively. The aggregate consideration for the acquisition will be funded partly by internal sources of our Company and partly through commercial loans by commercial banks. The Boeing aircraft will be delivered in stages to our Company during the period from 2019 to 2020. On February 28, 2019, we entered into the supplemental Boeing aircraft acquisition agreement with Boeing to amend the terms of the aforesaid aircraft acquisition agreement to change the 2 B777-300ER aircraft originally agreed to be acquired by the Company to 2 B777F aircraft.

On March 21, 2018, Xiamen Airlines entered into the Boeing Aircraft Acquisition Agreement with Boeing to purchase the 20 B737-8 aircraft and 10 B737-10 aircraft. The catalogue price of each B737-8 series aircraft and B737-10 series aircraft is about US$104 million and US$116 million, respectively. The aggregate consideration for the acquisition will be funded partly by internal sources of our Company and partly through commercial loans by commercial banks. The Boeing aircraft will be delivered in stages to Xiamen Airlines during the period from 2019 to 2022.

Capital Expenditure

We expended RMB37,210 million, RMB31,129 million and RMB29,454 million in capital expenditures in 2018, 2017 and 2016, respectively. Of such capital expenditures in 2018, RMB13,290 million was financed by capital leases, RMB22,499 million was financed by bank borrowings while the remaining RMB1,421 million was financed by internal resources. The capital expenditures were primarily incurred on the additional investments in aircraft and flight equipment under our fleet expansion plans and, to a small extent, additional investments in other facilities and buildings for operations. As of December 31, 2018, we had total capital commitments for aircraft, engines and related equipment of approximately RMB82,199 million.

Restructuring and Initial Public Offering

As part of China s economic reforms in the 1980 s, the PRC State Council directed the CAAC to separate its governmental, administrative and regulatory role from the commercial airline operations that were being conducted by the CAAC and its regional administrators. As a result, CSAH was established on January 26, 1991 for the purpose of assuming the airline and airline-related commercial operations of the Guangzhou Civil Aviation Administration, one of the then six regional bureaus of the CAAC. CSAH was one of the 55 large-scale enterprises designated by the Chinese government to play a leading role in their respective industries.

CSAH was restructured in 1994 and 1995 in anticipation of our initial public offering. The restructuring was effective through the establishment of our Company and the execution of the De-merger Agreement on March 25, 1995 by and between CSAH and our Company. Upon the restructuring, our Company assumed substantially the entire airline and airline-related businesses, assets and liabilities of CSAH, and CSAH retained its non-airline-related businesses, assets and liabilities. All interests, rights, duties and obligations of CSAH, whenever created or accrued, were divided between our Company and CSAH based on the businesses, assets and liabilities assumed by each of them under the De-merger Agreement. Under the De-merger Agreement, CSAH agreed not to conduct, participate or hold any interest in, either directly or indirectly, any business, activity or entity in or outside China that competes or is likely to compete with the commercial interests of our Group, although CSAH may continue to hold and control its affiliates existing on the date of the De-merger Agreement and may continue to operate the businesses of such associates. Under the De-merger Agreement, CSAH and our Company also agreed to indemnify each other against any losses, claims, damage, debts or expenses arising out of or in connection with the restructuring. As of the date of this Annual Report, no indemnity has been provided by either CSAH or us.

In July 1997, we completed a private placement of 32,200,000 H Shares to certain limited partnership investment funds affiliated with Goldman Sachs & Co. and an initial public offering of 1,141,978,000 H Shares, par value RMB1.00 per share, and the listing of the H Shares on the Hong Kong Stock Exchange and ADSs on the New York Stock Exchange. Prior to the private placement and the initial public offering, all of our issued and outstanding shares of capital stock, consisting of 2,200,000,000 non-tradable domestic shares (Domestic Shares), par value RMB1.00 per share, were owned by CSAH, which owned and exercised, on behalf of the Chinese government and under the supervision of the CAAC, the rights of ownership of such Domestic Shares. After giving effect to the private placement and the initial public offering, CSAH maintained its ownership of the 2,200,000,000 Domestic Shares (representing approximately 65.2% of the total share capital of our Company), and became entitled to elect all the directors of our Company and to control the management and policies of our Group. The Domestic Shares and H Shares are both ordinary shares of our Company.

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In July 2003, we issued 1,000,000,000 A Shares, par value of RMB1.00 per share, and listed these shares on the Shanghai Stock Exchange. Subsequent to the issuance of the A Shares, the shareholding of CSAH in our Company was reduced from 65.2% to 50.30%.

Share Reform Scheme

Pursuant to relevant PRC laws, we launched the share reform scheme in May 2007, whereby all the 2,200,000,000 non-tradable Domestic Shares held by CSAH would be converted into tradable A Shares. Upon the completion of such scheme on June 20, 2008, all the non-tradable Domestic Shares have been successfully converted into tradable A Shares. Subject to the restriction, CSAH shall not transfer or trade these shares within 36 months after the commencement date of the share reform scheme, which is June 18, 2007.

Bonus Shares Issuance by Conversion of Share Premium

On June 25, 2008, our shareholders approved issuance of bonus shares by way of conversion of share premium, and on August 14, 2008, the Ministry of Commerce approved the bonus share issuance. The issuance was effected by conversion of share premium on the basis of five new shares, credited as fully paid, for every ten existing shares. Upon the completion of the bonus share issuance of 2,187,089,000 shares, as of December 31, 2007, the number of paid up shares increased from 4,374,178,000 shares to 6,561,267,000 shares.

Non-Public Subscriptions

On December 10, 2008, we entered into an A Shares subscription agreement with CSAH, pursuant to which CSAH conditionally agreed to subscribe and we conditionally agreed to allot and issue 721,150,000 new A Shares for a consideration of RMB2,278,834,000, equivalent to the subscription price of RMB3.16 per new A Share. Separately and on the same date, our Company and Nan Lung (a wholly-owned subsidiary of CSAH) entered into an H Shares subscription agreement, pursuant to which Nan Lung conditionally agreed to subscribe and our Company conditionally agreed to allot and issue 721,150,000 new H Shares for a consideration of RMB721,150,000, equivalent to the subscription price of RMB1.00 (equivalent to approximately HK$1.13) per new H Share. The subscription agreements were approved in the extraordinary general meeting and the respective class meetings of shareholders of A and H Shares on February 26, 2009. On June 3, 2009, we received the formal approval from CSRC for the proposed non-public issuance of H Shares. On August 14, 2009, we received the formal approval from CSRC for the proposed non-public issuance of A Shares. The issuance of 721,150,000 new A Shares to CSAH and 721,150,000 new H Shares to Nan Lung were completed on August 20, 2009 and August 21, 2009, respectively.

On March 8, 2010, our board approved the placement of up to 1,766,780,000 new A shares to not more than 10 specific investors including CSAH and the placement of not more than 312,500,000 new H shares to Nan Lung, a wholly-owned subsidiary of CSAH. On the same date, we entered into the A shares subscription agreement with CSAH, pursuant to which CSAH conditionally agreed to subscribe and our Company conditionally agreed to allot and issue new A shares of not more than 132,510,000 at the subscription price of not less than RMB5.66 per A share. In addition, our Company and Nan Lung entered into the H shares subscription agreement, pursuant to which Nan Lung conditionally agreed to subscribe and our Company conditionally agreed to allot and issue new H shares of not more than 312,500,000 at the subscription price of not less than HK$2.73 per H share. The above placement and subscription agreements were approved in the extraordinary general meeting and the respective class meetings of shareholders of A and H shares on April 30, 2010. On September 8, 2010, we received the formal approval from CSRC for the proposed non-public issuance of H Shares. On September 15, 2010, we received the formal approval from CSRC for the proposed non-public issuance of A Shares. In November 2010, we completed the placements of 1,501,500,000 new A shares and 312,500,000 H shares, among which 123,900,000 new A shares were issued to

CSAH at the subscription price of RMB6.66 per share, and 312,500,000 H shares were issued to Nan Lung at the subscription price of HK$2.73 per share.

On June 11, 2012, we entered into an A Shares subscription agreement with CSAH, pursuant to which CSAH conditionally agreed to subscribe and we conditionally agreed to allot and issue up to 487,804,878 A Shares for a consideration of not more than RMB2 billion, equivalent to the subscription price of approximately RMB4.10 per new A Share. The subscription agreement was approved in the extraordinary general meeting on August 10, 2012, which remained effective for a period of twelve months from the date of approval of the resolution at the general meeting. As of August 9, 2013, the relevant work regarding the 2012 Non-public A Share Issuance of our Company was not completed. The proposal for the 2012 Non-public A Share Issuance of our Company and A Shares subscription agreement therefore lapsed automatically due to the expiration of the resolution passed at the general meeting.

On March 27, 2017, we entered into an H Shares subscription agreement as well as a framework agreement with American Airlines, Inc. (American Airlines), pursuant to which American Airlines conditionally agreed to subscribe and we conditionally agreed to issue 270,606,272 H Shares for a consideration of HK$1,553.28 million, equivalent to the subscription price of HK$5.74 per new H Share. In July 2017, we received the formal approval from CSRC for the proposed non-public issuance of H Shares. The issuance of 270,606,272 new H Shares American Airlines was completed on August 10, 2017. Key principles of the above mentioned framework agreement include: (i) except for certain permitted transfers, American Airlines shall not dispose of any of the subscription shares for a period of three years (the Lock-up Period) following the purchase of the subscription shares unless any Lock-up termination event occurs; (ii) after the expiry of Lock-up Period, American Airlines shall have the right to dispose of the subscription shares, and we shall have a right of first refusal to purchase such subscription shares; after the Lock-Up Period, American Airlines shall notify us of its first disposal of subscription shares within three business days following the consummation of such sale, and shall announce any subsequent disposals as and if required by applicable law; (iii) whilst the Framework Agreement is in effect, in the event we or any of our subsidiaries intends to sell or issue, or enter into any agreement to sell or issue, equity or equity linked securities or any such subsidiary to any airline that is then a member of or is participating in an airline alliance as agreed by American Airlines and us (other than a PRC Mainland airline company), or any affiliate of any such airline, American Airlines shall have a right of first refusal to purchase such securities; and (iv) subject to applicable laws (including the Hong Kong Listing Rules), our Board will appoint one person to serve as an observer to our Board at the request of American Airlines (the Board Observer), and the Board Observer is allowed to attend all meetings of our Board whether in-person or by telephone or video-conference but will not be entitled to vote as a director; the Board Observer will be subject to the same non-disclosure, insider trading restrictions and conflicts of interest policies and procedures as and to the extent the same apply to the members of our Board from time to time, and the Board Observer will no longer serve as the observer to our Board if any Board Observer termination event occurs.

On June 26, 2017, our board proposed to put forward to the extraordinary general meeting and the class meetings to approve and authorize our board (i) to issue not more than 1,800,000,000 new A Shares to not more than 10 specific investors including CSAH, and as part of such A Share issuance, to enter into the A Share subscription agreement with CSAH, pursuant to which CSAH subscribes for no less than 31% of such new A Shares, the consideration of which shall be satisfied by transfer 50% of the Zhuhai MTU shares to our Company and cash; and (ii) to issue no more than 590,000,000 new H Shares to Nan Lung at the subscription price of HK$6.27 per H Share (subject to adjustments) and to enter into the H Share subscription agreement with Nan Lung. The total funds to be raised from the aforesaid A Share issuance and the H Share issuance will be not more than RMB12,737.00 million, which will be used for procurement of aircraft, the project for selection and installation of lightweight seats for A320 series aircraft and the supplemental to the general working capital. The aforesaid A Share issuance and the H Share issuance are inter-conditional upon each other. On September 19, 2017, our board considered and approved that (i) our Company to enter into the supplemental agreement I to the A Share subscription agreement with CSAH, pursuant to which 50% of the Zhuhai MTU shares as partial consideration payable by CSAH for its subscription of new A Shares under the A Share subscription agreement has been adjusted to RMB1,741.08 million according to the final assessment results as filed and approved by the SASAC; and (ii) the subscription price and the number of H Shares to be issued pursuant to the H Share subscription agreement shall be adjusted to HK$6.156 and not more than 600,925,925 new H Shares, respectively due to the implementation of the 2016 dividend distribution plan of our Company. On November 8, 2017, the aforesaid A Share issuance and the H Share issuance were approved in the extraordinary general meeting and the respective class meetings of shareholders of A and H shares on November 8, 2017. We have received the approval from CSRC for the aforesaid H Share issuance in March 2018, and the aforesaid A Share issuance in August 2018.

On August 30, 2018, as our 2017 profit distribution plan was completed, the issue price of the H Shares was adjusted to HK$6.034 per H Share.

On September 11, 2018, we issued 600,925,925 H shares in to Nan Lung at the issue price of HKD6.034 per share.

On September 27, 2018, we published the announcement of results of non-public issuance of A shares by the Company and change in shareholdings . We, in accordance with the issuance proposal, issued 1,578,073,089 domestically listed RMB ordinary shares (A shares) through non-public issuance, at the issue price of RMB6.02 per share, to a total of seven investors, including CSAH, China National Aviation Fuel Group Corporation, Spring Airlines Co., Ltd., Guo Xin Central Enterprise Operation (Guangzhou) Investment Fund (LLP), China Structural Reform Fund Co., Ltd., Hotland Innovation Asset Management Co., Ltd. and China Life Asset Management Company Limited, with a total proceeds of RMB9,499,999,995.78.

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Issuance of Corporate Bonds

On November 13, 2015, we were approved by the CSRC to publicly issue corporate bonds (the Corporate Bonds) in the amount of not more than RMB19 billion to qualified investors. The issuance of the Corporate Bonds shall be conducted in multiple tranches. The issuance of the first tranche must be completed within 12 months from the date of the approval and the issuance of the remaining tranches must be completed within 24 months from the date of the approval. On November 20, 2015, we issued the first tranche of 2015 corporate bonds of RMB3,000 million with an interest rate of 3.63% per annum due 2020. On March 3, 2016, we issued the first tranche of 2016 corporate bonds of RMB5,000 million with an interest rate of 2.97% per annum due 2019. On May 25, 2016, we issued the second tranche of 2016 corporate bonds of RMB5,000 million with an interest rate of 3.12% per annum due 2021. On November 26, 2018, we issued the first tranche of 2018 corporate bonds of RMB2,000 million with an interest rate of 3.92% per annul due 2021.

Our website is located at www.csair.com. The information contained on or connected to our website is not incorporated by reference into this Annual Report and should not be considered part of this or any other report filed with the SEC. Our filings with the SEC, including reports, proxy and information statements, and other information regarding us that file electronically with the SEC are available on the SEC s websites at www.sec.gov.

B. BUSINESS OVERVIEW

General

We provide commercial airline services throughout Mainland China, Hong Kong, Macau and Taiwan regions, Southeast Asia and other parts of the world. Based on the statistics of the CAAC, we are one of the largest Chinese airlines and, as of December 31, 2018, ranked the first in terms of number of passengers carried, number of scheduled flights per week, number of hours flown, number of routes and size of aircraft fleet. During the three years ended December 31, 2018, our RPKs increased at a compound annual growth rate of 8.71 % from 206,106 million in 2016 to 230,697 million in 2017 and 259,194 million in 2018 while its capacity, measured in terms of ASKs, increased at a compound annual growth rate of 8.65%, from 255,992 million in 2016 to 280,646 million in 2017 and 314,421 million in 2018. In 2018, our Group carried 139.89 million passengers and had passenger revenue of RMB128,038 million (approximately US$18,656 million).

We conduct a portion of our airline operations through our airline subsidiaries, namely Xiamen Airlines, Shantou Airlines Company Limited (Shantou Airlines), Zhuhai Airlines Company Limited (Zhuhai Airlines), Guizhou Airlines Company Limited (Guizhou Airlines), Chongqing Airlines Company Limited (Chongqing Airlines) and China Southern Airlines Henan Airlines Company Limited (Henan Airlines), (collectively, the Airline Subsidiaries). In 2018, the Airline Subsidiaries carried 54.58 million passengers and had passenger revenue of RMB41,521 million (approximately US$6,050 million) and accounted for 39.02% and 32.43% of our passengers carried and passenger revenue, respectively.

We also provide air cargo and mail services. Our cargo and mail revenue increased by 10.39% to RMB10,026 million (approximately US$1,461 million) in 2018 as compared with that of 2017. Our airline operations are fully integrated with our airline-related businesses, including aircraft maintenance, ground services and air catering operations.

Our operations primarily focus on the domestic market. In addition, we also operate regional routes and international flights. As of December 31, 2018, we operated 950 routes, of which 772 were domestic, 154 were international and 24 were regional. We operate the most extensive domestic route network among all Chinese airlines. Our route network covers commercial centers and rapidly developing economic regions in Mainland China. Our regional operations include flights between destinations in Mainland China, Hong Kong, Macau and Taiwan. Our international operations include scheduled services to cities in Australia, Azerbaijan, Bangladesh, Cambodia, Canada, Dutch, France, German, India, Indonesia, Iran, Italy, Japan, Kenya, Kazakhstan, Kyrgyzstan, Malaysia, Maldives, Nepal, New Zealand, Pakistan, Philippines, Russia, Singapore, South Korea, Tajikistan, Thailand, Turkmenistan, United Arab Emirates (UAE), United Kingdom, United States of American (USA), Uzbekistan and Vietnam, Mexico, Laos, and Sri Lanka.

We focused on building the Guangzhou-Beijing Dual Hub strategic layout and acceleration of all the preparation work for stationing in Beijing s new Airport. On October 10, 2017, we held the opening ceremony of Beijing s new airport s base project. During 2018, we continued to optimize the Guangzhou hub and completed the transfer operation to T2 terminal of Guangzhou Baiyun Airport. Meanwhile, we were fully committed to building the Beijing hub, and launched Beijing-Istanbul and other new routes, and Xiongan Airlines was approved for establishment. We built the base project of Beijing Daxing International Airport with high standards, and actively prepared for the operation and studied the transfer plan in advance. This new base will be completed simultaneously with Beijing s new airport. Through Beijing s new airport base, we will spare no effort to make Beijing core hub. By 2025, it is estimated to station 250 aircraft to build the network covering international and domestic destinations.

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Our corporate headquarters and principal base of operations are located in Guangzhou, the capital of Guangdong Province and the largest city in southern China. Located in the rapidly developing Pearl River Delta region, Guangzhou is also the transportation hub of southern China and one of China s major gateway cities. Guangzhou s significance has increased as the transportation infrastructure of Guangdong Province has developed through the construction and development of expressways, an extensive rail network and the port cities of Guangzhou, Shenzhen, Zhanjiang, Zhuhai and Shantou.

As of December 31, 2018, we had a fleet of 840 aircraft, consisting primarily of Boeing737, 747, 777, 787 series, Airbus 320, 330, 380 series, etc. The average age of our registered aircraft was 6.5 years as of December 31, 2018.

Route Network

Overview

We operate the most extensive route network among all Chinese airlines. As of December 31, 2018, we operated 950 routes consisting of 772 domestic routes, 24 regional routes and 154 international routes.

We continually evaluate our network of domestic, regional and international routes in light of our operating profitability and efficiency. We seek to coordinate flight schedules with the Airline Subsidiaries on shared routes to maximize load factors and utilization rates. The acquisition of domestic, regional and international routes is subject to approval of the CAAC, and the acquisition of regional and international routes is also subject to agreements between the Chinese government and the government of the Hong Kong SAR, the government of the Macau SAR, the government of Taiwan province and the government of the proposed foreign destination.

In order to expand our international route network, we have entered into code-sharing agreements with several international airlines, including American Airlines, INC., Japan Airlines International Company Ltd., British Airways PLC, Qantas Airways Limited., Aeroflot Russian Airlines, Air France, AlitaliaLinee Aeree Italiane, China Airlines, China Eastern Airlines, CSA Czech Airlines, Delta Air Lines, Kenya Airways, KLM Royal Dutch Airline, Korean Air, Mandarin Airlines, PT Garuda Indonesia (Persero) Tbk., Saudi Arabian Airlines, Vietnam Airlines, Xiamen Airlines., Asiana Airlines, Chongqing Airlines Company Limited, Etihad Airways PJSC, Pakistan International Airlines, Sichuan Airlines Co., Ltd., and WestJet. Under the code-sharing agreements, the participating airlines are permitted to sell tickets on certain international routes operated by us to passengers using their codes. Similarly, we are permitted to sell tickets for the other participating airlines using CZ code. The code-sharing agreements help increase the number of our international sales outlets. At present, we share codes with 31 international and domestic airlines in 790 routes, including trunk routes and beyond routes, and serve more than 253 destinations in more than 41 countries. This further enlarged our sales channels and flight route network.

The following table sets forth certain statistical information with respect to our passenger, cargo and mail traffic for the years indicated.

	Passenger carried		Cargo and Mail arrived (tons)		Total traffic (tons kilometres)	
Year	**Total (in millions)**	**Increase (decrease) over previous**	**Total (in millions)**	**Increase (decrease) over previous**	**Total (in millions)**	**Increase (decrease) over previous**

		year (%)		year (%)		year (%)
2016	114.62	4.8	1,613	6.7	24,387	8.9
2017	126.30	10.2	1,672	3.7	27,321	12.03
2018	139.89	10.76	1,732	3.6	30,334	11.03

Route Bases

In addition to our main route bases including Guangzhou and Beijing as core hub, we maintain regional route bases in Urumqi, Chongqing, Zhengzhou, Wuhan, Changsha, Shenzhen, Shenyang, Changchun, Dalian, Harbin, Haikou, Zhuhai, Xiamen, Shanghai, Xi an, Fuzhou, Nanning, Guilin, Shantou, Guiyang, Sanya, Chengdu and Kunming. Most of our regional route bases are located in provincial capitals or major commercial centers in the PRC.

We believe that our extensive network of route bases enables us to coordinate flights and deploy our aircraft more effectively and to provide more convenient connecting flight schedules and access service and maintenance facilities for our aircraft. We believe that the number and location of these route bases may enhance our ability to obtain the CAAC s approval of requests by our Group to open new routes and provide additional flights between these bases and other destinations in China. Current regulations of the CAAC generally limit airlines to operations principally conducted from their respective route bases.

Domestic Routes

Our domestic routes network serves substantially all provinces and autonomous regions in China, including Guangdong, Fujian, Hubei, Hunan, Hainan, Guangxi, Guizhou, Henan, Heilongjiang, Jilin, Liaoning, Sichuan and Xinjiang, and serves all four centrally-administered municipalities in China, namely, Beijing, Shanghai, Tianjin, and Chongqing. In 2018, our most profitable domestic routes were: Beijing-Shenzhen, Shanghai-Shengzhen, Guangzhou-Shanghai, Guangzhou-Haikou, Beijing-Guangzhou, Beijing-Changsha, Beijing-Changchun, Beijing-Dalian, Beijing-Guiyang, and Guangzhou-Hangzhou.

Regional Routes

We offer scheduled service between Hong Kong and Beijing, Shenyang, Meixian, Wuhan, Yiwu, Shantou, Xiamen, Wuyishan, and Quanzhou; and between Taipei and Guangzhou, Shanghai, Fuzhou, Hangzhou, Xiamen, Shenyang, Changsha, Wuhan, Dalian, Guilin, Harbin, Guiyang, Zhengzhou, Changchun, Zhangjiajie, Nanning, Shantou, Yiwu, Quanzhou, Yanji and Shenzhen. In 2018, the most profitable scheduled regional routes were: Shenzhen-Taipei, Guangzhou-Taipei, Shanghai-Taipei, Changsha-Taipei, Wuhan-Hong Kong, Guiyang-Taipei, Zhengzhou-Taipei, Nanning-Taipei, Guilin-Taipei, and Wuhan-Taipei.

In 2018, we conducted a total of 19,440 flights on our regional routes, accounting for approximately 22.4% of all passengers carried by Chinese airlines on routes between Hong Kong, Macau or Taiwan and destinations in Mainland China according to CAAC statistics briefing.

Previously, direct flights between Taiwan and Mainland China were only available during certain festivals. Other than that, travelers between Taiwan and Mainland China had to make use of intermediate stops in Hong Kong or elsewhere. Since July 2008, however, the ban on direct flights was further liberalized to allow direct charter flights on weekends. We were the first Chinese carrier to fly nonstop to Taiwan. On November 4, 2008, the Mainland China and Taiwan agreed to have regular direct passenger charter flights across the Taiwan Strait. On August 31, 2009, the Mainland China and Taiwan increased the number of regular cross-Strait direct passenger flights from 108 to 270 a week. Cross-Strait direct passenger flights were further increased in the following years. As of April 26, 2019, there were 80 cross-Strait direct passenger flights a week.

International Routes

We are the principal Chinese airlines serving Southeast Asian destinations and Australasia, including Singapore and major cities in Australia, New Zealand, Bangladesh, Indonesia, Thailand, Malaysia, Philippines, Vietnam, Myanmar and Cambodia.

In addition, we also provide scheduled services to cities in Azerbaijan, Canada, Dutch, France, German, India, Iran, Italy, Japan, Kenya, Kazakhstan, Kyrgyzstan, Maldives, Nepal, Pakistan, Russia, South Korea, Tajikistan, Turkmenistan, United Arab Emirates (UAE), United Kingdom, United States of American (USA), and Uzbekistan.

In 2018, our most profitable international routes were: Guangzhou-Tokyo, Yanji-Seoul, Shenyang-Seoul, Guangzhou-Dhaka, Shanghai-Seoul, Haikou-Guangzhou-Seoul, Shanghai-Osaka, Guangzhou-Manila, Sanya-Guangzhou- Osaka, and Dalian-Seoul.

Aircraft Fleet

Our fleet plan in recent years emphasized expansion and modernization through the acquisition of new aircraft and the retirement of less efficient and old aircraft. As of December 31, 2018, we operated a fleet of 840 aircraft with an average age of 6.5 years. Most aircraft of our Group are Boeing and Airbus aircraft. We have the largest fleet among Chinese airline companies. Among all the aircraft, 558 aircraft operated by our Group are leased pursuant to various types of leasing arrangements. Please see the table below for an analysis of our aircraft in terms of average age and respective passenger capacity.

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Model	Number of Aircraft	Passenger Capacity
Airbus 380 series	5	506
Airbus 330 series	50	218/258/259/260/278/283/284/286
Airbus 320 series	299	94/122/130/138/152/160/166/168/179/189/195
Boeing 787 series	30	228/237/266/276/287/297
Boeing 777 series	10	309/361
Boeing 757 series	4	174/180
Boeing 737 series	402	128/134/159/161/164/169/170/172/178/184
EMB190	26	98
Boeing 747 series	2	N/A
Boeing 777 series Freighter	12	N/A
Total	**840**	**N/A**

In 2018, we continued to expand and modernize our aircraft fleet. During 2018, we (i) took scheduled delivery of 46 aircraft under purchase agreements, including 1 A320neo, 1 A321, 1 A321neo, 5 A330-300, 18 B737-8, 13 B737-800, 7 B787-9 aircraft; (ii) took scheduled delivery of 12 A320neo, 13 A321neo, 8 B737-8, 22 B737-800, 3 B787-9 aircraft under operating leases; (iii) returned 3 B737-700 and 11 B737-800 aircraft under operating leases upon expiry; and (iv) disposed of 2 B757-200 and 2 B777-200A aircraft.

In specfic, Xiamen Airlines (i) took scheduled delivery of 12 B737-800 aircraft under operating leases; and (ii) took scheduled delivery of 9 B737-8, 4 B737-800, 2 B787-9 aircraft under financing leases.

On March 21, 2018, Xiamen Airlines entered into the aircraft acquisition agreement with Boeing for the acquisition of 20 B737-8 and 10 B737-10 aircraft, to be delivered from 2019 to 2022.

Aircraft Financing Arrangements

Overview

A significant portion of our aircraft is acquired under long-term capital or operating leases or long-term mortgage loans with remaining terms to maturity mainly ranging from one to eleven years. As of December 31, 2018, of our Group s 840 aircraft, 232 aircraft were operated under capital leases, 326 were operated under operating leases, and 282 were either owned aircraft financed by long-term mortgage loans, or acquired either with cash proceeds or acquired by exercising the purchase options upon expiry of the respective capital leases. Our planned acquisition of aircraft in the foreseeable future will generally be made through acquisition by bank loans and our own funds, and in accordance with operating leases or capital leases. Our determination as to our acquisition strategy depends on our evaluation at the time of our capacity requirements, anticipated deliveries of aircraft, our capital structure and cash flow, prevailing interest rates and other general market conditions.

The following table sets forth, as of December 31, 2018, the number of aircraft operated by our Group pursuant to capital and operating leases and the average remaining terms, of such leases.

Model	Capital Lease Number of Aircraft	Operating Lease Number of Aircraft	Average Remaining Lease Term Year

Boeing 787-8	11	2	6.11
Boeing 787-9	10	3	9.62
Boeing 737-800	64	157	6.31
Boeing 777-200F	5	0	7.82
Boeing 777-300ER	9	0	7.64
Airbus 380	2	0	4.66
Airbus 330-300	23	8	6.35
Airbus 330-200	7	2	3.56
Airbus 321-200	42	22	5.62
Airbus 320-200	41	55	4.45
Airbus 319-100	0	17	1.62
Airbus 320-200 NEO	0	19	11.25
Airbus 321-200 NEO	0	13	11.60
Boeing 737-8 MAX	18	8	10.11
EMB190	0	20	1.33
Total	**232**	**326**	**6.12**

Capital leases

The majority of the capital leases in respect to aircraft and related equipment have terms of 10 to 15 years expiring during the years 2019 to 2030. As of December 31, 2018, our aggregate future minimum lease payments (including future finance charges) required under its capital leases were RMB82,765 million. Our capital leases typically cover a significant portion of the relevant aircraft s useful life and transfer the benefits and risks of ownership to our Group. Under its capital leases, we generally have an option to purchase the aircraft at or near the end of the lease term. As is customary in the case of capital leases, our obligations are secured by the related aircraft, as well as other collaterals.

Operating Leases

As of December 31, 2018, our aggregate future minimum lease payments required under its operating leases were RMB75,729 million. As of December 31, 2018, our operating leases had original terms generally ranging from 5 to 15 years from the date of delivery of the relevant aircraft, and the remaining terms of these leases ranged from 1 to 12 years. Pursuant to the terms of the operating leases, we are obligated to make rental payments based on the lease term, with no termination payment obligations or purchase option, and the lessor bears the economic benefits and risks of ownership. Under our operating leases, we have no option to purchase the aircraft and is required to return the aircraft in the agreed condition at the end of the lease term. Although title to the aircraft remains with the lessor, we are responsible during the lease term for the maintenance, service, insurance, repair and overhaul of the aircraft.

For capital leases or operating leases, we are obligated to indemnify the lessors against any withholding or similar taxes that may be imposed on the lessors by taxing authorities in China with regard to payments made pursuant to such leases. In accordance with relevant PRC tax regulations, a PRC lessee is liable to withhold 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 6% to 10% of the lease payments, or in certain cases, the interest components of such payments for capital lease. The PRC withholding tax payable in respect of the lease arrangements amounting RMB240 million, RMB234 million, and RMB237 million during 2018, 2017 and 2016, has been included as part of the lease charges.

Aircraft Flight Equipment

The jet engines used in our aircraft fleet are manufactured by General Electric Corporation, Rolls-Royce plc, United Technologies International, Inc., CFM International, Inc. and International Aviation Engines Corporation. We had 90 and 94 spare jet engines for our fleet as of December 31, 2018 and 2017, respectively. We determine our requirements for jet engines based on all relevant considerations, including manufacturers recommendations, the performance history of the jet engines and the planned utilization of its aircraft. Acquisition of rotables and certain of the expendables for our aircraft are generally handled by Southern Airlines (Group) Import and Export Trading Company Limited (SAIETC), a subsidiary we acquired from CSAH in August 2016, in consideration of an agency fee. We arrange the ordering of aircraft, jet engines and other flight equipment for the Airline Subsidiaries and keep an inventory of rotables and expendables for the Airline Subsidiaries.

Aircraft Maintenance

A major part of the maintenance for our fleet other than overhauls of jet engines is performed by Guangzhou Aircraft Maintenance Engineering Company Limited (GAMECO), an entity jointly controlled by our Company, Hutchison Whampoa (Hutchison) and South China International Aircraft Engineering Company Limited, consistent with our strategy to achieve fully integrated airline operations and to assure continued access to a stable source of high quality maintenance services. The remaining part of the maintenance for our fleet other than overhauls of jet engines is performed by service providers in China and overseas. GAMECO performs all types of maintenance services, ranging from maintenance inspections performed on aircraft (line maintenance services) to major overhaul performed at specified intervals. GAMECO was the first of three aircraft maintenance facilities in China that has been certified as a repair station by both the CAAC and the Federal Aviation Administration. In March 1998, GAMECO received the Joint Civil Aviation Authorities certificate, which was transferred to European Aviation Safety Agency certification in November 2004, for the repair and maintenance of aircraft and aircraft engines.

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We believe that GAMECO performs major maintenance checks on our aircraft within time periods generally consistent with those of large international airline maintenance centers. GAMECO s repair and maintenance capacity include overhaul of more than 36% of our aircraft. Although rotables for our aircraft are generally imported through SAIETC, a portion of expendables and other maintenance materials are directly imported by GAMECO. Our agreement with GAMECO usually has a term of one year.

Overhauls of jet engines are performed by Zhuhai MTU, a jointly controlled entity of the Company and MTU Aero Engines GmbH, and also by domestic qualified service providers in Xiamen (TEXL), Hong Kong (HAESL) and Taiwan (EGAT), and by overseas qualified service providers in USA, Germany, Korea, Singapore, France, Malaysia, Netherlands and UK . On September 19, 2017, our Company entered into an agreement with CSAH to buy its 50% equity interest in Zhuhai MTU. The transfer was completed in August 2018.

The amounts incurred by our Group for comprehensive maintenance services provided by GAMECO and Zhuhai MTU were RMB4,521 million, RMB3,925 million, and RMB3,897 million for the years ended December 31, 2018, 2017 and 2016, respectively.

Safety

We endeavor to maintain strict compliance with all laws and regulations applicable to flight safety. In addition, we have adopted measures to eliminate or minimize factors that may impair flight safety, including specialized training programs and safety manuals. The Air Safety Management Department of our Company implements safety-related training programs on an on-going basis in all of our operations to raise the safety awareness of all employees. As a result, overall flight safety has gradually improved. For incidents which include various events and conditions prescribed by the CAAC that do not involve serious personal injury or material damage to flight equipment, our Group has kept the number consistently below what is prescribed by the CAAC. For example, our Air Transportation Incidents Per Ten Thousands Hours Ratio was 0.005, 0.01, and 0.005 in 2018, 2017 and 2016, respectively. In comparison, CAAC s published maximum acceptable Air Transportation Incidents Per Ten Thousands Hours Ratio was 0.6, 0.5, and 0.14 in 2018, 2017 and 2016, respectively. This ratio is defined as the number of occurrences of air transportation incident for every 10,000 hours of flight time. In 2008, we received the Five-Star Flight Safety Award from CAAC, being the first in domestic aviation industry to receive such a great honor. Subsequently in 2012, we were awarded the Safe Flight Diamond Award by CAAC for our 10,000,000 safety flight hours record. On June 15, 2018, our company was honored with the 2-Star Flight Safety Diamond Award by the CAAC, becoming the leading Chinese carrier to maintain the highest safety records in China. By December 31, 2018, our continuous safe flight span were 21.265 million hours.

Jet Fuel

Jet fuel costs typically represent a major component of an airline s operating expenses. Our jet fuel costs accounted for 30.6%, 25.9%, and 22.4% of our operating expenses for the years ended December 31, 2018, 2017 and 2016, respectively. Like other Chinese airlines, we are generally required by the Chinese government to purchase our jet fuel from regional branches of CAOSC and Bluesky Oil Supplies Company, except at the Shenzhen, Sanya, Haikou, Shanghai Pudong where jet fuel is supplied by Sino-foreign joint venture in which CAOSC is a joint venture partner. CAOSC is a State-owned organization controlled and supervised by the CAAC that controls the importation and distribution of jet fuel throughout China.

Jet fuel obtained from CAOSC s regional branches is purchased at uniform prices throughout China that are determined and adjusted by CAOSC from time to time with the approval of the CAAC and the pricing department of the NDRC based on market conditions and other factors. As a result, the costs of transportation and storage of jet fuel in all regions of China are spread among all domestic airlines. Jet fuel costs in China are influenced by costs at state-owned oil refineries and limitations in the transportation infrastructure, as well as by insufficient storage facilities for jet fuel in certain regions of China.

Prior to 1994, domestic jet fuel prices were generally below international jet fuel prices. The Chinese government had gradually increased domestic jet fuel prices in order to reflect more accurately the costs of supplying jet fuel in China. As a result, domestic jet fuel prices have become higher than those in the international market since the beginning of 1994. For 2007 and the first half of 2008, the crude oil prices in the international market reached historic highs. In response to the pressure imposed by such soaring prices, on November 1, 2007 and June 20, 2008, respectively, the NDRC increased the domestic jet fuel prices. Thereafter, in order to reduce fuel cost pressure faced by Chinese airlines, the NDRC approved reductions in domestic jet fuel prices in 2008 and 2009. However, during a period from February 2009 to 2013, the crude oil price in the international market continued to increase and maintained at a high level. However, influenced by excessive oil supply, global economic weakness and the strong US$, the international oil prices have been trending downward since 2014. Our jet fuel costs increased from RMB 31,895 million in 2017 to RMB42,922 million in 2018 as a result of the increase in average jet fuel prices from 2017 to 2018.

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In addition to purchases of jet fuel from CAOSC, we are also permitted by the Chinese government to purchase a portion of our jet fuel requirements for our international flights from foreign fuel suppliers located outside China at prevailing international market prices. Jet fuel purchased from such sources accounted for approximately 17.55% and 17.31% of our total jet fuel consumption in 2018 and 2017, respectively.

Fuel Surcharge

Our profit for the year may suffer from an unexpected change in the fuel surcharge collection policies and other factors beyond our control. The level of fuel surcharges, which is regulated by Chinese government, affects domestic customers air travel demand as well as our ability to generate profits. On January 14, 2009, the NDRC and the CAAC jointly announced that the collection of passenger fuel surcharge for domestic routes should be suspended from January 15, 2009 onwards. Subsequently, in response to the increase in international fuel prices, the NDRC and CAAC issued a notice on November 11, 2009 to introduce a new pricing mechanism of fuel surcharge that links it with airlines jet fuel costs, which was further adjusted subsequently.

From April 1, 2015, the NDRC adjusted the benchmark oil price to RMB5,000 per ton, for every RMB100 by which the cost of jet fuel exceeds that price, the airlines are allowed to charge RMB0.00002566 per kilometer for the flight distance. Based on that rate, for every RMB100 by which the cost of jet fuel exceeds RMB5,000 per ton, the airlines are allowed to charge RMB 0.0002566 per kilometer for the flight distance. The NDRC decreased the rate of fuel surcharge from RMB 0.00002641 per kilometer to RMB 0.00002566 per kilometer, from April 1, 2017 to March 31, 2018.

Flight Operations

Flight operations for our flights originating in Guangzhou are managed by our flight operations and marketing divisions, which are responsible for formulating flight plans and schedules consistent with route and flight approvals received from the CAAC. Our flight operations center in Guangzhou is responsible for the on-site administration of flights, including the dispatch and coordination of flights, deployment of aircraft, ground services and crew staffing. In addition, each of the Airline Subsidiaries maintains flight operations centers at all servicing airports for on-site administration of their flights. Our general dispatch offices are responsible for monitoring conditions of our route network, administering our flight plans, collecting and monitoring navigation data and analyzing and monitoring airport conditions.

To enhance our management of flight operations, our computerized flight operations control system (SOC) began operation in May 1999. The system utilizes advanced computer and telecommunications technology to manage our flights on a centralized, real-time basis. We believe that the system will assist us to (i) compile flight schedules more efficiently; (ii) increase the utilization of aircraft; (iii) allow real-time tracking of all of our flights; and (iv) improve coordination of our aircraft maintenance and ground servicing functions.

Training of Pilots and Flight Attendants

We believe that our pilot training program, which was established in cooperation with the CAAC affiliated Beijing University of Aeronautics and Astronautics (the BUAA), has significantly improved the quality of the training received by our pilots and has helped maintain the quality of our staff of pilots at a level consistent with the expansion of operations called for by our business strategy.

As part of the pilot training program, trainee pilots receive their initial training in the operation of a specific aircraft with Zhuhai Xiang Yi Aviation Technology Company Limited (Zhuhai Xiang Yi), a wholly-owned subsidiary of the

Company, which also provides training to pilots from other Chinese airlines. Zhuhai Xiang Yi is equipped with simulators for majority models of aircraft currently operated by us and provides flight simulation training services to us.

Our pilots are required to be licensed by the CAAC, which requires an annual proficiency check. Our pilots attend courses in simulator training twice annually and in emergency survival training once annually. We also conduct regular advanced training courses for captains and captain candidates. Pilots advance in rank based on number of hours flown, types of aircraft flown and their performance history.

We funded the training of our recruited pilots in previous years and, as a result, incurred significant costs over the years. Recently, there is a trend in the financing of pilot training worldwide from employer-sponsored to self-sponsored scheme. Such a change does not only cut down our training expenses significantly, but also ensures the long-term dedicated service of the pilots. Starting from 2007, we began to recruit pilots under the self-sponsored training arrangement.

Under the program, the self-sponsored pilots are bound to enter into service contracts with us when they finish their training courses. They have the choice to repay their loans in advance or in installments.

We conduct theoretical and practical training programs for our flight attendants at our Flight Attendants Training Center in Guangzhou (the Guangzhou Training Center). The Guangzhou Training Center is equipped with computerized training equipment, as well as simulator cabins for all models of aircraft currently operated by us. At the Guangzhou Training Center, our flight attendants receive comprehensive training in in-flight service, emergency evacuation and water rescue.

Ground Services

We make arrangements with airport authorities, other airlines or ground services companies for substantially all ground facilities, including runway, ramp, terminal and support services buildings, at each airport that they serve. We pay landing, parking and other fees to such airports, including Guangzhou Baiyun International Airport (the Guangzhou Baiyun Airport). At domestic airports, such fees are generally determined by CAAC.

At Guangzhou Baiyun Airport, we operate our own passenger check-in, cargo, mail and baggage handling, aircraft maintenance and cleaning services. We also provide such services to our customer airlines that operate in Guangzhou Baiyun Airport.

Ground services at the airports, such as those in Shenzhen, Changsha, Wuhan, Zhengzhou, Haikou, Zhuhai, Guilin, Jieyang, Guiyang, Shenyang, Harbin, Dalian, Changchun, Sanya, Nanning, Chongqing, Shanghai Hongqiao, Shanghai Pudong and Urumqi, are operated directly by us. Ground services at the airport in Beijing have been primarily provided by Beijing China Southern Airlines Ground Services Co., Ltd, which became a wholly-own subsidiary of the Company in June 2009. Ground services at other airports in China are provided to us by local airport authorities or local airlines in accordance with relevant service agreements. Ground services and other services at airports outside China are provided to us by foreign services providers in accordance with relevant service agreements with such parties. All our such agreements are short-term and otherwise on customary terms in the industry.

Air Catering

We own a 70.5% equity interest in Guangzhou Nanland Air Catering Company Limited (Nanland). Nanland provides in-flight meals, snacks, drinks and related services for all of our flights originating in Guangzhou and substantially all other flights departing from Guangzhou Baiyun Airport. We contract with various air catering suppliers with respect to in-flight catering services for flights originating from other airports, generally on an annual basis and otherwise on customary terms in the industry.

Cargo and Mail

We also provide air cargo and mail services. A significant portion of these services are combined with passenger flights services. In 2018, we had 2 Boeing 747 freighters and 12 Boeing 777 freighters, mainly servicing 13 international cargo routes, including Guangzhou Chongqing Amsterdam Guangzhou, Guangzhou Amsterdam Guangzhou, Guangzhou London Frankfurt Guangzhou, Guangzhou London Guangzhou, Guangzhou Frankfurt Guangzhou, Guangzhou Anchorage Los Angeles Guangzhou, Guangzhou Ho Chi Minh City Hanoi Guangzhou, Shanghai Pudong Amsterdam Chongqing Shanghai Pudong, Shanghai Pudong Amsterdam Shanghai Pudong, Shanghai Pudong Frankfurt Shanghai Pudong, Shanghai Pudong Anchorage Chicago Shanghai Pudong, Shanghai Pudong LosAngeles Shanghai Pudong, and Shanghai Pudong Luxembourg Shanghai Pudong. We conduct our cargo business primarily through our cargo hubs in

Guangzhou and Shanghai.

Sales, Reservations and Marketing

Passenger Ticket Sales and Reservations

Our ticket sales and reservations are conducted by or through independent sales agents and our own network of exclusive sales offices, as well as the CAAC s sales offices and CSAH s affiliates. We have sales offices in Guangzhou and our other route bases. In addition, we maintain regional sales offices in other cities in China, including Beijing and Shanghai. We maintain international sales offices in Almaty, Amsterdam, Ashkhabad, Auckland, Baku, Bangkok, Bishkek, Brisbane, Busan, Chicago, Christchurch, Daegu, Daejeon, Delhi, Dhaka, Dubai (Sharjah), Dushanbe, Frankfurt, Fukuoka, Hanoi, Hiroshima, Ho Chi Minh City, Irkutsk, Islamabad, Istanbul, Jakarta, Kathmandu, Khabarovsk, Khudzhand, Kitakyushu, Kuala Lumpur, London, Los Angeles, Manila, Melbourne, Mexico City, Moscow, Nagoga, New York, Niigata, Novosibirsk, Nairobi, Oakland, Osaka, Osh, Paris, Penang, Perth, Phnom Penh, Phuket, Roma, San Francisco, Sapporo, Sendai, Seoul, Siem Reap, Singapore, Sydney, Tashkent, Tehran, Toronto, Tokyo, Toyama, Tbilisi, Vancouver, Vladivostok, Vientiane and Yangon.

We have agency agreements with airlines in the Asia-Pacific region, Europe, the United States and Africa for the processing of ticket sales and reservations on a reciprocal basis. In 2018, over 50.63% of all ticket sales for our scheduled flights were made by our network of sales offices and CSAH s affiliates. We also sell tickets and accept reservations through an extensive network of non-exclusive independent sales agents. Under the agency agreements with them, we pay commissions based on the value of tickets sold. In 2018, sales by independent sales agents accounted for less than 49.37% of our ticket sales of our scheduled flights.

Substantially all of our sales offices and agents in China are linked electronically to the TravelSky Technology Limited s computerized ticketing and reservations system, which is in turn linked to all domestic airlines for flights throughout China. We have also entered into membership agreements with several international reservation systems, including ABACUS in Southeast Asia, SABRE and GALILEO in the United States, AMADEUS in Europe and INFINI in Japan. These systems facilitate reservations and sales of tickets for our international flights. Since 2016, we have been focusing on improving the digitalization and intelligence level. We have launched the China Southern e Travel strategy, which aims to explore the needs of passengers and plan and design products from the perspective of passengers. We have built a number of quality products such as flight dynamics, seat selection and check-in, electronic invoices, face recognition, full-channel self-service refund, and meal service. The grand vision of one machine in hand, the whole journey worry-free has become a reality in technology, and the digitalization of the entire process of passenger travel has been realized. In 2018, we released the Internet + strategy centering on China Southern e Travel , and formally built a one-stop service mobile application platform to provide passengers with excellent door-to-door service experience. Intelligence has become our core competitiveness.

Cargo

Our cargo and mail services are promoted through our own cargo divisions and independent cargo agents both within and outside China that track available space among all airlines. In particular, we employ a number of cargo agents in the Pearl River Delta region. In 2018, we generally pay the cargo agents an average commission of 0.39% of the relevant cargo freight rate for domestic and international services, and a commission of 0.70% to cargo agents in the Pearl River Delta region.

Promotional and Marketing Activities

We engage in regular promotional and marketing activities to increase our market share. Our promotional and marketing activities for domestic routes emphasize safety, passenger comfort and the frequency of our flights. Our promotional and marketing activities for international and regional passengers emphasize our quality of service, extensive route network in China and higher frequency of flights compared to other Chinese airlines. We were among the first to launch premium economy class of seating. In addition, we also promote and market our regional and international routes on the basis of price competitiveness.

We seek to increase our name recognition by offering new services to passengers. For example, we were the first Chinese airline to provide off-airport check-in services. We also offered transfer and baggage through-handling services to passengers connecting to other airlines, including passengers connecting in Hong Kong for flights to Taiwan. We widened our use of information technology and introduced new services such as cell phone check-in, SMS platforms and online meal booking. In 2017, our Company reached a strategic cooperation agreement with American Airlines. According to this agreement, American Airlines subscribed our Company s shares in August 2017 by USD200 million. Our Company and American Airlines also established a code sharing partnership on January 18, 2018 to provide more convenient and diversified trip options for passengers. During the reporting period, given the demand from our own development strategy and the new trend of cooperation model in the global air transport industry, we decided not to renew the SkyTeam Alliance Agreement from January 1, 2019. We will continue to properly carry out the work of exit and fully guarantee the rights and interests of passengers. We will carry out bilateral and multilateral cooperation in a more targeted manner while deepening the cooperation with the existing partners such as France Airlines and KLM Royal Dutch Airlines, expand code sharing and frequent passenger cooperation with American Airlines, and launch strategic cooperation with numbers of internationally renowned airlines such as British Airways, Finnair and Emirates to provide passengers with more convenient and high-quality travel options. At the same time, we continue to strengthen the coordinated development of the China Southern Alliance by gradually integrating with Xiamen Airlines and Sichuan Airlines in terms of capacity layout, route cooperation, resource sharing and customer collaboration. At present, we share codes with 31 international and domestic airlines, such as, France Airlines, KLM Royal Dutch Airlines, American Airlines, Qantas Airways, Finnair in 790 routes (including trunk routes and beyond routes). This further enlarged our sales channels and flight route network.

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On the wake of permitted direct flights on weekends between Taiwan and Mainland China starting from July 4, 2008, our Company became the first Chinese carrier to fly nonstop to Taiwan. By taking advantage of such further liberalized air travel policy between Taiwan and Mainland China, our Company has taken measures to explore opportunities presented by and increase our name recognition in Taiwan market. On June 23, 2008, our Company entered into a memorandum of cooperation with China Airlines, which is the largest carrier in Taiwan by route network. Based on the memorandum, the scope of cooperation between the parties will cover passenger, cargo, maintenance and ground handling services. We believe that our strategic collaboration with China Airlines will be beneficial to both parties, expand their route network worldwide, increase their freight load factors, reduce labor and operating costs, and enhance the competitiveness of both airlines in the global air travel market.

To enhance relationships with our passengers, we have launched two major frequent flyer programs, namely the China Southern Airlines Sky Pearl Club and the Xiamen Airlines Egret Card Frequent Flyer Program . By the end of 2018, we had approximately 39.78 million members (including those of Xiamen Airlines) under these programs.

Regulation

The Chinese commercial aviation industry is subject to a high degree of regulation and oversight by the CAAC. Regulations and policies issued or implemented by the CAAC encompass substantially all aspects of airline operations, including route allocation, pricing of domestic airfare, the administration of air traffic control systems and certain airports, air carrier certifications and air operator certification and aircraft, registration and aircraft airworthiness certification. The Civil Aviation Law, which became effective in March 1996, provides a framework for regulation of many of these aspects of commercial aviation activities. Although Chinese airlines operate under the supervision and regulation of the CAAC, they are accorded an increasingly significant degree of operational autonomy in the application for domestic, regional and international routes, the allocation of aircraft among routes, the purchase of flight equipment, the pricing of air fares within a certain range, the training and supervision of personnel and their day-to-day operations.

As an airline providing services on international routes, we are also subject to a variety of bilateral civil air transport agreements that provide for the exchange of air traffic rights between China and various other countries. In addition, China is a contracting state, as well as a permanent member, of the International Civil Aviation Organization (the ICAO), an agency of the United Nations established in 1947 to assist in the planning and development of international air transport, and is a party to many other international aviation conventions. The ICAO establishes technical standards for the international aviation industry. We believe that we, in all material respects, comply with all such technical standards.

Route Rights

Domestic Routes. The right of any Chinese airline to carry passengers or cargo on any domestic route must be obtained from the CAAC. Non-Chinese airlines are not permitted to provide domestic air service between destinations in China. The CAAC s policy is to assign a domestic route to the Chinese airline that is best suited to serve the route based, in part, on the location of the airline s main or regional base at the point of origin. Under current regulations, airlines are generally expected to operate mainly from their route bases, and flights within a particular region are expected to be served by airlines based in that region. We believe that these regulatory parameters benefit airlines, such as our Group, that have a large number of regional route bases. The CAAC also considers other factors that may make a particular airline suitable to operate a domestic route, including the applicant s general operating authority, compliance with pricing regulations and regulations applicable to safety and service quality, market demand, the ability of the applicant in terms of its existing routes, airport facilities and related support services.

The CAAC considers market conditions for a domestic route in determining whether the route should be allocated to one or more airlines. Generally, the CAAC requires the passenger load factor on certain route should be above the average rate of the whole market in the last flight season before additional flights and participants may be put on that route.

Regional Routes. Hong Kong and Macau routes and landing rights are derived from agreements between the Chinese government and the government of the Hong Kong SAR, and between the Chinese government and the government of Macau SAR. The rights to fly between Beijing and Hong Kong, Beijing and Macau, Shanghai and Hong Kong and Shanghai and Macau are allocated by the CAAC among the four Chinese airlines. We understand that the criteria for determining whether a Hong Kong and Macau route will be allocated to a particular airline include market demand, the ability of the airline to service the route and the appropriateness of the airline s aircraft for such route.

Previously, direct flights between Taiwan and Mainland China were only available during certain festivals. Since July 4, 2008, however, the ban on direct flights has been further liberalized to allow direct charter flights on weekends. On November 4, 2008, the Mainland China and Taiwan agreed to regular direct passenger charter flights across the Taiwan Strait. On August 31, 2009, the Mainland China and Taiwan extended the number of regular cross-Strait direct passenger flights from 108 to 270 a week. Cross-Strait direct passenger flights were further increased in the following years. As of April 26, 2019, there were 80 cross-Strait direct passenger flights a week.

International Routes. International route rights, as well as the corresponding landing rights, are derived from air services agreements negotiated between the Chinese government, through the CAAC, and the government of the relevant foreign country. Each government grants to the other the right to designate one or more domestic airlines to operate scheduled service between certain destinations within each of such countries. Upon entering into an air services agreement, the CAAC determines the airline to be awarded such routes based on various criteria, including the availability of appropriate aircraft, flight and management personnel, safety record, the overall size of the airline, financial condition and sufficiency of assets to bear civil liabilities in international air services. These route rights may be terminated by the CAAC under special circumstances.

Air Fare Pricing Policy

In recent years, there were a series of air fare reform to deregulate the control on the air fare pricing policy step by step. Pursuant to Pricing Reform of Domestic Civil Aviation as approved by the State Council of the PRC effective on April 20, 2004, prices on domestic routes fluctuate freely within a predetermined range. Instead of direct supervision by setting prices of air tickets through a local price bureau, the government provides guidance on domestic flights and domestic civil aviation is controlled by the government indirectly. Market-oriented pricing policy was introduced and pricing system has been adjusted as a result of the above pricing reform. The CAAC and NDRC issued a notice on April 13, 2010, pursuant to which, effective on June 1, 2010, airlines may set first-class and business-class airfares freely in accordance with market prices, subject to relevant PRC laws. The economy-class airfares remain to be subject to the predetermined range. The CAAC and NDRC further issued a notice, pursuant to which, effective on October 20, 2013, airlines are free to set domestic flights airfares not exceeding up to 25% above the bench mark prices where governmental pricing guidance is applicable; and to freely determine the airfares for domestic routes with the market-oriented pricing policy based on the market demand and supply situation. On September 29, 2016, the CAAC and NDRC further issued the Notice on Deepening the Pricing Reform of Demotic Civil Aviation to further expand the scope of the routes with the market-oriented pricing policy: airfares for the routes below 800 kilometers or the routes above 800 kilometers and in the competing relationship with the high-speed rail EMU trains can be freely determined by airlines. Airlines may raise the non-discounted announced airfares for a certain amount of routes with the market-oriented pricing policy. In principle, such amount shall be no more than 10 per flight season, and the accumulative increase rate of airfares shall be no more than 10 percent per route per flight season. On December 17, 2017, the CAAC further issued the Notice on Further Deepening the Pricing Reform of Demotic Civil Aviation, pursuant to which the airlines will be allowed to decide their own prices on domestic routes that have at least five carriers competing. Price increases of no more than 10 percent would be also allowed for each travel season.

On December 17, 2017, the CAAC further issued the Notice on Further Deepening the Pricing Reform of Demotic Civil Aviation, pursuant to which the airlines will be allowed to decide their own prices on domestic routes that have at least five carriers competing. For each airline, the total number of the routes which the airline can decide itself shall be no less than 10 but shall generally not exceed 15 percent of the total number of the market-oriented routes operated by such airline in one flight season. On April 13, 2018, CAAC issued the Notice on Distributing the Catalog of Domestic Routes adopting Market Regulation Price. The catalog of domestic routes is published together with such notice.

Published air fares of Chinese airlines for the Hong Kong and Taiwan routes are determined by the CAAC and the relevant civil aviation authorities in Hong Kong or Taiwan. Airlines may offer discounts on flights on their Hong Kong and Taiwan regional routes.

Published air fares of Chinese airlines for international routes (except for Japan) are determined by Chinese airlines at their own discretion, taking into account the international air fare standards established through the International Air Transport Association. For Japan routes, air fares must be approved by the relevant civil aviation authorities in Japan, and discounting of published international air fares is permitted.

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Acquisition of Aircraft and Flight Equipment

If a Chinese airline plans to acquire an aircraft, the airline must first seek approval from the CAAC and NDRC. The airline must, as a condition of approval, provide specific acquisition plans, which are subject to modification by the CAAC and NDRC. If the CAAC and NDRC approve an aircraft acquisition, the airline negotiates the terms of the acquisition with the manufacturer together with China Aviation Suppliers Holding Company (CASC), an entity controlled by CAAC, because CASC possesses the license required to import or export aircraft, and CASC receives a commission in respect thereof. Most Chinese airlines are also required to acquire their aircraft engines, spare parts and other flight equipment through CASC. Our Company and a few other Chinese airlines are permitted to import jet engines and other flight equipment for their own use without the participation of CASC. In the case of our Company, SAIETC acts as our import agent and receives an agency fee for our services.

Jet Fuel Supply and Pricing

CAOSC and Bluesky Oil Supplies Company, companies supervised by the CAAC, are the only jet fuel supply companies in China, with the exception of the joint venture jet fuel supply companies that supply Shenzhen, Zhuhai, Sanya, Haikou, Shanghai Pudong and other small airports. Airlines are generally not permitted to buy jet fuel from other suppliers in their domestic operations, since the direct import of jet fuel for domestic purposes is prohibited. As a result, all Chinese airlines purchase their domestic jet fuel supply requirements (other than the above mentioned exceptions) from the seven regional branches of CAOSC. Jet fuel obtained from such regional branches is purchased at uniform prices throughout China that are determined and adjusted by CAOSC from time to time with the approval of the CAAC and the pricing department of the NDRC based on market conditions and other factors.

Safety

The CAAC puts the improvement of air traffic safety in China on a high priority and is responsible for the establishment of operational safety, maintenance and training standards for all Chinese airlines. The Chinese airlines are required to provide monthly flight safety reports to the CAAC, including reports of flight or other incidents or accidents and other safety related problems involving such airline s aircraft occurring during the relevant reporting period. The CAAC periodically conducts safety inspections on individual airlines.

Every pilot is required to pass CAAC-administered examinations before obtaining a pilot license and is subject to an annual recertification examination.

All aircraft operated by Chinese airlines, other than a limited number of leased aircraft registered in foreign countries, are required to be registered with the CAAC. All aircraft operated by Chinese airlines must have a valid certificate of airworthiness, which is issued annually by the CAAC. In addition, maintenance permits are issued to a Chinese airline only after its maintenance capabilities have been examined and assessed by the CAAC. Such maintenance permits are renewed annually. All aircraft operated by Chinese airlines may be maintained and repaired only by CAAC-certified maintenance facilities, whether located within or outside China. Aircraft maintenance personnel must be certified by the CAAC before assuming aircraft maintenance positions.

Security

The CAAC establishes and supervises the implementation of security standards and regulations for the Chinese commercial aviation industry. Such standards and regulations are based on Chinese laws, as well as standards developed by international commercial aviation organizations. Each airline and airport in China is required to submit to the CAAC an aviation security handbook describing specific security procedures established by such airline or airport for the day-to-day operations of commercial aviation and procedures for staff training on security. Such security procedures must be based on relevant CAAC regulations and international commercial aviation treaties. Chinese airports and airlines that operate international routes must also adopt security measures in accordance with the requirements of the relevant international agreements.

Noise and Environmental Regulation

All airlines in China must comply with the noise and environmental regulations of the PRC State Environmental Protection Agency. Applicable regulations of the CAAC permit Chinese airports to refuse to grant take-off and landing rights to any aircraft that does not comply with noise regulations.

Chinese Airport Policy

The CAAC supervises and regulates all civilian airports in China. The local government of the PRC manages the administration of most civilian airports in China. Airports in China are also subject to regulation and ongoing review by the CAAC, which determines take-off and landing charges, as well as charges for the use of airports and airport services.

Competition

The CAAC s extensive regulation of the Chinese commercial aviation industry has had the effect of managing competition among Chinese airlines. Nevertheless, competition has become increasingly intense in recent years due to a number of factors, including relaxation of certain regulations by the CAAC, an increase in the number of Chinese airlines and an increase in the capacity, routes and flights of Chinese airlines.

In the Chinese aviation industry, the three dominant airlines are our Group, Air China Limited (the Air China) and China Eastern Airlines Corporation Limited (the China Eastern Airlines). In 2018, these three airlines together controlled approximately 60.1% of the commercial aviation market in China as measured by passengers carried.

Most major Chinese airlines in recent years significantly expanded their fleets, while at the same time passenger traffic may not increase proportionately. In some years, this resulted in a reduction in our passenger load factors. As a result, we are required to be more competitive with respect to, for example, quality of service, including ticketing and reservations, in-flight services, flight scheduling and timeliness.

In the next few years, the target customers of high-speed railway and airline will gradually differenciate, so passengers of airline will not be massively redirected to high-speed railway. However, the positive changes in the high-speed railway will continue to erode the aviation market. First of all, the eight horizontal and eight vertical high-speed railway corridors are gradually being perfected. The advantages of scale are becoming obvious. Secondly, in the future, the railway system will gradually release its own pricing, adopt flexible pricing and market pricing. Passengers can get discounts on more routes. Hence, the competition that aviation industry faces will become more intense. Thirdly, one-third of high-speed railway will speed up, which may attract more passengers. The competition on passengers whose trip distance are from 750 kilometers to 1000 kilometers is intense. Following the increase of speed, high-speed railway may attract passengers who travel longer than 1000 kilometers. In addition, the operational efficiency of high-speed railways and train capacity will increase.

We believe that our Company possesses certain competitive advantages as compared to other Chinese airlines. We have the most extensive route network and the largest number of regional route bases among Chinese airlines, which we believe places us in a favorable position in the route allocation process. We also have the largest aircraft fleet among all Chinese airlines, which, together with our planned aircraft acquisitions, will permit us to expand our operations and to improve the deployment of the aircraft in our fleet. We also believe that our dominant presence in the populous and economically developed southern and central regions of China provides us with a competitive advantage in attracting new customers, and our fully integrated flight training, aircraft and engine maintenance and air catering operations enable us to achieve and maintain high quality service to our customers. In light of increasing competition from high-speed trains, we intend to place more flight fleet to the international routes, where we will make an effort for a stronger market position. We also believe that our optimized route network, increased operational efficiency and improved service quality will attract more customers. The proposed cooperation between us and the high speed trains operators will also enable us to render a seamless air-ground service to customers and bring a win-win situation for both us and the high speed trains operators.

According to CAAC statistics briefing, the following table sets forth our market share of passengers carried, cargo and mail carried and total traffic of Chinese airlines for the years indicated.

	Passenger Carried		Cargo and Mail Carried (tons)		Total Traffic (tons kilometers)	
Year	**Industry Total (in millions)**	**Group s Share (% of total)**	**Industry Total (in millions)**	**Group s Share (% of total)**	**Industry Total (in millions)**	**Group s Share (% of total)**
2014	391.7	25.8	5,933	24.2	74.9	26.4
2015	435.6	25.1	6,253	24.2	85.0	26.3
2016	487.8	23.5	6,669	22.7	96.1	25.4
2017	551.6	25.2	7,058	23.7	108.3	22.9
2018	611.7	22.9	7,385	23.5	120.7	25.1

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Domestic Routes

We compete against our domestic competitors primarily on the basis of flight schedule, route network, quality of service, safety, type and age of aircraft and, to a lesser extent, price. We compete against other major Chinese airlines in our various domestic route markets. Of these competitors, the largest two are Air China Limited and China Eastern Airlines Corporation Limited, which are owned or controlled by the Chinese government.

The following table sets forth our market share in terms of passengers carried, cargo and mail carried on departing flights and total departing flights at the 10 busiest airports in China in 2018 according to passenger volume data from CAAC statistics briefing.

Airport	Passenger Carried (% of total)	Cargo and Mail Carried (% of total)	Departing Flight (% of total)
Beijing	16.4	9.3	16.7
Shanghai Pudong	9.1	7.4	9.8
Guangzhou	48.5	32.4	49.0
Chengdu	11.2	10.9	10.5
Shenzhen	28.2	15.4	26.4
Kunming	11.0	15.4	10.2
Xi an	13.1	11.2	13.2
Shanghai Hongqiao	13.3	24.2	13.3
Chongqing	21.9	19.1	23.3
Hangzhou	25.7	13.2	24.8

The following table sets forth our market share in terms of passengers carried, cargo and mail carried on departing flights and total departing flights at eight busiest airports in southern and central China (excluding Guangzhou and Shenzhen, which are included in the table above) in 2018 according to passenger volume data from CAAC statistics briefing.

Airport	Passenger Carried (% of total)	Cargo and Mail Carried (% of total)	Departing Flight (% of total)
Zhengzhou	28.6	9.3	29.1
Changsha	31.0	31.7	31.5
Wuhan	36.0	28.9	35.7
Haikou	21.7	28.5	20.9
Sanya	23.8	31.7	25.0
Nanning	20.5	22.1	21.2
Zhuhai	29.3	37.0	29.0
Guilin	18.5	22.4	19.5

Regional Routes

In 2018, we conducted a total of 19,440 flights on our regional routes, accounting for approximately 22.40 % of all passengers carried by Chinese airlines on routes between Hong Kong, Macau or Taiwan and destinations in China. We face less competition on regional routes than that on domestic and international routes, and earn higher operating margin. Air China, China Eastern Airlines, Air Macau, Cathay Dragon, Cathay Pacific, China Airlines and Eva Airways compete with our Group in the regional traffic markets.

International Routes

We compete with a number of Chinese airlines, including Air China and China Eastern Airlines and many well-established foreign airlines on our international routes. Most of these international competitors have significantly longer operating histories, substantially greater financial and technological resources and greater name recognition than us. In addition, the public s perception of the safety and service records of Chinese airlines may adversely affect our ability to compete against our regional and international competitors. Many of our international competitors have larger sales networks and participate in more comprehensive and convenient reservation systems, or engage in promotional activities that may enhance their ability to attract international passengers.

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In Southeast Asian routes, our competitors mainly include Thai Airways International, Singapore Airlines, Malaysian Airlines System, Vietnam Airlines, Garuda Indonesia, Philippine Airlines, Air China and China Eastern Airlines. In European routes, our competitors mainly include Air China, China Eastern Airlines, Cathay Pacific and Lufthansa German Airlines. In the United States routes, our competitors mainly include Air China, China Eastern Airlines, Cathay Pacific and United Airlines. In Australian routes, our competitors include Air China, China Eastern Airlines, Cathay Pacific and Qantas Airways. We compete in the international market primarily on the basis of safety, price, timeliness and convenience of scheduling.

Airline Subsidiaries

Our Airline Subsidiaries are joint ventures established by our Company and local companies in the provinces or special economic zones where our Airline Subsidiaries are based and are engaged in providing airline and related services. As of December 31, 2018, our Company owns a 55% or 60% equity interest in each of our Airline Subsidiaries.

As of December 31, 2018, Xiamen Airlines operated under the MF code with a fleet of 210 aircraft. In 2018, Xiamen Airlines carried a total of about 35.89 million passengers, or approximately 25.66% of the passengers carried by our Group in that year, and had RMB28,727 million in traffic revenue.

As of December 31, 2018, Shantou Airlines operated under CZ code with a fleet of 16 aircraft. In 2018, under the centralized allocation of flight routes of our Group, Shantou Airlines carried a total of about 3.22 million passengers, or 2.30 % of the passengers carried by our Group in that year. Total traffic revenue of Shantou Airlines for the year ended December 31, 2018 was RMB 2,271 million.

As of December 31, 2018, Zhuhai Airlines operated under the CZ code with a fleet of 13 aircraft. In 2018, under the centralized allocation of flight routes of our Group, Zhuhai Airlines carried a total of about 2.19 million passengers, or approximately 1.57% of the total number of passengers carried by our Group in that year. Total traffic revenue of Zhuhai Airlines for the year ended December 31, 2018 was RMB1,670 million.

As of December 31, 2018, Guizhou Airlines operated under the CZ code with a fleet of 20 aircraft. In 2018, under the centralized allocation of flight routes of our Group, Guizhou Airlines carried a total of about 3.57 million passengers, or approximately 2.55% of the total number of passengers carried by our Group in that year. Total traffic revenue of Guizhou Airlines was approximately RMB2,767 million for the year ended December 31, 2018.

As of December 31, 2018, Chongqing Airlines operated under the OQ code with a fleet of 27 aircraft. In 2018, under the centralized allocation of flight routes of our Group, Chongqing Airlines carried a total of about 3.66 million passengers, or 2.62% of the total number of passengers carried by our Group in that year. Total traffic revenue of Chongqing Airlines for the year ended December 31, 2018 was RMB2,635 million.

As of December 31, 2018, Henan Airlines operated under the CZ code with a fleet of 31 aircraft. In 2018, under the centralized allocation of flight routes of our Group, Henan Airlines carried a total of about 6.05 million passengers, or approximately 4.32% of the total number of passengers carried by our Group in that year. Total traffic revenue of Henan Airlines was approximately RMB4,508 million for the year ended December 31, 2018.

Insurance

The CAAC maintains fleet and legal liability insurance on behalf of us and all other Chinese airlines with PICC Property and Casualty Company Limited, or PICCP&C, and China Pacific Property Insurance Company Ltd., Ping An

Property and Casualty Insurance Company of China, Ltd. under the PICCP&C master policy. We maintain aviation hull all risks, spares and airline liability insurance, aircraft hull all risks and spare engines deductible insurance, aviation hull war and allied perils policy of the type and in the amount customary in the Chinese aviation industry.

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Under the relevant PRC laws, civil liability of Chinese airlines for death or injuries suffered by passengers on domestic flights is limited to RMB400,000 (approximately US$64,538) per passenger. As of July 31, 2006, the Convention for the Unification of Certain Rules for International Carriage by Air of 1999, or Montreal Convention, became effective in China. Under the Montreal Convention, carriers of international flights are strictly liable for proven damages up to 100,000 Special Drawing Rights and beyond that, carriers are only able to exclude liability if they can prove that the damage was not attributable to negligence or other wrongful act of the carrier (and its agents), or the damage arose solely from the negligence or other wrongful act of a third party. We believe that we maintain adequate insurance coverage for the civil liability that can be imposed in respect of death or injuries to passengers under Chinese law, the Montreal Convention and any agreement which we are subject to.

The CAAC allocates insurance premiums payable in respect of the PICCP&C master policy to each participating airline based on the value of the airline s insured aircraft or, in the case of leased aircraft, based on the amount required by the terms of the lease. Insurance claims made by any participating airline may cause the premiums paid by us under the PICCP&C master policy to increase. PICCP&C s practice has been to reinsure a substantial portion of its aircraft insurance business through reinsurance brokers on the London reinsurance market.

Intellectual Property

Our businesses and operations, other than the businesses and operations of Xiamen Airlines and Chongqing Airlines, are conducted under the names China Southern and China Southern Airlines in both English and Chinese. We use as our logo a stylized rendition of a kapok plant. Xiamen Airlines conducts its businesses and operations under the name of Xiamen Airlines in English and Chinese and uses its own logo depicting a stylized rendition of an egret. Chongqing Airlines conducts its business and operations under the name of Chongqing Airlines in English and Chinese and uses its own logo depicting a cross of two rivers.

We own various trademarks and trade names related to our business. The names China Southern and China Southern Airlines contain Chinese words of common usage and are therefore not eligible for registration as trade names under current Chinese law. The kapok logo is a trademark registered in China and recorded with the International Air Transport Association (IATA), the rights to which are owned by CSAH. Our Company and CSAH have entered into a trademark license agreement (the Trademark License Agreement), pursuant to which CSAH has licensed to our Group the right to use the names China Southern and China Southern Airlines in both English and Chinese and granted our Company a ten-year renewable license from 1997 to use the kapok logo on a world-wide basis. CSAH 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 our Group to use the kapok logo. Unless CSAH gives a written notice of termination three months before the expiration of the agreement, the agreement will be automatically renewed for another ten-year term. In May of 2017, the Trademark License Agreement has been automatically renewed by the two parties for another ten-year term ending 2027. Xiamen Airlines owns all rights to its egret logo, which is a trademark registered in China, and recorded with the IATA. Chongqing Airlines also owns all rights to its logo, which is a trademark registered in China, and recorded with the IATA.

Iran Sanctions Disclosure

Pursuant to Section 13(r) of the Securities Exchange Act of 1934, or the Exchange Act, if during 2018, our Company or any of our affiliates have engaged in certain transactions with Iran or with persons or entities designated under certain executive orders, our Company would be required to disclose information regarding such transactions in our Annual Report as required under Section 219 of the Iran Threat Reduction and Syria Human Rights Act of 2012, or ITRA. During 2018, our Company operated air services to and from Iran through the specifically designated route of

Beijing - Tehran - Beijing (the Iran Route) and engages in international traffic in passengers, cargo and mail.

In order to provide our aviation service in Iran, our Company has entered into certain grounding service agreement with Iran Air, whereby Iran Air provides our Company with grounding service, maintenance and other support services in return for certain service fees to be paid by our Company in accordance with the agreement. Our Company does not provide, nor has it ever provided any equipment, component, or technology to Iran. The service rendered by our Company to Iran is limited to the provision of international traffic in passengers, cargo and mail and those services provided by our local offices and agents to customers. Our Company does not operate flights within Iran.

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Our Company s international route rights, as well as the corresponding landing rights, are derived from air services agreements negotiated between the Chinese government, through the CAAC, and the governments of the relevant foreign countries. With respect to the Iran Route, our Company s international route rights associated thereto are derived from and based on the bilateral air transport agreement (the Bilateral Agreement) entered into by and between the Chinese government and the Iranian government. Both parties are contracting parties to the Convention on International Civil Aviation, opened for signature at Chicago on December 7, 1944, and entered into the Bilateral Agreement with an aim to establish and operate scheduled air services between and beyond the two countries respective territories. The Bilateral Agreement, which has been registered with the International Civil Aviation Organization, sets forth general principles and specific rules governing our Company s aviation services in Iran.

Our Company understands that Iran Air is Iran s national airline carrier and is designated by the U.S. Department of the Treasury pursuant to Executive Order No. 13382. However, Executive Order No. 13382 only prohibits all transactions between the designees and any U.S. person. Our Company is incorporated in the People s Republic of China and is a foreign issuer in the United States. As our Company is not a U.S. person, our transactions with Iran Air are not prohibited by Executive Order No. 13382. Our Company further understands that it has an obligation to disclose our transactions with Iran Air as described above under Exchange Act Section 13(r)(1)(D)(iii). Iran Air is Iran s national airline carrier and is controlled or owned by the Government of Iran. Our Company believes that Iran Air can be identified as the Government of Iran under Section 560.304 of title 31, Code of Federal Registration (relating to the definition of the Government of Iran). Our Company has not obtained any specific authorization of a Federal department or agency of the United States concerning our transactions with Iran Air.

Our Company does not anticipate any significant change in our service to Iran, either by way of increasing significantly the size of or altering the nature of our operations in the territory. For the year ended December 31, 2018, the asset of Iran office and revenue generated from the air services to Iran amounted to US$17,465.39 and US$3.72million, representing only 0.000049% and 0.017765% of the total asset and total revenue generated by our Group for the year ended December 31, 2018, respectively. Therefore, our Company believes that our operations in Iran for the year ended December 31, 2018 are inconsequential and quantitatively immaterial to our business, financial condition and results of operations.

C. ORGANIZATIONAL STRUCTURE

The following chart illustrates the corporate structure of our Group as of December 31, 2018 and the aggregate effective equity interest of our Company in each of our principal subsidiaries, associates and jointly controlled entities.

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The particulars of our principal subsidiaries as of December 31, 2018 are as follows:

Name of Company	Place and Date of Establishment/Operation	Proportion of Ownership Interest Held by our Company
Xiamen Airlines Company Limited	PRC August 11, 1984	55%
Shantou Airlines Company Limited	PRC July 20, 1993	60%
Zhuhai Airlines Company Limited	PRC May 8, 1995	60%
Guizhou Airlines Company Limited	PRC June 17, 1998	60%
Chongqing Airlines Company Limited	PRC May 30, 2007	60%
China Southern Airlines Henan Airlines Company Limited	PRC September 27, 2013	60%
China Southern Airlines Xiong an Airlines Company Limited	PRC June 29, 2018	100%
Southern Air Cargo Logistics (Guangzhou) Co., Ltd.	PRC June 8, 2018	100%
Southern Airlines General Aviation Company Limited	PRC November 17, 2014	100%
Guangzhou Nanland Air Catering Company Limited	PRC November 21, 1989	70.5%
Beijing Southern Airlines Ground Services Company Limited	PRC April 1, 2004	100%
Southern Airlines Group Import and Export Trading Company	PRC June 8, 1993	100%

The particulars of our principal associates and joint ventures as of December 31, 2018 are as follows:

			Proportion of Ownership Interest Held by	
Name of Company	Place and Date of Establishment/Operation	Group Effective Interest	Our Company	Subsidiaries
Guangzhou Aircraft Maintenance Engineering Co., Ltd.	PRC October 28, 1989	50%	50%	
Southern Airlines Group Finance Company Limited	PRC June 28, 1995	33.98%	25.28%	8.7%
Sichuan Airlines Co., Ltd.	PRC August 28, 2002	39%	39%	
Southern Airlines Culture and Media Co., Ltd.	PRC May 13, 2004	40%	40%	
MTU Maintenance Zhuhai Co., Ltd.	PRC March 1, 2001	50%	50%	

D. PROPERTY, PLANT AND EQUIPMENT

For a discussion of our aircraft, see Item 4 Information on our Company-History and development of our Company Aircraft Acquisitions.

Our headquarters in Guangzhou occupy an area of approximately 1,532,491 square meters of land and a total gross floor area of approximately 1,016,105 square meters. We lease the land in Guangzhou on which our headquarters and other facilities are located from CSAH. We also lease from CSAH certain buildings mainly at the Haikou, Wuhan, Nanyang, Shenyang, Dalian, Jilin, Harbin, Xinjiang and other PRC cities.

Our principal properties are located at our headquarters site and at our route bases. The following table sets forth certain information with respect to our properties at our headquarters in Guangzhou and certain route bases as of the date hereof.

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	Land (in square meters)		Building (in square meters)	
	Owned	Leased	Owned	Leased
Guangzhou	1,443,562	88,929	933,974	82,131
Shenzhen	256,280		124,505	5,730
Zhuhai	152,993	81,413	20,124	3,601
Changsha	255,422	6,238	81,293	12,536
Haikou	346,820		58,443	4,763
Wuhan	284,339	32,579	36,429	18,669
Nanyang		1,140,015	11,936	16,439
Sanya	106,680		64,698	
Shenyang	142,199	31,226	28,743	60,002
Dalian		158,240	64,226	33,322
Jilin	150,246	65,076	85,274	9,332
Harbin	30,969	267,871	51,832	32,372
Xinjiang	3,754	540,493	137,932	3,497
Guangxi	73,787		52,554	
Beijing	85,453		91,124	8,195
Shanghai	42,292		37,013	6,360
Chengdu			1,964	
Qingdao			767	
Hefei			2,321	
Sydney			1,151	
Amsterdam			555	
Xi an			4,364	

The following table sets forth certain information with respect to the properties of the Airline Subsidiaries as of the date hereof.

	Land (in square meters)		Building (in square meters)	
	Owned	Leased	Owned	Leased
Xiamen Airlines	710,181		543,367	10,229
Shantou Airlines	137,075	2,660	73,419	5,891
Zhuhai Airlines	99,306		54,971	
Guizhou Airlines	254,871		53,717	
Chongqing Airlines	82,449		68,242	
Henan Airlines	364,255		64,892	
Zhuhai Xiang Yi Aviation Technology Co., Ltd..	213,973		52,323	3,570

The land in Guangzhou on which our headquarters and other facilities are located and the buildings that our Company uses at our route bases in Wuhan and Haikou are leased by our Company from CSAH. However, CSAH lacks adequate documentation evidencing CSAH s rights to such land and buildings, and, as a consequence, the lease agreements between CSAH and our Company for such land may not be registered with the relevant authorities. Lack of registration may affect the validity of such lease agreements. There are certain other parcels of land and buildings owned or used by us that lack adequate documentation. Lack of adequate documentation for land use rights and ownership of buildings may impair our ability to dispose of or mortgage such land use rights and buildings. As of December 31, 2018, we were in the process of applying for the land use right certificates and property title certificates in respect of the properties located in Guangzhou (including Guangzhou Baiyun International Airport), Guangxi, Guizhou, Chengdu, Xiamen, Heilongjiang, Jilin, Dalian, Hunan, Beijing, Zhuhai, Shenyang, Shenzhen, Henan, Shantou, Xinjiang, Hainan, Shanghai, Hubei and Chongqing , in which we have interests and for which such certificates have not been granted. Our directors are of the opinion that the use of and the conduct of operating activities at the properties referred to above are not affected by the fact that we have not yet obtained the relevant land use right certificates and property title certificates.

ITEM 4A. UNRESOLVED STAFF COMMENTS

Not applicable.

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ITEM 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS

The following discussion and analysis should be read in conjunction with our consolidated financial statements, which have been prepared in accordance with IFRSs, included elsewhere in this Annual Report.

Critical Accounting Policies

The preparation of the consolidated financial statements requires our Group to make estimates and judgments that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the end of each reporting period, and the reported revenues and expenses during each reporting period. Actual results may differ from these estimates under different assumptions or conditions.

Critical accounting policies are defined as those that are reflective of significant judgments and uncertainties, and potentially result in materially different results under different assumptions and conditions. Our principal accounting policies are set forth in Note 3 to the consolidated financial statements. We believe that the following critical accounting policies involve the key accounting judgments and estimates used in the preparation of our financial statements.

Impairment of long-lived assets (other than goodwill)

If circumstances indicate that the carrying amount of a long-lived asset may not be recoverable, the asset may be considered impaired , and an impairment loss may be recognized in accordance with IAS 36, Impairment of Assets. The carrying amounts of long-lived assets 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 higher of the fair value less costs of disposal and value in use. In particular, in determining the value in use of the Group s aircraft fleet, expected future cash flows to be generated by the asset are discounted to their present value, which requires significant judgement relating to forecast traffic revenue, forecast operating costs and discount rate applied. The Group uses all readily available information in determining an amount that is a reasonable approximation of recoverable amount, including estimates based on reasonable and supportable assumptions for projections of traffic revenue and operating costs and application of discount rate.

Provision for major overhauls

Provision for the cost of major overhauls to fulfil the lease return conditions for airframes and engines held under operating leases are accrued and charged to the income statement over the estimated overhaul period. This requires estimation of the expected overhaul cycles and overhaul costs, which are based on the historical experience of actual costs incurred for overhauls of airframes and engines of the same or similar types and current economic and airline-related developments. Different estimates could significantly affect the estimated provision and the results of operations.

Frequent flyer revenue

According to the frequent flyer award programs, the allocation of stand-alone selling price of the mileage awarded involves the estimation of the expected redemption rate. The expected redemption rate is estimated based on historical experience, anticipated redemption patterns and the frequent flyer programs design. Different estimates could significantly affect the estimated contract liabilities and the results of operations.

In the comparative periods, the amount of revenue attributable to the mileage earned by the members of the Group s frequent flyer award programs was estimated based on the fair value of the mileage awarded and the expected redemption rate. The fair value of mileage awarded was estimated by reference to external sales. The method to estimate the expected redemption rate remains unchanged.

Depreciation

Property, plant and equipment are depreciated on a straight-line basis over the estimated useful lives, after taking into account the estimated residual value. The Group reviews the estimated useful lives of assets annually in order to determine the amount of depreciation expense to be recorded during any financial year. The useful lives are based on the Group s historical experience with similar assets and take into account anticipated technological changes. The depreciation expense for future periods is adjusted if there are significant changes from previous estimates.

Provision for consumable spare parts and maintenance materials

Provision for consumable spare parts and maintenance materials is made based on the difference between the carrying amount and the net realizable value. The net realizable value is estimated based on current market condition, historical experience and the Group s future operation plan for the consumable spare parts and maintenance materials. The net realizable value may be adjusted due to the change of market condition and the future plan for the consumable spare parts and maintenance materials.

Income tax

There are certain transactions and calculations for which the ultimate tax determination is uncertain during the ordinary course of business. The Group recognizes liabilities for anticipated tax audit issues based on estimates of whether additional tax will be due. Where the final tax outcome of these matters is different from the amounts that were initially recorded, such differences will impact the current and deferred income tax assets and liabilities in the year in which such determination is made.

Loss allowances

Loss allowances for trade receivables are always measured at an amount equal to lifetime ECLs. The ECLs are estimated using a provision matrix based on the Group s historical credit loss experience, adjusted for factors that are specific to the debtors and an assessment of both the current and forecast general economic conditions at the reporting date. Different estimates could significantly affect the results of operations.

In the comparative periods, when there is objective evidence that the Group will not be able to collect all amounts due according to the original terms of the receivables, a provision for impairment of trade receivables is established based on the difference between the receivable s carrying amount and the present value of estimated future cash flows, discounted at the original effective interest rate.

Ticket breakage revenue

The Group recognizes, in proportion to the pattern of rights exercised by the customer, the breakage amount to which the Group expects to be entitled as ticket breakage revenue. Such portion is estimated based on the Group s historical experiences, and the estimated revenue is recognized only to the extent that it is highly probable that a significant reversal in cumulative revenue recognized will not occur when the uncertainty is resolved. Different estimates could significantly affect the ticket breakage revenue recognized in the current financial year.

In the comparative periods, ticket breakage revenue was recognized when the tickets expired, and such revenue recognition did not involve significant accounting estimates.

Retirement benefits

According to IAS 19, Employee Benefits, an entity shall account not only for its legal obligation under the formal terms of a defined benefit plan, but also for any constructive obligation that arises from the entity s informal practices where the entity has no realistic alternative but to pay the employee benefits. The Company believes the payments of welfare subsidy to those retirees who retired before the establishment of Pension Scheme (as defined in Note 52(a)) are discretionary and have not created a legal or constructive obligation. Such payments are made according to the Group s business performance, and can be suspended at any time (Note 13).

Recently Pronounced International Financial Reporting Standards

Information relating to the recently pronounced IFRSs is presented in Note 60 to the consolidated financial statements.

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Key Factors Affecting Results of operations

Our results of operations are affected by the factors discussed below.

Financial and operating leverage

Like most airlines, we are subject to a high degree of financial and operating leverage. A significant percentage of our operating expenses are fixed costs that do not vary proportionally to our yields or the load factors. These fixed costs include depreciation expense, jet fuel costs, landing and navigation fees, financing costs, operating lease payments, aircraft maintenance costs and labor costs for flight crew, cabin crew and ground personnel. Thus, a minor change in our yields or load factors could have a material effect on our results of operations. In addition, certain of these expenses, primarily financing costs and operating lease payments, labor costs and depreciation do not vary proportionally to the number of flights flown. Thus, even minor change in aircraft utilization rates may affect our results of operations. We are and will continue to be highly leveraged with substantial obligations denominated in foreign currencies and, accordingly, the results of our operations are significantly affected by fluctuations in foreign exchange rates, particularly for the U.S. dollar. Our net exchange loss of RMB1,853 million was recorded in 2018 mainly due to the translation of balances of borrowings and obligations under finance lease which are denominated in USD and the depreciation of RMB against USD.

Political and economic conditions and regulations

A number of other external factors including political and economic conditions in China, tend to have a major impact on our performance. Our financial performance is also significantly affected by factors arising from operating in a regulated industry. As substantially all aspects of our airline operations are regulated by the PRC government, our operating revenues and expenses are directly affected by the PRC government s policies with respect to domestic air fares, jet fuel prices and landing and navigation fees, among others. The nature and extent of airline competition and the ability of Chinese airlines to expand are also affected by CAAC s control over route allocations. Any changes in the PRC government s regulatory policies or any implementation of such policies could have a significant impact on our future operations and our ability to implement our operating strategy.

Foreign exchange risk

We finance our aircraft acquisitions mainly through capital leases or bank loans in U.S. dollars, and have a substantial amount of transactions and obligations denominated in U.S. dollars in relation to our global purchases of jet fuel, lease and purchase of aviation equipment as well as major repairs, in addition to the landing fees of our international flights in the airports of other countries, and, as a result, our business will be affected by the Renminbi depreciation. Renminbi depreciation has caused exchange loss to our Group and increased our operating costs which are denominated in foreign currencies.

Seasonality

Our operating revenue is substantially dependent on the passenger and cargo traffic volume carried, which is subject to seasonal and other changes in traffic patterns, the availability of appropriate time slots for our flights and alternative routes, the degree of competition from other airlines and alternate means of transportation, as well as other factors that may influence passenger travel demand and cargo and mail volume. In particular, our airline revenue is generally higher in the second half of the year than in the first half of the year due to the greater demand for air travel during the summer months .

In addition, our future operations will be affected by, among other things, changes in the aviation market, the cost of jet fuel, aircraft acquisition and leasing costs, aircraft maintenance expenses, take-off and landing charges, wages, salaries and benefits and other operating expenses, foreign exchange rates and the rates of income taxes paid.

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Certain Financial Information and Operating Data by Geographic Region

The following table sets forth certain financial information and operating data by geographic region for the years ended December 31, 2018, 2017 and 2016.

Traffic	**Year ended December 31,** 2018	2017	2016	**2018 vs. 2017% increase (decrease)**	**2017 vs. 2016% increase (decrease)**
RPK (million)					
Domestic	178,972.96	160,427.72	144,979.57	11.56	10.66
Regional	3,304.83	2,934.65	3,083.71	12.61	(4.83)
International	76,916.01	67,334.50	58,042.36	14.23	16.01
Total	259,193.80	230,696.87	206,105.64	12.35	11.93
RTK (million)					
Domestic	17,437.56	15,833.96	14,551.2	10.13	8.82
Regional	315.39	282.52	292.46	11.63	(3.40)
International	12,580.72	11,204.15	9,542.9	12.29	17.41
Total	30,333.67	27,320.63	24,386.56	11.03	12.03
Passengers carried (thousand)					
Domestic	119,494.01	108,616.65	98,463.43	10.01	10.31
Regional	2,527.08	2,329.80	2,340.68	8.47	(0.46)
International	17,863.96	15,352.29	13,814.52	16.36	11.13
Total	139,885.04	126,298.75	114,618.63	10.76	10.19
Cargo and mail carried (thousand tons)					
Domestic	1,043.91	1,048.18	1083.6		