

CHINA SOUTHERN AIRLINES CO LTD  
Form 20-F  
May 28, 2010

UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

FORM 20-F

(Mark One)

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, 2009

OR

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

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 \_\_\_\_\_

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

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)

278 JI CHANG ROAD  
GUANGZHOU, 510405

PEOPLE'S REPUBLIC OF CHINA

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(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.

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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 Receipts	New York Stock Exchange, Inc.

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

None

(Title of Class)

SEC 1852 (05-06) Persons who respond to the collection of information contained in this form are not required to respond unless the form displays a currently valid OMB control number.

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

None

(Title of Class)

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. 5,521,150,000 ordinary A Shares of par value RMB1.00 per share and 2,482,417,000 ordinary H Shares of par value RMB1.00 per share were issued and outstanding as of December 31, 2009.

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

Note — Checking the box above will not relieve any registrant required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 from their obligations under those Sections.

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 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

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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 contains forward-looking statements. 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 “estimates”, “projects”, “expects”, “intends”, “believes”, “plans”, “anticipates”, or their negatives or comparable words. Also look for discussions of strategy that involve risks and uncertainties. Forward-looking statements include statements regarding the outlook for the Company’s future operations, forecasts of future costs and expenditures, evaluation of market conditions, the outcome of legal proceedings (if any), the adequacy of reserves, or other business plans. You are cautioned that such forward-looking statements are not guarantees and involve risks, assumptions and uncertainties. The Company’s actual results may differ materially from those in the forward-looking statements due to risks facing the Company or due to actual facts differing from the assumptions underlying those forward-looking statements.

Some of 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 the Company operates, including changes in interest rates;
- the effects of competition on the demand for and price of our services;
- natural phenomena;
- actions by government authorities, including changes in government regulations, and changes in the CAAC’s regulatory policies;
- the Company’s relationship with China Southern Air Holding Company (the “CSAHC”);
- uncertainties associated with legal proceedings;
- technological development;
- 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.

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

## INTRODUCTORY NOTE

In this Annual Report, unless the context indicates otherwise, the “Company” means China Southern Airlines Company Limited, a joint stock company incorporated in China on March 25, 1995, the “Group” means the Company and its consolidated subsidiaries, and “CSAHC” means China Southern Air Holding Company, the Company’s parent company which holds a 59.32% controlling interest in the Company as of May 7, 2010.

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 currency of the United States of America (the “U.S.” or “United States”), and reference to “HK\$” is to the currency of Hong Kong. Reference to the “Chinese government” is 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.

The Company presents its consolidated financial statements in Renminbi. The consolidated financial statements of the Company for the year ended December 31, 2009 (the “Financial Statements”) have been prepared in accordance with all applicable International Financial Reporting Standards (“IFRSs”), which collective term includes all applicable individual International Financial Reporting Standards, International Accounting Standards (“IAS”) and interpretations issued by the International Accounting Standards Board (the “IASB”).

Solely for the convenience of the readers, this Annual Report contains translations of certain Renminbi amounts into U.S. dollars at the rate of US\$1.00 = RMB6.8282, 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 31, 2009. 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.

## 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 Measurements

“available seat kilometers” or “ASKs”                      the number of seats made available for sale multiplied by the kilometers flown

“available ton kilometers” or “ATKs”                      the tons of capacity available for the transportation of revenue load (passengers and cargo) multiplied by the kilometers flown

### Traffic Measurements

“cargo ton kilometers”    the load in tons multiplied by the kilometers flown

“revenue passenger kilometers” or “RPKs”                      the number of passengers carried multiplied by the kilometers flown

“revenue ton kilometers” or “RTKs”                      the load (passenger and cargo) in tons multiplied by the kilometers flown

### Yield Measurements

“average yield”    revenue from airline operations (passenger and cargo) divided by RTKs

“cargo yield”    revenue from cargo operations divided by cargo ton kilometers

“passenger yield”    revenue from passenger operations divided by RPKs

“ton”    a metric ton, equivalent to 2,204.6 pounds

### Load Factors

“breakeven load factor”

the load factor required to equate scheduled traffic revenue with operating costs assuming that total operating surplus is attributable to scheduled traffic operations

“overall load factor”

RTKs expressed as a percentage of ATKs

“passenger load factor”

RPKs expressed as a percentage of ASKs

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Utilization

“utilization rates” the actual number of flight and taxi hours per aircraft per operating day

Equipment

“expendables” aircraft parts that are ordinarily used up and replaced with new parts

“rotables” aircraft parts that are ordinarily repaired and reused

Liquidity Ratios

“current ratio” current assets divided by current liabilities

“quick ratio” current assets excluding inventories divided by current liabilities

Others

“ADR” American Depositary Receipt

“A Shares” Shares issued by the 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

“CSRC” China Securities Regulatory Commission

“H Shares” Shares issued by the 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 CSAHC)

“NDRC” National Development and Reform Commission of China

“SA Finance” Southern Airlines Group Finance Company Limited

“SAFE” State Administration of Foreign Exchange of China

“SEC” United States Securities and Exchange Commission

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.

Selected Financial Data

The following tables present selected financial data of the Group as of and for each of the years in the five-year period ended December 31, 2009. The selected consolidated income statement data for each of the years in the three-year period ended December 31, 2009 and selected consolidated balance sheet data as of December 31, 2009 and 2008 excluding basic and diluted earnings/(loss) per ADR, are derived from the consolidated financial statements of the Company, including the related notes, included elsewhere in this Annual Report. The selected consolidated income statement data for the years ended December 31, 2006 and 2005 and selected consolidated balance sheet data as of December 31, 2007, 2006 and 2005 are derived from the Company's 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” are included elsewhere in this Annual Report. Our consolidated financial statements are prepared and presented in accordance with International Financial Reporting Standards, or IFRSs.

## Year ended December 31,

	2009	2009	2008	2007	2006	2005
	US\$	RMB	RMB	RMB	RMB	RMB

(in million, except per share data)

Consolidated Income Statement  
Data:

Operating revenue	8,026	54,802	55,288	54,401	46,081	38,233
Operating expenses	(8,106)	(55,351)	(61,767)	(52,956)	(45,899)	(39,598)
Operating profit/(loss)	211	1,440	(5,646)	1,881	663	(1,323)
profit/(loss) before taxation	63	432	(4,724)	2,879	227	(1,913)
profit/(loss) for the year	77	527	(4,786)	2,032	104	(1,891)
profit/(loss) attributable to:						
Equity shareholders of the Company	48	330	(4,823)	1,839	106	(1,893)
Minority interests	29	197	37	193	(2)	2
Basic and diluted earnings/(loss) per share	0.01	0.05	(0.74)	0.28	0.02	(0.29)
Basic and diluted earnings/(loss) per ADR	0.34	2.33	(36.75)	14.01	0.81	(14.43)

## Year ended December 31,

	2009	2009	2008	2007	2006	2005
	US\$	RMB	RMB	RMB	RMB	RMB

(in million)

Consolidated Balance Sheet  
Data:

Cash and cash equivalents	636	4,343	4,649	3,824	2,264	2,901
Other current assets	701	4,785	4,599	4,966	4,419	4,320
Asset classified as held for sale	77	529	-	-	-	-
Property, plant and equipment, net	9,325	63,673	53,237	58,441	56,335	54,254
Total assets	13,876	94,750	83,042	82,006	75,689	71,491
Bank and other loans, including long-term bank and other loans due within one year	2,556	17,452	22,178	24,948	23,822	16,223
Short-term financing bills	-	-	2,000	-	-	-
Obligations under capital leases due within one year	210	1,431	1,781	2,877	3,091	3,373



Bank and other loans, excluding balance due within one year	4,082	27,875	17,429	9,074	10,018	12,740
Obligations under capital leases, excluding balance due within one year	1,741	11,887	11,157	12,858	12,307	12,459
Total equity	1,942	13,262	9,479	14,310	11,752	11,667
Number of shares (in million)	8,003	8,003	6,561	4,374	4,374	4,374

#### Selected Operating Data

The following selected operating data of the Group for each of the years in the five-year period ended December 31, 2009 have been derived from consolidated financial statements prepared in accordance with IFRSs and other data provided by the Group which have not been audited.

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The operating data and the profit analysis and comparison for other years below is calculated and disclosed in accordance with the statistical standards, which have been implemented by the 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,

	2009	2008	2007	2006	2005
<b>Capacity</b>					
ASK (million)	123,441	112,767	109,733	97,059	88,361
ATK (million)	15,446	14,276	14,208	12,656	11,509
Kilometers flown (thousand)	746,133	686,236	675,127	594,957	539,844
Hours flown (thousand)	1,195	1,106	1,075	931	846
Number of landing and take-offs	616,296	556,914	543,789	481,810	438,674
<b>Traffic</b>					
RPK (million)	93,002	83,184	81,727	69,582	61,923
RTK (million)	10,067	9,200	9,250	8,071	7,284
Passengers carried (thousand)	66,281	58,237	56,903	49,206	44,119
Cargo and mail carried (tons)	862,000	835,000	872,000	819,000	775,000
<b>Load Factors</b>					
Passenger load factor (RPK/ASK) (%)	75.3	73.8	74.5	71.7	70.1
Overall load factor (RTK/ATK) (%)	65.2	64.4	65.1	63.8	63.3
Breakeven load factor (%)	68.1	73.8	64.8	65.1	67.1
<b>Yield</b>					
Yield per RPK (RMB)	0.54	0.61	0.61	0.60	0.55
Yield per cargo and mail ton kilometers (RMB)	1.63	1.96	1.87	1.89	1.75
Yield per RTK (RMB)	5.26	5.86	5.75	5.57	5.13
<b>Fleet</b>					
— Boeing	194	179	177	159	140
— Airbus	157	133	119	103	71
— McDonnell Douglas	16	25	25	36	36
— Others	11	11	11	11	14
Total aircraft in service at period end	378	348	332	309	261
Overall utilization rate (hours per day)	9.4	9.1	9.4	9.5	9.6
<b>Cost</b>					
Operating cost per ATK (RMB)	3.58	4.33	3.73	3.63	3.44

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.

Period	Period End	Average (1) (RMB per US\$)	High	Low
<b>Annual Exchange Rate</b>				
2005	8.0694	8.1825	8.2767	8.0702

2006	7.8041	7.9723	8.0702	7.8041
2007	7.2946	7.6058	7.8127	7.2946
2008	6.8225	6.9477	7.2946	6.7800
2009	6.8259	6.8307	6.8470	6.8176

(1) Determined by averaging the rates on the last business day of each month during the relevant period.

The following table sets out the range of high and low exchange rates, based on the Noon Buying Rate, between Renminbi and U.S. dollars, for the following periods.

Period	High	Low
Monthly Exchange Rate		
November 2009	6.8300	6.8255
December 2009	6.8299	6.8299
January 2010	6.8295	6.8258
February 2010	6.8330	6.8258
March 2010	6.8270	6.8254
April 2010	6.8275	6.8229
May 2010 (up to May 7, 2010 the latest practicable date)	6.8265	6.8245

#### Dividend Payments

No interim dividends were paid during the year ended December 31, 2009. The Board of Directors of the Company did not recommend the payment of a final dividend in respect of the year ended December 31, 2009.

#### Capitalization and Indebtedness

Not applicable.

#### Reasons for the Offer and Use of Proceeds

Not applicable.

#### Risk Factors

##### Risks Relating to the Company

The Company is indirectly majority owned by the Chinese government, which may exert influence in a manner that may conflict with the interests of holders of ADRs, H Shares and A Shares.

Major Chinese airlines are wholly- or majority-owned either by the Chinese government or by provincial or municipal governments in China. CSAHC, an entity wholly-owned by the Chinese government, holds and exercises the rights of ownership of 59.32% of the equity of the Company. On August 21, 2009, the Company completed its capital injection from CSAHC directly, and indirectly through CSAHC's wholly-owned subsidiary, Nan Lung, in an aggregate amount of approximately RMB3 billion. On March 8, 2010, the Company entered into the A shares subscription agreement with CSAHC, pursuant to which CSAHC has conditionally agreed to subscribe and the Company has 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, the Company and Nan Lung, a wholly owned subsidiary of CSAHC entered into the H shares subscription agreement, pursuant to which Nan Lung has conditionally agreed to subscribe and the Company has 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. Upon completion of the foregoing subscriptions, CSAHC's direct and indirect ownership in the Company will be approximately 51.50% of the issued share capital of the Company. The interests of the Chinese government in the Company and in other Chinese airlines may conflict with the interests of the holders of the ADRs, H Shares and A Shares. The public policy considerations of the Chinese government in regulating the Chinese commercial aviation industry may also conflict with its indirect ownership interest in the Company. In addition, the Company may accept further capital injection from CSAHC through non-public subscriptions, which may have dilutive impact for other holders of ADRs, H Shares and A Shares.

Due to high degree of operating leverage and high fixed costs, a decrease in revenues of the Group could result in a proportionately higher decrease in its net income. The results of the Group's 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 revenues could result in a proportionately higher decrease in net income. Moreover, as the Group has substantial obligations denominated in foreign currencies, its results of operations are significantly affected by fluctuations in foreign exchange rates, particularly for the U.S. dollar. Net exchange gain decreased by RMB2,499 million, from RMB2,592 million in 2008 to RMB93 million in 2009 because the exchange rate of RMB against USD was relatively stable in 2009 while RMB appreciated significantly against USD in 2008.

The Group has significant committed capital expenditures in the next three years, but may face challenges and difficulties as it seeks to maintain liquidity.

As of December 31, 2009, the Group's current liabilities exceeded its current assets by RMB28,441 million. The Group generally maintains sound operating cash flow. However, both current ratio and quick ratio are below average, which have negatively impacted, or may in the future negatively impact our liquidity. In addition, the Group has significant committed capital expenditures in the next three years, due to aircraft acquisitions. In 2010 and thereafter, the liquidity of the Group is primarily dependent on its ability to maintain adequate cash inflow from operations to meet its debt obligations as they fall due, and its ability to obtain adequate external financing to meet its committed future capital expenditures. However, the Group may not be able to meet its debt obligations as they fall due and commit future capital expenditures if certain assumptions about the operations and the availability of external financing on acceptable terms are inaccurate. In particular, our ability to access adequate external funding may be impacted by the economic stagnation globally.

As at December 31, 2009, the Group had banking facilities with several PRC commercial banks for providing loan finance up to approximately RMB128,175 million, of which approximately RMB50,455 million was utilized. The directors of the Company believe that sufficient financing will be available to the Group. However there can be no assurance that such loan financing will be available on terms acceptable to the Group.

CSAHC will continue to be the controlling shareholder of the Company, whose interests may conflict with those of the Group. CSAHC and certain of its associates will continue to provide certain important services to the Group. Any disruption of the provision of services by CSAHC or its associates could affect the Group's operations and financial conditions.

CSAHC will continue to be the controlling shareholder of the Company. CSAHC and certain of its associates will continue to provide certain important services to the Group, including the import and export of aircraft spare parts and other flight equipment, advertising services, provision of air catering, air ticket selling services, cleaning services, property management services, leasing of properties and financial services. The interests of CSAHC may conflict with those of the Group. In addition, any disruption of the provision of services by CSAHC's associates or a default by CSAHC of its obligations owed to the Group could affect the Group's operations and financial conditions. In particular, as part of its cash management system, the Group periodically places significant amount of demand deposits with SA Finance, a PRC authorized financial institution controlled by CSAHC and an associate of the Company. The Group has taken certain measures to monitor the fund flows between itself and SA Finance and the placement of funds by SA Finance. Such monitoring measures may help to enhance the safety of the Group's deposits with SA Finance. In addition, the Company has received a letter of undertakings from CSAHC dated March 31, 2009, in which, among other things, CSAHC warranted that the Group's deposits and loans with SA Finance were definitely 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 the risks associated with the business of SA Finance over which the Group does not exercise control. As of December 31, 2008 and 2009, the Group had deposits of RMB1,139 million and RMB862 million, respectively, with SA Finance.

Certain transactions between the Company and CSAHC or its associates (as defined in the Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong Limited (the "Hong Kong Listing Rules")) will constitute connected transactions of the Company under the Hong Kong Listing Rules and, unless exemptions are applicable or waivers are granted, will be subject to disclosure requirements and/or independent shareholders' approval in a general meeting.

Both international and domestic economic fluctuations and Chinese government's macroeconomic controls affect the demand for air travel, which will in turn cause volatility to the Group's business and results of our operations.

The US subprime crisis meltdown is an ongoing economic problem manifesting itself through liquidity issues in the global banking system owing to foreclosures which accelerated in the United States in late 2006 and has an adverse impact on global economy in 2007 and 2008. The deepening global recession has continued into 2009. The aviation industry as a whole is experiencing significantly weaker demand for air travel driven by the severe downturn. The financial crisis and other global events may reduce consumer spending or cause shifts in spending. A general reduction or shift in discretionary spending can result in decreased demand for leisure and business travel and can also impact the Group's ability to raise fares to counteract increased fuel and labour costs. No assurance can be given that capacity reductions or other steps we may take will be adequate to offset the effects of reduced demand.

The global economic slowdown has also negatively affected the growth rate of the Chinese economy. Chinese macroeconomic controls, taken to counteract such slowdown, such as financing adjustments, credit adjustments, price controls and exchange rate policies, would present unexpected changes to the aviation industry. As a result, the changing economic situation and Chinese macroeconomic controls may cause volatility to the Group's business and

results of our operations.

In summary, both international and domestic economic fluctuations and Chinese macroeconomic controls affect the demand for air travel. Additionally, increasingly strict security measures make air travel a hassle in the eyes of some consumers. These factors can have an uncertain impact on the development of the aviation industry.

The Group could be adversely affected by an outbreak of a disease or large scale natural disasters that affect travel behaviour.

The outbreak of the A/H1-N swine flu in March 2009 has had an adverse impact on the aviation industry globally (including the Group). The spread of the swine flu has been adversely affecting the Group's international routes operations. If the swine flu spreads more widely, it could also affect the Group's regional and domestic routes operations, and result in significant impact on our business operations. If there were another outbreak of a disease that affects travel behaviour in the future, it could have a material adverse impact on us.

In 2010, a number of large-scale natural disasters occurred globally, such as earthquakes in Haiti, Mexico and Qinghai province of China, and the volcanic eruption in Iceland in April 2010. Disasters such as these can affect the airline industry and the Group by reducing revenues and impacting travel behavior.

Lack of adequate documentation for land use rights and ownership of buildings subjects the Company to challenges and claims by third parties with respect to the Company's use of such land and buildings.

Although systems for registration and transfer of land use rights and related real property interests in China have been implemented, such systems do not yet comprehensively account for all land and related property interests. The land in Guangzhou on which the Company's headquarters and other facilities are located and the buildings that the Company uses at its route bases in Wuhan, Haikou and Zhengzhou are leased by the Company from CSAHC. However, CSAHC lacks adequate documentation evidencing CSAHC's rights to such land and buildings, and, as a consequence, the lease agreements between CSAHC and the Company 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 subjects the Company to challenges and claims by third parties with respect to the Company's use of such land and buildings.

The Company has been occupying all of the land and buildings described above without challenge or claim by third parties. CSAHC has received written assurance from the CAAC to the effect that CSAHC is entitled to continued use and occupancy of the land and certain related buildings and facilities. However, such assurance does not constitute formal evidence of CSAHC's right to occupy such lands, buildings and facilities or the right to transfer, mortgage or lease such real property interests. The Company cannot predict the magnitude of the adverse effect on its operations if its use of any one or more of these parcels of land or buildings were successfully challenged. CSAHC has agreed to indemnify the Company against any loss or damage caused by or arising from any challenge of, or interference with, the Company's right to use certain land and buildings.

Given the preliminary stage of direct flights arrangement between Taiwan and Mainland China, no assurance can be given that the Group will generate significant yields from such new route. In addition, any discontinuity or disruption in such arrangement may negatively affect the Group's results.

Further to temporary lifts of the ban on direct flights between Taiwan and Mainland China during certain festivals, as of July 4, 2008, the ban has been further liberalized to allow direct charter flights on weekends. Previously, travellers between Taiwan and China have had to make use of intermediate stops in Hong Kong or elsewhere. The Company became the first Chinese carrier to fly non-stop from Mainland China to Taiwan. 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. As a result, the permitted direct flights may benefit the Group by shortening flights time, cutting fuel costs and reducing flight fares between Taiwan and Mainland China. However, given the preliminary stage of such direct flights arrangement, no assurance can be given that the Group will generate significant yields from the new route. In addition, the results of the Group's operations will be negatively impacted by any discontinuity or disruption in the direct flight arrangement, which in turn will be subject to a number of factors beyond our control.

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

The aviation industry as a whole has been beset with high-profile terrorist attacks, most notably on September 11, 2001 in the United States. The issue could also affect China. Notably, on March 7, 2008, on a China Southern Airlines flight boarding in Urumqi, crew members discovered a suspected terrorist. Thereafter, the CAAC implemented



increased security measures. Additional terrorist attacks, even if not made directly on the airline industry, or the fear of or the precautions taken in anticipation of such attacks (including elevated threat warnings or selective cancellation or redirection of flights) could materially and adversely affect the Company and the airline industry. Among possible effects that the Company could experience from terrorist attacks are substantial flight disruption costs caused by grounding of fleet, significant increase of security costs and associated passenger inconvenience, increased insurance costs, substantially higher ticket refunds and significantly decreased traffic and revenue per revenue passenger kilometer.

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

The Group is increasingly dependent on technology to operate its business. In particular, to enhance its management of flight operations, the Group's computerized flight operations control system (SOC) began operation in May 1999. The system utilizes advanced computer and telecommunications technology to manage the Group's flights on a centralized, real-time basis. The Group believes that the system will assist it to enhance the efficiency of flight schedule, increase the utilization of aircraft and improve the coordination of the Group's aircraft maintenance and ground servicing functions. However, the computer and communications systems on which we rely could be disrupted due to various events, some of which are beyond our control, including natural disasters, power failures, terrorist attacks, equipment failures, software failures and computer viruses and hackers. The Group has taken certain steps to help reduce the risk of some of these potential disruptions. There can be no assurance, however, that the measures we have taken are adequate to prevent or remedy disruptions or failures of these systems. Any substantial or repeated failure of these systems could impact our operations and customer services, result in the loss of important data, loss of revenues, and increased costs, and generally harm our business. Moreover, a failure of certain of our vital systems could limit our ability to operate our flights for an extended period of time, which would have a material adverse impact on our operations and our business.

The Company's 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 ADRs, 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 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, the Company's independent registered public accounting firm is required to report on the effectiveness of the Company's internal control over financial reporting. Our independent registered public accounting firm may not be satisfied with our internal controls, the level of which our controls are documented, designed, operated and reviewed, or our independent registered public accounting firm may interpret the requirements, rules and regulations differently from us, then it may conclude that our internal control over financial reporting are not effective. Although our management concluded that our internal control over financial reporting as of December 31, 2009 was effective, we may discover other 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, in accordance with the Sarbanes-Oxley Act. 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 ADRs, H Shares or A Shares.

The Company 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 value of our shares and ADRs and the nature of our assets and income over time, 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. The Company believes that it was not a PFIC for the taxable year 2009. However, there can be no assurance that the Company will not be a PFIC for the taxable year 2010 and/or later taxable years, as PFIC status is re-tested each year and depends on the facts in such year.

The Company will be classified as a PFIC in any taxable year if either: (1) the average percentage value of its gross assets during the taxable year that produce passive income or are held for the production of passive income is at least 50% of the value of its total gross assets (the "Asset Test") or (2) 75% or more of its 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 held for the production of passive income and (2) the average value of the Company's gross assets is calculated based on its market capitalization.

If the Company were a PFIC, you would generally be subject to additional taxes and interest charges on certain "excess" distributions the Company makes regardless of whether the Company continues to be a PFIC in the year in which you receive an "excess" distribution or dispose of or are deemed to dispose of your ADRs. An excess distribution would be either (1) a distribution with respect to ADRs that is greater than 125% of the average of such distributions over the preceding three years, or (2) 100% of the gain from the disposition of shares/ADRs. 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".

Risks Relating to the Chinese Commercial Aviation Industry

The Group's business is subject to extensive government regulations, and there can be no assurance as to the equal treatment of all airlines under those regulations.

The Group's ability to implement its business strategy will continue to be affected by regulations and policies issued or implemented by the CAAC, which encompasses substantially all aspects of the Chinese commercial aviation industry, including the approval of domestic, regional and international route allocation, air fares, aircraft acquisition, jet fuel prices and standards for aircraft maintenance, airport operations and air traffic control. Such regulations and policies limit the flexibility of the Group to respond to market conditions, competition or changes in the Group's cost structure. The implementation of specific CAAC policies could from time to time adversely affect the Group's operations. The CAAC has confirmed in writing that the Company will be treated equally with other Chinese airlines with respect to certain matters regulated by the CAAC. Nevertheless, there can be no assurance that the CAAC will, in all circumstances, apply its regulations and policies in a manner that results in equal treatment of all airlines.

The Group's results may be negatively impacted by the fluctuation in domestic prices for jet fuel, and we would be adversely affected by disruptions in the supply of fuel.

The availability and cost of jet fuel have a significant impact on the Group's results of operations. The Group's jet fuel cost for 2009 accounted for 55.95% of its flight operations expenses. All of the domestic jet fuel requirements of Chinese airlines (other than at the Shenzhen, Zhuhai, Sanya, Haikou, Shanghai Pudong and other small airports) must be purchased from the exclusive providers, CAOSC and Bluesky Oil Supplies Company, companies controlled and supervised by the CAAC. Chinese airlines may also purchase their jet fuel requirements at the Shenzhen, Zhuhai, Sanya, Haikou, Shanghai Pudong and other small airports from joint ventures in which the CAOSC is a partner. Jet fuel obtained from the CAOSC's regional branches is purchased at uniform prices throughout China that are determined and adjusted by the 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.

Given the constant fluctuation in global oil prices, there is no way to assure that domestic prices for jet fuel do not fluctuate as well. For example, prior to 1994, domestic jet fuel prices were generally below international jet fuel prices. From 1994 to 2006, however, CAOSC's domestic jet fuel prices were above international jet fuel prices, sometimes creating tensions over the fuel supply. In 2007 through the first half of 2008, the crude oil price in the international market reached its historic high level. In response to the pressure imposed by such rocketing price, NDRC increased the domestic price for jet fuel on November 1, 2007 and June 20, 2008, respectively. The increased fuel costs have significantly limited the Group's ability to generate operating profit. In the second half of 2008, the crude oil price in the international market began to decrease continuously. In order to cushion fuel cost pressure faced by Chinese airlines, on December 19, 2008 and January 1, 2009, respectively, NDRC approved reductions in domestic prices for jet fuel. Starting from February 2009, the crude oil price in the international market started to pick up gradually. As a result, NDRC increased the domestic price for jet fuel in July 2009 and made several subsequent adjustments thereafter. (see "Item 4, "Information on the Company - Business Overview - "Jet Fuel" section below for further discussion.)

In summary, given the constant fluctuation of volatile fuel price, no assurance can be given that the Group's results will not be negatively impacted by the fluctuation in domestic prices for jet fuel.

In addition, jet fuel shortages have occurred in China and, on some rare occasions prior to 1993, required the Group to delay or even cancel flights. Although such shortages have not materially affected the Group's operations since 1993, there can be no assurance that such a shortage will not occur in the future. If such a shortage occurs in the future and the Group is forced to delay or cancel flights due to fuel shortage, its operational reputation among passengers as well as its operations may suffer.

In 2009, a reasonable possible increase or decrease of 10% in jet fuel price affects the Group's annual fuel costs by approximately RMB1,639 million, assuming no change in volume of fuel consumed. Accordingly, even if the jet fuel supply remains uninterrupted, increases in jet fuel prices will nevertheless adversely impact our financial results.

The Group's net income may suffer from an 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 demand as well as the Group's ability to generate net incomes. On January 14, 2009, the NDRC and the CAAC jointly announced the suspension of the collection of passenger fuel surcharge for domestic routes since January 15, 2009. In response to the pick up of international fuel prices, the NDRC and CAAC issued a notice to introduce a new pricing mechanism of fuel surcharge that links it with airlines' jet fuel costs on November 11, 2009. According to the new

mechanism, when the purchase cost of jet fuel is lower than RMB 4,140 per ton (i.e., the benchmark price of jet fuel), airlines should not charge fuel surcharge. When the purchase cost of jet fuel exceeds RMB 4,140 per ton, the airlines may charge appropriate fuel surcharge provided that such airlines should digest at least 20 percent of the rising cost. As such, following a suspension period of more than one year, in November, 2009, the Group resumed the imposing of fuel surcharges for the domestic routes. However, the Group's net income may suffer from an unexpected change in the fuel surcharge collection policy and a number of factors beyond our control.

The Group's results of operations tend to be volatile and fluctuate due to seasonality.

The Group's 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 the Group's 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, the Group's airline revenue is generally higher in the second and third quarters than in the first and fourth quarters. As a result, the Group's results tend to be volatile and subject to rapid and unexpected change.

The Group's 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 the Group, 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 has placed increasing emphasis on the safety of Chinese airline operations and has implemented measures aimed at improving the safety record of the industry. The ability of the Group 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 and navigation systems and ground control operations at Chinese airports, factors which are beyond the control of the Group.

The Group faces increasingly intense competition both in domestic aviation industry and in the international market, as well as from alternative means of transportation.

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 and an increase in the capacity, routes and flights of Chinese airlines. Competition in the Chinese commercial aviation industry has led to widespread price-cutting practices that do not in all respects comply with applicable regulations. Until the interpretation of CAAC regulations limiting such price-cutting has been finalized and strictly enforced, discounted tickets from competitors will continue to have an adverse effect on the Group's sales.

The Group faces varying degrees of competition on its regional routes from certain Chinese airlines and Cathay Pacific Airways, Dragonair and Air Macau, and on its 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 the Group. In addition, the public's perception of the safety and service records of Chinese airlines could adversely affect the Group's ability to compete against its regional and international competitors. Many of the Group's international competitors have larger sales networks and participate in reservation systems that are more comprehensive and convenient than those of the Group, or engage in promotional activities, that 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 train, the construction of nationwide high-speed railway network and the improvement of inter-city expressway network, the commercial aviation sector as a whole faces increasing competition from the alternative means of transportation such as railways and highways. In particular, the so-called "Four Longitudinal and Four Horizontal" high-speed railways under construction may have a huge negative impact on the domestic commercial aviation sector once it goes into operation. Since the Group has the most extensive domestic route network and the largest number of flights in China, the Group may be affected by the increasing popularity of high-speed trains to certain extent. For example, 38 lines of the "Four Longitudinal and Four Horizontal" overlap with current flights of the Group, 21 of which run for a distance of less than 4 hours. If the high-speed railways go into full operation, according to the statistic of the Group, 13 out of the total 18 airline subsidiaries and branches of the Group involving 798 flights (i.e. to and fro flights/week) may be seriously impacted.

Due to limitation on foreign ownership imposed by Chinese government policies, the Company may have no meaningful access to the international equity capital markets.

Chinese government policies limit foreign ownership in Chinese airlines. Under these policies, the percentage ownership of the Company's total outstanding ordinary shares held by investors in Hong Kong and any country outside China ("Foreign Investors") may not in the aggregate exceed 49%. Currently, we estimate that 31.02% of the total outstanding ordinary shares of the Company are held by Foreign Investors. For so long as the limitation on foreign ownership is in force, the Company will have no meaningful access to the international equity capital markets.

#### Risks Relating to the PRC

The Group has significant exposure to foreign currency risk as majority of the Group's lease obligations and bank and other loans are denominated in foreign currencies. Due to rigid foreign exchange control by Chinese government, the Group may face difficulties in obtaining sufficient foreign exchange to pay dividends or satisfy our foreign exchange liabilities.

Under current Chinese foreign exchange regulations, 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 centre.

The Group has significant exposure to foreign currency risk as substantially all of the Group's obligations under leases and bank and other loans are denominated in foreign currencies, principally US dollars. Depreciation or appreciation of the Renminbi against foreign currencies affects the Group's results significantly because the Group's foreign currency payments generally exceed its foreign currency receipts. The Group is not able to hedge its foreign currency exposure effectively other than by retaining its foreign currency denominated earnings and receipts to the extent permitted by SAFE, or subject to certain restrictive conditions, entering into foreign exchange forward option contracts with authorized banks. However, SAFE may limit or eliminate the Group's 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 the Group will be able to obtain sufficient foreign exchange to pay dividends or satisfy our foreign exchange liabilities.

The Group also has exposure to foreign currency risk in respect of net cash inflow denominated in Japanese Yen from ticket sales in overseas branch office after payment of expenses. The Group entered into certain foreign exchange forward option contracts to manage this foreign currency risk. However, like other derivative products, there can be no assurance that such option contracts can provide, at any given time, particular level of protection against foreign exchange risks.

The Group's 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 the Group's operations.

The members of the Group 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 applicable in China (including with respect to the commercial aviation industry), their interpretation and enforcement involve significant uncertainties.

The PRC new tax law has deprived, or may in the future deprive the Company of preferential income tax rates, which the Company previously enjoyed.

On March 16, 2007, the Fifth Plenary Session of the Tenth National People's Congress passed the Corporate Income Tax Law of the PRC which took effect on January 1, 2008. As a result of the new tax law, the statutory income tax rate adopted by the Company and its subsidiaries has been changed from 33% to 25% with effect from January 1, 2008. Prior to enactment of the new tax law, the headquarters of the Company was taxed at a preferential rate of 18% and the branches and subsidiaries were taxed at rates ranging from 15% to 33%. Pursuant to the new tax law, the income tax rates of entities that previously enjoyed preferential tax rates of 15% and 18% have been revised to 18%, 20%, 22%, 24% and 25% for 2008, 2009, 2010, 2011 and 2012 onwards respectively.

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

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

For individuals, Chinese tax law generally provides that an individual who receives dividends from the Company is subject to a 20% income tax. A 50% reduction of income tax is granted by Chinese tax law for an individual receiving dividends from a listed company on Shanghai Stock Exchange or Shenzhen Stock Exchange. As a result, the effective tax rate for dividends received by A Share individual holder is 10%. Currently, dividend income received by any foreign individual that holds overseas shares in any Chinese domestic enterprise is temporarily exempt from income tax. In the event that the exemption is discontinued, such payments will be subject to individual income tax at the 20% rate unless the holder is entitled to a tax waiver or a lower tax rate under an applicable double-taxation treaty.

#### ITEM 4. INFORMATION ON THE COMPANY.

##### History and Development of the Company

The Company is a joint stock company incorporated in China on March 25, 1995, and is 59.32% owned by CSAHC. The registered address of the Company is Guangzhou Economic & Technology Development Zone, People's Republic



of China (telephone no: (86)20-8612-4462, website: www.csair.com).

On March 13, 2003, the Company obtained an approval certificate from the Ministry of Commerce to change to a permanent limited company with foreign investments and on October 17, 2003 obtained a business license for its 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.

Pursuant to an extraordinary general meeting of shareholders held on May 21, 2002, a resolution was passed authorizing the Company to issue not more than 1,000,000,000 A Shares of par value of RMB1.00 each. The Company issued and listed its 1,000,000,000 A Shares with a par value of RMB1.00 each on the Shanghai Stock Exchange in July 2003.

Pursuant to a sale and purchase agreement dated November 12, 2004 between the Company, CSAHC, China Northern Airlines Company ("CNA") and Xinjiang Airlines Company ("XJA") which was approved by the Company's shareholders in an extraordinary general meeting held on December 31, 2004, the Company 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 April 30, 2006, the Company acquired certain assets of CSAHC Hainan Co., Limited, a wholly owned subsidiary of CSAHC, at a total consideration of RMB294 million.

On June 16, 2007, the Company together with an independent third party established Chongqing Airlines Company Limited (“Chongqing Airlines”), a non-wholly owned subsidiary of the Company. Up to December 31, 2009, the Company has transferred four aircraft to Chongqing Airlines as capital contribution.

On August 14, 2007, the Company signed an agreement to acquire a 51% equity interest of Nan Lung International Freight Company Limited beneficially owned by and registered in the name of Nan Lung Travel & Express (Hong Kong) Limited which is a wholly owned subsidiary of CSAHC and a 100% equity interest in Southern Airlines (Group) Catering Co., Limited, a wholly owned subsidiary of CSAHC for a total consideration of RMB112 million.

On August 14, 2007, the Company signed an agreement to dispose of its 90% equity interest in Guangzhou Aviation Hotel Company Limited to CSAHC at a consideration of RMB75 million.

In August 2008, the Company entered into an agreement with China Post Group to dispose of all of its 49% equity interest in China Postal Cargo Airlines Limited, its jointly controlled entity which China Post Group is the other venturer, at a consideration of RMB210 million and recorded a gain on disposal of RMB143 million.

In December 2008, the Company acquired a 26% equity interest in the China Southern West Australian Flying College Pty Ltd. (the “Australian Pilot College”), a subsidiary of the Company, from CSAHC, and Australian Pilot College became a 91% owned subsidiary of the Company.

In June 2009, the Company acquired 50% equity interest in a jointly controlled entity of the Company, Beijing Southern Airlines Ground Services Company Limited (“Beijing Ground Service”) from the other venturer, which has become a wholly-owned subsidiary of the Company since then.

On September 28, 2009, the Company entered into an agreement with CSAHC to dispose of its 50% equity interest in MTU Maintenance Zhuhai Co., Ltd (“MTU”), a jointly controlled entity of the Company, to CSAHC at a consideration of RMB1,607,850,000. The transfer was completed in February 2010.

#### Aircraft Acquisitions

Pursuant to the Xiamen Aircraft Acquisition Agreement dated April 18, 2008 between Xiamen Airlines Company Limited (“Xiamen Airlines”) and Boeing, Xiamen Airlines will acquire 20 Boeing B737 series aircraft from Boeing. According to the information provided by Boeing, the aggregate catalogue price for those aircraft is around US\$1,500 million, including price for airframe and engines. The aggregate consideration for the acquisition will be partly payable in cash by Xiamen Airlines, and partly through financing arrangements with banking institutions. The Boeing aircraft will be delivered in stages to Xiamen Airlines during the period commencing from April 2014 to October 2015.

Pursuant to the Aircraft General Terms Agreement dated January 20, 2010 between the Company and the Airbus S.A.S. and A320 Family Aircraft Purchase Agreement dated January 20, 2010 between the Company and Airbus SNC, the Company 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 is around US\$77 million including price for airframe and engine. The aggregate consideration for the acquisition will be partly payable in cash and partly through financing arrangements with banking institutions. The Airbus aircraft will be delivered in stages to the Company from 2011 to 2013.

#### Capital Expenditure

The Group had RMB17,178 million, RMB8,645 million and RMB 9,832 million capital expenditures in 2009, 2008 and 2007, respectively. Of such capital expenditures in 2009, RMB 2,171 million was financed by capital leases, RMB7,293 million was financed by bank borrowings while the remaining RMB7,714 million was financed by internal resources. The capital expenditures were primarily incurred on the additional investments in aircraft and flight equipment under the Group's fleet expansion plans and, to a small extent, additional investments in other facilities and buildings for operations.

## Business Overview

### General

The Group provides commercial airline services throughout China, Hong Kong, Macau and Taiwan regions, Southeast Asia and other parts of the world. Based on the statistics from the CAAC, the Group is one of the largest Chinese airlines and, as of year end of 2009, ranked 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, 2009, the Group's RPKs increased at a compound annual growth rate of 6.7% from 81,727 million in 2007 to 83,184 million in 2008, and to 93,002 million in 2009, while its capacity, measured in terms of ASKs, increased at a compound annual growth rate of 6.1%, from 109,733 million in 2007 to 112,767 million in 2008, and to 123,441 million in 2009. In 2009, the Group carried 66.28 million passengers and had passenger revenue of RMB50,059 million (US\$7,331 million).

The Group conducts a portion of its airline operations through its airline subsidiaries namely Xiamen Airlines, Southern Airlines Shantou Airlines Company Limited (“Shantou Airlines”), Zhuhai Airlines Company Limited (“Zhuhai Airlines”), Guizhou Airlines Company Limited (“Guizhou Airlines”) and Chongqing Airlines Company Limited (“Chongqing Airlines”) (collectively, the “Airline Subsidiaries”). In 2009, the Airline Subsidiaries carried 16.87 million passengers and had passenger revenue of RMB11,314 million (US\$1,657 million) and accounted for 25% and 23% of the Group’s passengers carried and passenger revenue, respectively.

The Group also provides air cargo and mail services. The cargo and mail revenue of the Group decreased by 16.9% to RMB2,908 million (US\$426 million) in 2009 as compared with that of 2008. The Group’s airline operations are fully integrated with its airline-related businesses, including aircraft and engine maintenance, flight simulation and air catering operations.

As of the year end of 2009, the Group operated 655 routes, of which 528 were domestic, 99 were international and 38 were regional. The Group operates the most extensive domestic route network among all Chinese airlines. Its route network covers commercial centers and rapidly developing economic regions in Mainland China.

The Group’s 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 Shantou and etc.

In December 2005, the Company established a branch company in Beijing and has added wide-body airplanes to its operation base in Beijing, with the view to expanding its Beijing aviation business and building another main hub there in addition to its Guangzhou base. The establishment of Guangzhou and Beijing hubs will facilitate strategic refinement and enhancement of its route network operations, putting the Company in a better position to explore and seize the opportunities in the aviation market.

The Group’s operations primarily focus on the domestic market. In addition, the Group also operates regional routes and international flights. As of the year end of 2009, the Group had 38 regional routes and 99 international routes. The Group’s regional operations include flights between destinations in China and Hong Kong, Macau and Taiwan. The Group’s international operations include scheduled services to the cities in Australia, Bangladesh, France, India, Japan, Kazakhstan, Korea, Kyrgyzstan, Maldives, Nepal, Netherlands, Nigeria, Pakistan, Russia, Saudi Arabia, Tajikistan, UAE, USA and Southeast Asian destinations.

After joining Skyteam Alliance, the Group has established a network reaching 905 destinations globally, connecting 169 countries of regions and covering major cities around the world.

As of December 31, 2009, the Group had a fleet of 378 aircraft, consisting primarily of Boeing 737 series, 747, 757, 777, Airbus 320 series, 300, 330 and McDonnell Douglas 82 and 90. The average age of the Group’s registered aircraft was 6.32 years as of the year end of 2009.

#### 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, CSAHC 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 six regional bureaus of the CAAC. CSAHC was one of the 55 large-scale enterprises designated by the Chinese government to play a leading role in their respective industries.

CSAHC was restructured in 1994 and 1995 in anticipation of the initial public offering of the Company. The restructuring was effect through the establishment of the Company and the execution of the De-merger Agreement on March 25, 1995 by and between CSAHC and the Company. Upon the restructuring, the Company assumed substantially the entire airline and airline-related businesses, assets and liabilities of CSAHC, and CSAHC retained its non-airline-related businesses, assets and liabilities. All interests, rights, duties and obligations of CSAHC, whenever created or accrued, were divided between the Company and CSAHC based on the businesses, assets and liabilities assumed by each of them under the De-merger Agreement. Under the De-merger Agreement, CSAHC agreed not to conduct or 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 the Group, although CSAHC may continue to hold and control its associates existing on the date of the De-merger Agreement and may continue to operate the businesses of such associates. Under the De-merger Agreement, CSAHC and the Company also agreed to indemnify each other against any and all 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 CSAHC or the Company.

In July 1997, the Company 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 listing of the H Shares on the Stock Exchange of Hong Kong Limited (the “Hong Kong Stock Exchange”) and ADRs on the New York Stock Exchange. Prior to the private placement and the initial public offering, all of the issued and outstanding shares of capital stock of the Company, consisting of 2,200,000,000 non-tradable Domestic Shares, par value RMB1.00 per share, were owned by CSAHC, 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, CSAHC maintained its ownership of the 2,200,000,000 Domestic Shares (representing approximately 65.2% of the total share capital of the Company), and were entitled to elect all the directors of the Company and to control the management and policies of the Group. Domestic Shares and H Shares are both ordinary shares of the Company.

In July 2003, the Company issued 1,000,000,000 A Shares with a par value of RMB1.00 each and listed these shares on the Shanghai Stock Exchange. Subsequent to the A Share issue, the shareholding of CSAHC in the Company was reduced from 65.2% to 50.30%.

#### Share Reform Scheme

Pursuant to relevant PRC laws, the Company launched the share reform scheme in May 2007, whereby all the 2,200,000,000 non-tradable Domestic Shares held by CSAHC shall 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 that CSAHC 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 Issue by Conversion of Share Premium

On June 25, 2008, the shareholders of the Company approved a bonus share issue by way of conversion of share premium, and on August 14, 2008, the Ministry of Commerce approved the bonus share issue. The issue has been effected by conversion of share premium on the basis of 5 new shares, credited as fully paid, for every 10 existing shares. Upon the completion of the bonus share issue, which is based on 4,374,178,000 shares in issue as at December 31, 2007, the number of paid up shares has increased by 2,187,089,000 shares to 6,561,267,000 shares.

#### Non-Public Subscriptions

On December 10, 2008, the Company entered into an A Shares subscription agreement with CSAHC, pursuant to which CSAHC has conditionally agreed to subscribe and the Company has 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, the Company and Nan Lung (a wholly-owned subsidiary of CSAHC) entered into a H Shares subscription agreement, pursuant to which Nan Lung has conditionally agreed to subscribe and the Company has 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, the Company received the formal approval from CSRC for the proposed non-public issue of H Shares. On August 14, 2009, the Company received the formal approval from CSRC for the proposed non-public issue of A Shares. The issuance of 721,150,000 new A Shares to CSAHC 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, the board of the Company approved (i) the placement of not more than 1,766,780,000 new A shares to not more than 10 specific investors (subject to the maximum number as permitted by PRC laws and regulations at the time of the issuance) including CSAHC, at the same subscription price of not less than RMB5.66 per A share; and (ii) the placement of not more than 312,500,000 new H shares to Nan Lung, at the subscription price of not less than HKD2.73 per H share.

On the same date, the Company entered into the A shares subscription agreement with CSAHC, pursuant to which CSAHC conditionally agreed to subscribe and the 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, the Company and Nan Lung entered into the H shares subscription agreement, pursuant to which Nan Lung conditionally agreed to subscribe and the 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 HKD2.73 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 and are pending approval from the relevant security regulatory authorities.

#### Issuance of Short-term Financing Bills and Medium Term Notes

On April 18, 2008, the Company's Board approved the proposed issue of short-term financing bills in the principal amount of up to RMB4 billion in the PRC, and the submission of this proposal to the annual general meeting for the shareholders' approval. On June 25, 2008, shareholders of the Company approved such proposed bill issue at the annual general meeting for the year 2007. The Company believes that the bill issue will provide a further source of funding at an interest rate which is expected to be lower than that for loans from commercial banks, lower the financing cost of borrowings for the Company, and is in the interests of the Company and its shareholders as a whole. The Company has received the acceptance from National Association of Financial Market Institutional Investors to register the Company's short-term financing bills in the amount of RMB3.5 billion for a period up to September 10, 2010. The bills would be jointly underwritten by China CITIC Bank Cooperation Limited and Bank of China Limited. In October 2008, the Company issued short-term financing bills with total face value of RMB2 billion, bearing coupon interest rate at 4.7% with a maturity period of one year for funding of the business activities of the Company.

On May 28, 2008, the Board approved the proposed issue of medium term notes by the Company in the principal amount of up to RMB1.5 billion and the submission of such proposal to the shareholders for their consideration and approval. On June 25, 2008, shareholders of the Company approved such notes issue at the annual general meeting for the year 2007. The Company believes that the notes issue will provide a further source of medium to long term funding at an interest rate lower than the best lending rate for loans from commercial bank, lower the finance costs of borrowings for the Company and improve the debt structure of the Company.

## Traffic

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

Year	Passenger carried		Cargo and Mail Carried (tons)		Total traffic (tons kilometers)	
	Total (in million)	Increase (decrease) over previous year (%)	Total (in thousand)	Increase (decrease) over previous year (%)	Total (in million)	Increase (decrease) over previous year (%)
2007	56.90	15.6	872.0	6.5	9,250.0	14.6
2008	58.24	2.3	835.0	(4.2)	9,200.0	(0.5)
2009	66.28	13.8	862.0	3.2	10,067.0	9.4

## Route Network

### Overview

The Group operates the most extensive route network among the Chinese airlines. As of December 31, 2009, the Group operated 655 routes consisting of 528 domestic routes, 38 regional routes and 99 international routes.

The Group continually evaluates its network of domestic, regional and international routes in light of its operating profitability and efficiency. The Group seeks 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 the existence and the terms of 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 the Group's international route network, the Group has entered into code-sharing agreements with several international airlines, including Delta Airlines, Asiana Airlines, Korean Air, Japan Air System, Vietnam Airlines, Air France, KLM Royal Dutch Airlines, Garuda Indonesian, Malaysian Airline, KENYA AIRWAYS, Pakistan International Airlines, Aeroflot-Russian Airlines and CSA Czech Airlines. Under the code sharing agreements, the participating airlines are permitted to sell tickets on certain international routes operated by the Group to passengers using the Group's codes. Similarly, the Group is permitted to sell tickets for the other participating airlines using its "CZ" code. The code sharing agreements help increase the number of the Group's international sales outlets. After joining Skyteam Alliance, the Group has further established a network reaching 905 destinations globally, connecting 169 countries of regions and covering major cities around the world.

### Route Bases

In addition to its main route bases in Guangzhou and Beijing, the Group maintains certain regional route bases in Zhengzhou, Wuhan, Changsha, Shenzhen, Shenyang, Changchun, Dalian, Harbin, Urumqi, Haikou, Zhuhai, Xiamen, Shanghai, Xi'an, Fuzhou, Nanning, Guilin, Shantou, Guiyang, Chongqing and Sanya. Most of its regional route bases are located in provincial capitals or major commercial centers in the PRC.



The Group believes that its extensive network of route bases enable it to coordinate flights and deploy its aircraft more effectively and to provide more convenient connecting flight schedules and access service and maintenance facilities for its aircraft. The Group believes that the number and location of these route bases may enhance the Group's ability to obtain the CAAC's approval of requests by the 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

The Group's domestic routes network serves substantially all provinces and autonomous regions in China, including Guangdong, Fujian, Hubei, Hunan, Hainan, Guangxi, Guizhou, Henan, Heilongjiang, Jilin, Liaoning and Xinjiang, and serves all four centrally-administered municipalities in China, namely, Beijing, Shanghai, Tianjin, and Chongqing. In 2009, the Group's most profitable domestic routes were between: Guangzhou-Beijing, Beijing-Guangzhou, Shenzhen-Beijing, Fuzhou-Beijing, Beijing-Shenzhen, Shanghai-Guangzhou, Guangzhou-Shanghai, Xiamen-Beijing, Urumqi-Beijing, and Beijing-Urumqi.

## Regional Routes

The Group offers scheduled service between Hong Kong and Guangzhou, Shenyang, Wu Yi Shan, Zhang Jia Jie, Changchun, Yinchuan, Xiamen, Shantou, Beijing, Guilin, Meixian, Haikou, Wuhan, Zhengzhou, Nanning, Changsha, Sanya and Hohhot; between Macau and Hangzhou, Xiamen and Tianjin; between Taipei and Guangzhou, Shanghai, Fuzhou, Hangzhou, Xiamen, Shenyang, Changsha, Wuhan, Dalian, Guilin, Harbin, Guiyang, Zhengzhou and Shenzhen. In 2009, the most profitable scheduled regional routes were between: Taipei-Shanghai, Xiamen-Hong Kong, Shanghai-Taipei, Xiamen-Taipei, Taipei-Guangzhou, Fuzhou-Taipei, Guangzhou-Taipei, Hong Kong-Beijing, Changchun-Guangzhou-Hong Kong, and Hong Kong-Wuhan.

In 2009, the Group conducted a total of 12,227 flights on its regional routes, accounting for approximately 24.75% of all passengers carried by Chinese airlines on routes between Hong Kong, Macau or Taiwan and destinations in China according to CAAC statistics.

Previously, direct flights between Taiwan and Mainland China had only been available during certain festivals. And travelers between Taiwan and China have had to make use of intermediate stops in Hong Kong or elsewhere. Since July, 2008, however, the ban on direct flights has been further liberalized to allow direct charter flights on weekends. The Company became the first Chinese carrier to fly nonstop to Taiwan. 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 increased the number of regular cross-Strait direct passenger flights from 108 to 270 a week. The 108 direct passenger flights previously operating were all classed as charter flights. The new services comprise both regular charter and scheduled flights.

In order to further strengthen its presence in Taiwan, on June 23, 2008, the Company entered into a memorandum of cooperation with China Airlines, which is the largest carrier in Taiwan in terms of route network. Based on the memorandum, the scope of cooperation between the parties will cover passenger and cargo carrying, maintenance, and ground handling services.

## International Routes

The Group is the principal Chinese airline serving Southeast Asian destinations, including Singapore and major cities in Indonesia, Thailand, Malaysia, the Philippines, Vietnam, Myanmar and Cambodia.

In addition, the Group also provides scheduled services to the cities in Australia, Bangladesh, France, India, Japan, Kazakhstan, Maldives, Korea, Kyrgyzstan, Nepal, Netherlands, Nigeria, Pakistan, Russia, Saudi Arabia, Tajikistan, Turkmenistan, UAE and USA.

After joining Skyteam Alliance, the Group has established a network reaching 905 destinations globally, connecting 169 countries of regions and covering major cities around the world.

In 2009, the Group's most profitable international routes were: Tianjin-Xiamen-Singapore, Beijing-Guangzhou-Phnom Penh, Guangzhou-Beijing-Amsterdam, Guangzhou-Sydney, Guangzhou-Los Angeles, Phnom Penh-Guangzhou-Beijing, Singapore-Guangzhou-Shenyang, Guangzhou-Tokyo, Beijing-Guangzhou-Hanoi, Shenyang-Guangzhou-Singapore.

## Aircraft Fleet

The Group's fleet plan in recent years has emphasized expansion and modernization through the acquisition of new aircraft and the retirement of less efficient, older aircraft. As of December 31, 2009, the Group operated a fleet of 378

aircraft with an average age of 6.32 years. Most aircraft of the Group are Boeing and Airbus aircraft. The Group has the largest fleet among Chinese airline companies. Among all the aircraft, 203 aircraft operated by the Group are leased pursuant to various types of leasing arrangements.

The following table sets forth certain information regarding the Group's fleet of 378 aircraft as of December 31, 2009.

Model	Number of Aircraft	Average age (years)	Average Passenger Capacity
Boeing 777-200A	4	13.71	380
Boeing 777-200B	6	11.36	292
Boeing 757-200	27	10.76	200
Boeing 747F	2	7.53	n/a
Boeing 737-800	80	3.09	167/170
Boeing 737-700	46	5.32	126
Boeing 737-500	2	13.53	130
Boeing 737-300	25	15.35	145
Boeing 777F	2	0.08	n/a
Airbus 319-100	44	3.36	128
Airbus 300-600	5	15.19	272
Airbus 320-200	54	6.26	158
Airbus 321-200	40	3.10	185
Airbus 330-200	6	4.10	264
Airbus 330-300	8	1.57	292
McDonnell Douglas 82	3	17.89	144
McDonnell Douglas 90	13	12.02	157
Embraer 145 Jet	6	5.31	50
ATR-72	5	12.58	72/79
Total	378		

During 2009, the Group continued to expand and modernize its aircraft fleet. The Group's major aircraft transactions included:

In 2009, the Group took scheduled delivery of 36 aircraft during the year (eight A319-100 aircraft, six A320-200 aircraft, nine A321-200 aircraft, three B737-700 aircraft and ten B737-800 aircraft). The acquisition was financed by bank loans and the Group's own funds. In addition, the Group took schedule delivery of two B777F Freighters, which was financed by a capital lease agreement with a ten-year lease term.

In 2009, the Group exercised purchase options of seven leased aircraft (one B777-200B aircraft, five A320-200 aircraft and one MD90 aircraft) upon expiry of the respective lease terms.

In 2009, four B737-800, three A319-100 were acquired under operating lease; one B757-200 aircraft, three B737-500 aircraft and one A320-200 aircraft under operating lease were returned during 2009.

In 2009, two MD82 aircraft were modified as simulators for training purpose and were reclassified as other flying equipment.

In 2009, the Group disposed of seven MD82 aircraft and one A300-600 aircraft.

In January, 2010, the Company entered into Aircraft General Terms Agreement and A320 Family Aircraft Purchase Agreement, pursuant to which the Company agreed to purchase 20 Airbus A 320 series aircraft from Airbus SNC, scheduled for delivery from 2011 to 2013.

## Aircraft Financing Arrangements

### Overview

A significant portion of the Group's aircraft is acquired under long-term capital or operating leases or long-term mortgage loans with remaining terms to maturity ranging from one to eleven years. As of December 31, 2009, 55 of the Group's 378 aircraft were operated under capital leases, 148 were operated under operating leases, 60 were financed by long-term mortgage loans, while the remaining were acquired either with cash proceeds or acquired by exercising the purchase options upon expiry of the respective capital leases. The Group's planned acquisition of aircraft in the foreseeable future will generally be made through acquisition by bank loans and the Group's own funds, and pursuant to operating leases or capital leases. The Group's determination as to its acquisition strategy depends on the Group's evaluation at the time of its capacity requirements, anticipated deliveries of aircraft, the Group's capital structure and cash flow, prevailing interest rates and other general market conditions.

The following table sets forth, as of December 31, 2009, the number of aircraft operated by the Group pursuant to capital and operating leases and the remaining terms, expressed in years, of such leases.

Model	Capital Lease	Operating Lease	Average Remaining Lease Term
Boeing 777-200A and 777-200B	0	4	2.95
Boeing 757-200	0	8	1.21
Boeing 737-700	9	15	4.60
Boeing 737-800	12	40	6.25
Boeing 737-500	0	2	0.11
Boeing 737-300	0	4	2.36
Boeing 777F	2	0	9.92
Airbus 319-100	6	30	6.20
Airbus 320-200	15	15	6.23
Airbus 321-100	7	20	8.20
Airbus 330-200	4	2	7.90
Airbus 330-300	0	8	10.68
Total	55	148	

#### Capital leases

The majority of the capital leases in respect to aircraft and related equipment have terms of ten to twelve years expiring during the years 2011 to 2019. As of December 31, 2009, the Group's aggregate future minimum lease payments (including future finance charges) required under its capital leases were RMB15,812 million. The Group's capital leases typically cover a significant portion of the relevant aircraft's useful life and transfer the benefits and risks of ownership to the Group. Under its capital leases, the Group generally has an option to purchase the aircraft at or near the end of the lease term. As is customary in the case of capital leases, the Group's obligations are secured by the related aircraft, as well as other collateral.

#### Operating Leases

As of December 31, 2009, the Group's aggregate future minimum lease payments required under its operating leases were RMB30,366 million. As of the year end of 2009, the Group's operating leases had original terms generally ranging from six to fifteen years from the date of delivery of the relevant aircraft, and the remaining terms of these leases ranged from one to eleven years. Pursuant to the terms of the operating leases, the Group is 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 its operating leases, the Group has 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, the Group is responsible during the lease term for the maintenance, servicing, insurance, repair and overhaul of the aircraft.

For capital leases or operating leases, the Group is 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 RMB198 million, RMB142 million and RMB143 million during 2009, 2008 and 2007 respectively, have

been included as part of the lease charges.

In August 2008, Xiamen Airlines, a non wholly-owned subsidiary of the Company entered into an operating lease agreement with GE Commercial Aviation Services, and such agreement has been approved by the Board of the Company on August 18, 2008. Pursuant to the agreement, Xiamen Airlines plans to lease seven Boeing B737-800 aircraft by way of operating lease. The term of the lease is eight years from 2011 to 2019, with the price for the operating lease to be determined by the two parties with reference to the prevailing market price. The Board believes that the introduction of new aircraft under the operating lease is beneficial to the implementation of the Group's development strategy, will improve the Group's operating capacity to accommodate the continuous growth in demand for aviation services in the PRC, serve passengers with better services, and enhance the competitiveness of the Group.

### Aircraft Flight Equipment

The jet engines used in the Group's aircraft fleet are manufactured by General Electric Corporation, Rolls-Royce plc, United Technologies International, Inc., CFM International, Inc. and International Aviation Engines Corporation. The Group had 69 and 66 spare jet engines for its fleet as of the year end of 2009 and 2008, respectively. The Group determines its 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 the Group's aircraft are generally handled by Southern Airlines (Group) Import & Export Trading Corporation ("SAIETC"), a subsidiary of CSAHC acting as agent for the Group, in consideration of an agency fee. The Group arranges the ordering of aircraft, jet engines and other flight equipment for the Airline Subsidiaries and keeps an inventory of rotables and expendables for the Airline Subsidiaries.

### Aircraft Maintenance

A major part of the maintenance for the Group's fleet other than overhauls of jet engines is performed by GAMECO, a jointly controlled entity established by the Company, Hutchison Whampoa ("Hutchison") and South China International Aircraft Engineering Company Limited, consistent with the Group's 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 the Group's 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 having been certified as a repair station by both the CAAC and the Federal Aviation Administration. In March 1998, GAMECO received an approval certificate from the United Kingdom Civil Aviation Authority for the repair and maintenance of aircraft and aircraft engines.

The Group believes that GAMECO performs major maintenance checks on the Group's 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 70% of the Group's aircraft. Although rotables for the Group's aircraft are generally imported through SAIETC, a portion of expendables and other maintenance materials are directly imported by GAMECO. GAMECO also provides line maintenance services to 13 other Chinese airlines and 19 international airlines. GAMECO provides heavy maintenance services to 7 other Chinese airlines and 6 international airlines.

The Company and GAMECO had entered into an Aircraft Maintenance and Engineering Agreement for the provision of aircraft repair and maintenance services. On May 17, 1996, the Company and GAMECO entered into an agreement regarding the fee arrangement for the provision of such repair and maintenance services.

Overhauls of jet engines are performed by MTU, a jointly controlled entity of the Company and MTU Aero Engines GmbH, and also by overseas qualified service providers in Germany, Malaysia, Canada and England. On September 28, 2009, the Company entered into an agreement with CSAHC to dispose of its 50% equity interest in MTU to CSAHC at a consideration of RMB1,607,850,000. The transfer was completed in February 2010.

The amounts incurred by the Group for comprehensive maintenance services provided by GAMECO and MTU were RMB1,344 million, RMB1,129 million, and RMB1,047 million for the years ended December 31, 2009, 2008 and 2007, respectively.

### Safety

The Group endeavors to maintain strict compliance with all laws and regulations applicable to flight safety. In addition, the Group has 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 the Company implements safety-related training programs on an ongoing basis in all of the Group's operations to raise the safety awareness of all employees. As a result, overall flight safety has gradually improved. There were no serious incidents involving casualty or flight damage throughout the three years ended December 31, 2009. For minor "incidents" which include various events and conditions prescribed by the CAAC which do not involve serious personal injury or material damage to flight equipment, the Group has kept the number consistently below the standard prescribed by the CAAC. For example, the Company's "Accident Signs Per Ten Thousands Hours Ratio" was 0.089, 0.064 and 0.065 in 2009, 2008 and 2007, respectively. In comparison, CAAC's published maximum acceptable Accident Signs Per Ten Thousands Hours Ratio was 0.6, 0.6, 0.7 in 2009, 2008 and 2007, respectively. This ratio is defined as the occurrence of one incident for every 10,000 hours of flight time. In 2009, the Group strengthened its flight safety management as per the internal and external safety requirements. In 2008, the Group received the "Five-Star Flight Safety Award" from CAAC, making it the first in the aviation industry to receive such a great honor. By December 2009, the Company's continuous safe flight span totaled to 6.53 million hours.

#### Jet Fuel

Jet fuel costs typically represent a major component of an airline's operating expenses. The Group's jet fuel costs accounted for 29.6%, 37.4% and 34.6% of the Group's operating expenses for the years ended December 31, 2009, 2008 and 2007, respectively. Like all Chinese airlines, the Group is generally required by the Chinese government to purchase its jet fuel requirements from regional branches of CAOSC and Bluesky Oil Supplies Company, except at the Shenzhen, Zhuhai, Sanya, Haikou, Shanghai Pudong and other small airports 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. In 2007 through the first half of 2008, the crude oil prices in the international market reached historic highs. In response to the pressure imposed by such rocketing prices, on November 1, 2007 and June 20, 2008, respectively, NDRC increased the domestic price for jet fuel. Thereafter, in order to cushion fuel cost pressure faced by Chinese airlines, on December 19, 2008 and January 1, 2009, respectively, NDRC approved reductions in domestic prices for jet fuel. However, starting from February 2009, the crude oil price in the international market started to pick up gradually. As a result, NDRC increased the domestic price for jet fuel in July 2009 and made several subsequent adjustments thereafter.

Jet fuel costs decreased from RMB23,086 million in 2008 to RMB16,390 million in 2009 as a result of decrease in average jet fuel price by 35.3%.

In addition to purchases of jet fuel from CAOSC, the Group is also permitted by the Chinese government to purchase a portion of its jet fuel requirements for its international flights from foreign fuel suppliers located outside China at prevailing international market prices. Jet fuel purchased from such sources outside China accounted for approximately 7% and 9% of the Group's total jet fuel consumption in 2009 and 2008, respectively.

#### Fuel Surcharge

According to the relevant regulations promulgated by the NDRC and the CAAC, domestic airlines imposed fuel surcharges for all the domestic routes (excluding those from the mainland PRC to Hong Kong and Macau) with effect from August 1, 2005 (based on flight time). The imposition of the fuel surcharge helped relieve, to a certain extent, the burden of high jet fuel cost, on the Group. The level of fuel surcharges, and any adjustment of which, are determined by CAAC and NDRC based on such factors as jet fuel price, route miles and the location of destination. Due to the downward trend in domestic fuel prices, on December 19, 2008, the CAAC and the NDRC decided, on December 25, 2008, to reduce fuel surcharges for both domestic and international routes. Thereafter, the CAAC and the NDRC called for a stop on imposing fuel surcharges for domestic routes by Chinese airlines with effect from January 15, 2009. Such suspension on imposing fuel surcharge lasted until November 2009. As international fuel prices gradually pick up, and in response to rises in the fuel cost, on November 11, 2009, the NDRC issued a notice to introduce a new pricing mechanism of fuel surcharge that links it with airlines' jet fuel costs. According to the new mechanism, when the purchase cost of jet fuel is lower than RMB 4,140 per ton (i.e., the benchmark price of jet fuel), airlines should not charge fuel surcharge. When the purchase cost of jet fuel exceeds RMB 4,140 per ton, the airlines may charge appropriate fuel surcharge provided that such airlines should digest at least 20 percent of the rising cost. As such, following a suspension period of almost one year, in November 2009, the Group resumed the imposing of fuel surcharges for domestic routes.

#### Flight Operations

Flight operations for the Group's flights originating in Guangzhou are managed by the Company's flight operations and marketing divisions, which are responsible for formulating flight plans and schedules consistent with route and flight

approvals received from the CAAC. The Company's 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. The Company's general dispatch offices are responsible for monitoring conditions on the Group's route network, administering the Group's flight plans, collecting and monitoring navigation data and analyzing and monitoring airport conditions.

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

#### Training of Pilots and Flight Attendants

The Group believes that its pilot training program which was established in cooperation with the CAAC affiliated Beijing Aeronautics and Aviation University (the "BAAU") has significantly improved the quality of the training received by the Group's pilots and has helped maintain the quality of the Group's staff of pilots at a level consistent with the expansion of operations called for by the Group's business strategy.

In the Group's pilot training program, trainees have two years of theoretical training at the BAAU. After successful completion of academic and physical examinations, the trainees receive flight training for a period of approximately 20 months at Australian Pilot College, a company that is 91% owned by the Company and 9% owned by CSAHC. Each trainee at the Australian Pilot College is required to fly at least 230 hours before being awarded a flight certificate. Graduates of the BAAU and the Australian Pilot College are hired by the Group as trainee pilots after passing a CAAC-administered examination to obtain a pilot license. The total training period for the Group's trainee pilots is approximately four years. The Group has about 1,720 trainees as at the end of May 7, 2010, about 790 trainees are expected to graduate in 2010.

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 jointly controlled entity between the Company and CAE International Holdings Limited, which also provides training to pilots from other Chinese airlines. Zhuhai Xiang Yi is equipped with simulators for all models of aircraft currently operated by the Group and provides flight simulation training services to the Group.

The Group's pilots are required to be licensed by the CAAC, which requires an annual recertification examination. The Group's pilots attend courses in simulator training twice annually and in simulator emergency procedures annually. The Group also conducts 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.

The Group used to fund the training of its recruited pilots in previous years and, as a result, incurred significant costs over the years. Recently, there has been a trend in the financing of pilot training worldwide from employer-sponsored to self-sponsored scheme. Such a change will not only cut down the Group's training expenses significantly, but also ensures the long-term dedicated service of the pilots. Starting from 2007, the Group began to recruit pilots under the self-sponsored training arrangement. On December 5, 2007, August 27, 2008 and August 27, 2009, the Board approved the Company to provide a guarantee with joint liability for the loans incurred under the self-sponsored pilot training program in an aggregate amount of RMB90,858,000, not more than RMB213,600,000 and not more than RMB184,750,000 respectively. On December 29, 2009, Xiamen Airlines, a 60%-owned subsidiary of the Company agreed to provide a guarantee with joint liability for the loans incurred under the partial self-sponsored pilot training program in an aggregate amount of not more than RMB100 million covering a period till December 31, 2011. As of December 31, 2009, the Group has provided a guarantee with joint liability for the loans of such self-sponsored pilots in an aggregate amount of RMB292,586,000, under which an aggregate of personal bank loans of RMB60,025,500 were drawn down from the banks.

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

The Group conducts theoretical and practical training programs for its flight attendants at its 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 the Group. At the Guangzhou Training Center, flight attendants of the Group receive comprehensive training in areas such as in-flight service, emergency evacuation and water rescue.

#### Ground Services

The Group makes arrangements with airport authorities, other airlines or ground services companies for substantially all ground facilities, including jet-ways, waiting areas, ticket counters and support services buildings, at each airport that it serves. The Group pays landing, parking and other fees to such airports, including Guangzhou Baiyun Airport. At domestic airports, such fees are generally determined by the CAAC.

At Guangzhou Baiyun Airport, the Group operates its own passenger check-in, cargo, mail and baggage handling, aircraft maintenance and cleaning services. The Group also provides such services to other airlines that operate in Guangzhou Baiyun Airport.

Ground services at the airports in Shenzhen, Changsha, Wuhan, Zhengzhou, Haikou, Zhuhai, Xiamen, Fuzhou, Guilin, Shantou, Guiyang and Beihai are primarily operated directly by the Group. Ground services at the airport in Beijing are primarily provided by Beijing Ground Service, which has become a wholly-own subsidiary of the Company in June 2009, since April 2004. Ground services at other airports in China are provided to the Group by local airport authorities or local airlines pursuant to various service agreements. Ground services and other services at airports outside China are provided to the Group by foreign services providers pursuant to various service agreements with such parties. All such agreements of the Group are short-term and otherwise on terms that are customary in the industry.

#### Air Catering

The Company owns a 55% equity interest in Guangzhou Nanland Air Catering Company Limited (“Nanland”) as of December 31, 2009. Nanland provides in-flight meals, snacks, drinks and related services for all of the Group’s flights originating in Guangzhou and substantially all other flights departing from Guangzhou Baiyun Airport. The Group contracts 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 terms that are customary in the industry.

To facilitate the Company to optimize its assets structure, better tightening its cost control, reduce the number of connected transactions and enhance the independence of the Company’s operations in the long-run, the Company acquired 100% interest in China Southern Airlines Group Air Catering Company Limited (“SAG Air Catering”) on August 31, 2007 from CSAHC. SAG Air Catering mainly provides in-flight meals to airlines for different flights of the Company originating or stopping at the domestic airports, mainly in northern China and Xinjiang regions.

## Cargo and Mail

The Group also provides air cargo and mail services. A significant portion of these services are combined with passenger flights services. Currently, the Group has two Boeing 747 freighters and two Boeing 777 freighters mainly servicing four international cargo routes, Shanghai to Amsterdam, Shanghai to Anchorage to Chicago, Shanghai to Frankfurt and Shanghai to Urumchi to Frankfurt.

Currently, the Group conducts its cargo business primarily through its cargo division in Guangzhou and Shenzhen.

## Sales, Reservations and Marketing

### Passenger Ticket Sales and Reservations

The Group's ticket sales and reservations are conducted by or through independent sales agents and the Group's own network of exclusive sales offices as well as the CAAC's sales offices and CSAHC's associates. The Group has sales offices in Guangzhou and its other route bases. In addition, the Group maintains regional sales offices in other cities in China, including Beijing and Shanghai. The Group maintains international sales offices in Almaty, Amsterdam, Ashkhabad, Astana, Baku, Bangkok, Bishkek, Brisbane, Busan, Chicago, Daegu, Daejeon, Delhi, Dubai (Sharjah), Dushanbe, Frankfurt, Fukuoka, Hanoi, Ho Chi Minh City, Islamabad, Irkutsk, Jakarta, Jeddah, Khabarovsk, Kathmandu, Kuala Lumpur, Lagos, Lahore, London, Los Angeles, Luanda, Manila, Melbourne, Moscow, New York, Novosibirsk, Osaka, Osh, Paris, Penang, Phnom Penh, Samarkand, Sapporo, Seoul, Singapore, Sydney, Tashkent, Tehran, Tokyo, Vancouver, Vladivostok and Yangon.

The Group has 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 2009, approximately 11.02% of all ticket sales for the Group's scheduled flights were made by the Group's network of sales offices and CSAHC's associates. The Group also sells tickets and accepts reservations through an extensive network of non-exclusive independent sales agents. Under the agency agreements with these sales agents, the Group pays commissions based on the value of tickets sold. The Group pays independent sales agents a commission of 3%-9% of the ticket price. Sales agents are typically permitted to withhold their commission from the proceeds of ticket sales that are remitted to the Group. In 2009, independent sales agents accounted for approximately 88.98% of the Group's ticket sales for its scheduled flights.

Substantially all of the Group's sales offices and agents in China are linked electronically to the CAAC's computerized ticketing and reservations system, which is in turn linked to all domestic airlines for flights throughout China. The Group has 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 the Group's international flights. During 2008, the Group further improved and optimized its online sales network, and launched Tencent sales counters in cooperation with Tencent Technology Limited, thus expanded the consumer sales network of the Group. Meanwhile, the Group upgraded and reconstructed the SMS platform, and launched the 95539 services hotlines, which provide SMS information services on mileage, flight schedule, flight status, and air ticket price.

## Cargo

The Group's cargo and mail services are promoted through its own cargo divisions and independent cargo agents both within and outside China that track available space among all airlines. In particular, the Group employs a number of cargo agents in the Pearl River Delta region. The Group generally pays such agents a commission of 4% - 5% of the relevant cargo freight rate for domestic and international services.

### Promotional and Marketing Activities

The Group engages in regular promotional and marketing activities in an effort to increase its market share. The Group's promotional and marketing activities for domestic routes emphasize safety, passenger comfort and the frequency of the Group's flights. The Group's promotional and marketing activities for international and regional passengers emphasize the Group's quality of service, extensive route network in China and greater frequency of flights relative to other Chinese airlines. In addition, the Group also promotes and markets its regional and international routes on the basis of price.

The Group has been seeking to increase its name recognition by offering new services to passengers. For example, the Group was the first Chinese airline to provide off-airport check-in services. The Group also offers transfer and baggage "through-handling" services to passengers connecting to other airlines, including passengers connecting in Hong Kong for flights to Taiwan. The Group widened its use of information technology and introduced new services such as cell phone check-in, and SMS platforms. During the Beijing Olympic Games, the Group launched a special promotion known as "Welcome the Olympic Games with Gold Medal Services" and successfully fulfilled its duties to deliver quality services for the Beijing Olympic Games and Paralympics Games.

On the wake of permitted direct flights on weekends between Taiwan and Mainland China starting from July 4, 2008, the 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, the Company has taken measures to explore opportunities presented by and increase its name recognition in Taiwan market. On June 23, 2008, the 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. The Company believes that its strategic collaboration with China Airlines will be beneficial to both parities, 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 its passengers, the Group has launched two frequent flyer programs, namely the “China Southern Airlines Sky Pearl Club”, and the “Egret Mileage Plus”. By the end of 2009, the Group had approximately 8,483,053 members 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 the approval of domestic, regional and international route allocation, published air fares, aircraft acquisition, jet fuel prices and standards for aircraft maintenance, airport operations and air traffic control. 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 China’s airlines operate under the supervision and regulation of the CAAC, they are accorded an increasingly significant degree of operational autonomy, including with respect to 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, the Group is 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. The Group believes that it, in all material respects, complies 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. The Group believes that these regulatory parameters benefit airlines, such as the 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, and 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. Such rights are allocated by the CAAC among the four Chinese airlines permitted to fly to Hong Kong or Macau. The Group understands 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.

A number of Hong Kong routes are operated by Chinese airlines on a "charter" flight basis. Permission to operate these flights is in theory subject to monthly review by the CAAC and the Hong Kong Civil Aviation Department. The CAAC has informally indicated that it primarily considers market demand and airline capability in granting permission for such flights.

Previously, direct flights between Taiwan and Mainland China had only been 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. The 108 direct passenger flights previously operating were all classed as charter flights. The new services comprise both regular charter and scheduled flights. The Company became the first Chinese carrier to fly nonstop to Taiwan. Previously, travelers between Taiwan and China have had to make use of intermediate stops in Hong Kong or elsewhere.

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.

The criteria for determining whether an international route will be allocated to a second airline generally include (i) the terms of the relevant bilateral civil aviation agreement; (ii) consistency with overall national plans and the national interest and the enhancement of reasonable competition; and (iii) whether the international airports to be used are sufficient for the aircraft flown and employ security measures consistent with international standards.

In addition, if the relevant bilateral civil aviation agreement permits more than one Chinese airline to operate a particular international route, the CAAC will only permit a second airline to operate on such route if the number of passengers carried annually exceeds 100,000 and if there is a minimum average load factor of 68% for routes with at least five weekly flights by Chinese airlines, or 80% for routes with four or fewer weekly flights by Chinese airlines.

#### Air Fare Pricing Policy

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 now fluctuate freely within a predetermined range. Instead of direct supervision by setting prices of air tickets through a local price bureau, the government now 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.

Published air fares of Chinese airlines for the Hong Kong and Macau routes are determined by the CAAC and the relevant civil aviation authorities in Hong Kong or Macau, subject to consultation between the relevant Chinese airlines and Hong Kong or Macau airlines. Airlines may offer discounts on flights on their Hong Kong regional routes. With respect to the Taiwan routes, the air fares are currently determined by Chinese airlines at their own discretion and may be subject to certain pricing guidance to be issued by the CAAC in the future.

Published air fares of Chinese airlines for international routes are determined through consultation between the relevant Chinese airlines and foreign airlines in accordance with the civil aviation agreements between the Chinese government and the relevant foreign government, taking into account the international air fare standards established through the International Air Transport Association. All air fares for international routes must be approved by the CAAC. Discounting of published international air fares is permitted.

#### Acquisition of Aircraft and Flight Equipment

The CAAC requires all Chinese airlines to acquire their aircraft through China Aviation Supplies Import and Export Corporation (“CASC”), an entity controlled by the CAAC. 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 CASC 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. The 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 the Company, SAIETC acts as its import agent and is paid an agency fee for its services.

#### Jet Fuel Supply and Pricing

CAOSC and Bluesky Oil Supplies Company, companies controlled and 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 the Shenzhen, Zhuhai, Sanya, Haikou, Shanghai Pudong and other small airports, in each of which CAOSC is a partner. 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 has made the improvement of air traffic safety in China 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.

The CAAC oversees the standards of all Chinese airline pilots through its operation of the CAAC Aviation College. The CAAC Aviation College is a monitoring unit located in Tianjin which implements a uniform pilot certification process applicable to all Chinese airline pilots and is responsible for the issuance, renewal, suspension and cancellation of pilot licenses. 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 posts.

### 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 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, including the Guangzhou Baiyun Airport with limited exceptions. 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 the Group, Air China and China Eastern Airlines. In 2009, these three airlines together controlled approximately 69.8% of the commercial aviation market in China as measured by passengers carried.

Most major Chinese airlines have in recent years significantly expanded their fleets, while at the same time passenger traffic has not increased proportionately. This has resulted in a reduction in the passenger load factors for most Chinese airlines. As a result, Chinese airlines 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.

The Group expects that competition in China's commercial aviation industry will continue to be intense. The Group will also face increasing competition from alternative means of transport, such as highway and rail, as China's transportation infrastructure improves. In particular, the so-called "Four Longitudinal and Four Horizontal" high-speed railways under construction may have a huge negative impact on the domestic commercial aviation sector once it goes into operation. 38 lines of the "Four Longitudinal and Four Horizontal" overlap with current flights of the Group, 21 of which run for a distance of less than 4 hours. If the high-speed railways go into full operation, according to the statistic of the Group, 13 out of the total 18 subsidiaries and branches of the Company involving 798 flights (i.e. to and fro flights/week) may be seriously impacted.

Relative to other Chinese airlines, however, the Group believes that it possesses certain competitive advantages. The Group has the most extensive route network and the largest number of regional route bases among Chinese airlines, which the Group believes places it in a favorable position in the route allocation process. The Group also has the largest aircraft fleet of any Chinese airline, which, together with the Group's planned aircraft acquisitions, will permit the Group to expand its operations and to improve the deployment of the aircraft in its fleet. The Group also believes that its dominant presence in the populous and economically developed southern and central regions of China provides it with a competitive advantage in attracting new customers and that its fully integrated flight training, aircraft and engine maintenance, and air catering operations enable it to achieve and maintain high quality service to its customers. In light of increasing competition from high speed trains, the Group intends to place more flight fleet to the international routes, where the Group enjoys an advantageous market position. The Group also believes that its optimized route network, increased operational efficiency and improved service quality will attract more customers. The proposed cooperation between the Company and the high speed trains operators will also enable the Group to render a seamless air-ground service to customers which will bring a win-win situation for both the Group and the high speed trains operators.

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

Year	Passenger carried		Cargo and Mail Carried (tons)		Total traffic (ton kilometers)	
	Industry Total	Group's Share	Industry Total	Group's Share	Industry Total	Group's Share
	(in millions)	(% of total)	(in thousands)	(% of total)	(in billion)	(% of total)
2005	138.3	31.8	3,067	25.3	26.1	27.9
2006	159.7	30.8	3,494	23.4	30.6	26.4
2007	185.8	30.6	4,018	21.7	36.5	25.3
2008	192.5	30.3	4,076	20.5	37.7	24.4
2009	230.5	28.8	4,455	19.3	42.7	23.6

#### Domestic Routes

The Group competes against its 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 and until recently, price. The Group competes against ten other Chinese airlines in its various domestic route markets. Of these competitors, the largest are two airlines owned or controlled by the Chinese government, and the remaining eight airlines are operated by or under the control of various Chinese provincial or municipal governments.

The following table sets forth the Group's market share of the passengers carried, cargo and mail carried on departing flights and total departing flights at the ten busiest airports in China, based on passenger volume data from CAAC statistics, in 2009.

Airport	Cargo and Mail		
	Passenger carried (% of total)	Carried (% of total)	Departing flight (% of total)
Beijing	18.05%	11.33%	17.22%
Shanghai Pudong	8.68%	2.83%	9.18%
Guangzhou	49.26%	26.84%	48.73%
Shanghai Hongqiao	15.78%	18.69%	15.53%
Shenzhen	29.06%	21.96%	27.69%
Chengdu	15.01%	15.71%	13.67%
Kunming	16.91%	19.24%	15.75%
Hangzhou	37.47%	31.99%	36.06%
Xi'an	19.27%	23.03%	17.97%
Chongqing	23.12%	26.43%	21.85%

The following table sets forth the Group's market share of the 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), based on passenger volume data from CAAC statistics, in 2009.

Airport	Cargo and Mail		
	Passenger carried (% of total)	Carried (% of total)	Departing flight (% of total)
Wuhan	44.41%	54.06%	39.91%
Changsha	45.25%	63.73%	44.35%

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Haikou	26.16%	26.05%	25.21%
Sanya	27.47%	27.50%	28.28%
Zhengzhou	51.48%	63.05%	47.41%
Guilin	37.03%	47.16%	36.13%
Nanning	37.05%	36.68%	32.22%
Zhang Jia Jie	36.28%	30.54%	38.02%

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## Regional Routes

In 2009, the Group conducted a total of 12,227 flights on its regional routes, accounting for approximately 24.75% of all passengers carried by Chinese airlines on routes between Hong Kong, Macau or Taiwan and destinations in China. The Group faces less competition on regional routes than that on domestic and international, and earns higher operating margin. Air China, Eastern Airlines, Air Macau, Dragon Air and Cathay Pacific Airways compete with the Group in the regional traffic markets.

## International Routes

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

Air China has the most extensive international route network among Chinese airlines. Beijing, the hub of Air China's operations, has been the destination for most international flights to China. The Group competes against, among other airlines, Thai Airways International, Singapore Airlines, Malaysian Airlines System, Air China and China Eastern on flights to Southeast Asian destinations. In the case of its European routes, the Group's competitors include Cathay Pacific Airways. The Group faces competition on its international routes from Air China and China Eastern, each of which operates several routes between destinations in China and the United States, as well as international airlines that fly to Los Angeles from Hong Kong. The Group competes in the international market primarily on the basis of safety, price, timeliness and convenience of scheduling.

## Airline Subsidiaries

The Airline Subsidiaries are joint ventures established by the Company and local companies in the provinces or special economic zones where the Airline Subsidiaries are based and are engaged in providing airline and related services. The Company owns a 60% equity interest in each of the Airline Subsidiaries.

As of December 31, 2009, Xiamen Airlines operated under its own "MF" code with a fleet of 57 aircraft on 100 domestic routes, 7 international routes and 10 regional routes. In 2009, Xiamen Airlines carried a total of about 11.12 million passengers, or approximately 16.78% of the passengers carried by the Group in that year, and had RMB7,622 million in traffic revenue.

As of December 31, 2009, Shantou Airlines operated under the Group's "CZ" code with a fleet of ten aircraft. In 2009, under the centralized allocation of flight routes of the Group, Shantou Airlines carried a total of about 1.95 million passengers, or 2.94% of the passengers carried by the Group in that year. Total traffic revenue of Shantou Airlines for the year ended December 31, 2009 was RMB1,422 million.

As of December 31, 2009, Chongqing Airlines operated under the "OQ" code with a fleet of seven aircraft. In 2009, under the centralized allocation of flight routes of the Group, Chongqing Airlines carried a total of about 1.41 million passengers, or 2.13% of the total number of passengers carried by the Group in that year. Total traffic revenue of Chongqing Airlines for the year ended December 31, 2009 was RMB779 million.

As of December 31, 2009, Zhuhai Airlines operated under the "CZ" code with a fleet of five aircraft. In 2009, under the centralized allocation of flight routes of the Group, Zhuhai Airlines carried a total of about 0.87 million passengers, or



approximately 1.30% of the total number of passengers carried by the Group in that year. Total traffic revenue of Zhuhai Airlines for the year ended December 31, 2009 was RMB673 million.

As of December 31, 2009, Guizhou Airlines operated under the “CZ” code with a fleet of eight aircraft. In 2009, under the centralized allocation of flight routes of the Group, Guizhou Airlines carried a total of about 1.52 million passengers, or approximately 2.29% of the total number of passengers carried by the Group in that year. Total traffic revenue of Guizhou Airlines was approximately RMB1,172 million for the year ended December 31, 2009.

#### Insurance

The CAAC maintains fleet and legal liability insurance on behalf of the Group and all other Chinese airlines with PICC Property and Casualty Company Limited, or PICCP&C, and China Pacific Property Insurance Company Ltd., under the PICCP&C master policy. The Group maintains 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.

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\$58,581) 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 due 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. The Group believes that it maintains 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 the Group is 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 the Group 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

The Group's 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. The Group uses as its 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.

The names "China Southern" and "China Southern Airlines" contain Chinese words of common usage and are therefore not eligible for registration as tradenames 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 CSAHC. The Company and CSAHC have entered into a trademark license agreement (the "Trademark License Agreement"), pursuant to which CSAHC has licensed to the Group the right to use the names "China Southern" and "China Southern Airlines" in both English and Chinese and granted the Company a 10-year renewable license from 1997 to use the kapok logo on a world-wide basis. CSAHC has retained the right to use the kapok logo in connection with its non-airline related businesses conducted as of the date of the Trademark License Agreement and to permit its associates that do not compete, directly or indirectly, with the Group to use the kapok logo. Unless CSAHC 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 2007, the Trademark License Agreement has been renewed by the two parties for another ten-year term ending 2017. 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.

The Company owns all rights to three trademarks, being SKY PEARL CLUB, the logo relating to Easy Cargo 5000 and "SKY PEARL CARD" which are registered in China, and recorded with Trademark Office of the State Administration for Industry and Commerce. Zhuhai Airlines Company Limited owns all rights to the airline logo which is registered with the Trademark Office of the State Administration for Industry and Commerce.

### Organizational Structure

The following chart illustrates the corporate structure of the Group as of December 31, 2009 and the aggregate effective equity interest of the Company in each of its principal subsidiaries, associates and jointly controlled entities.

Note a: Including 13% ownership interest held by CSA's subsidiaries.

The particulars of the Group's principal subsidiaries as of December 31, 2009 are as follows:

Name of company	Place and date of establishment /operation	Proportion of ownership interest held by the Company
Southern Airlines Shantou Airlines Company Limited	PRC July 20, 1993	60%
Zhuhai Airlines Company Limited	PRC May 8, 1995	60%
Xiamen Airlines Company Limited	PRC August 11, 1984	60%
Guizhou Airlines Company Limited	PRC November 12, 1991	60%
Chongqing Airlines Company Limited	PRC June 16, 2007	60%
Guangzhou Nanland Air Catering Company Limited	PRC November 21, 1989	55%
China Southern West Australian Flying College Pty Limited	Australia January 26, 1971	91%
Guangzhou Baiyun International Logistics Company Limited	PRC July 23, 2002	61%
Xinjiang Civil Aviation Property Management Limited	PRC February 12, 2002	51.8%
China Southern Airlines Group Air Catering Company Limited	PRC December 25, 2003	100%
Nan Lung International Freight Limited	Hong Kong October 1, 1996	51%
Beijing Southern Airlines Ground Service Company Limited	PRC April 1, 2004	100%

The particulars of the Group's principal associates and jointly controlled entities as of December 31, 2009 are as follows:

Name of company	Place and date of establishment /operation	Group effective interest	Proportion of ownership interest held by	
			The Company	Subsidiaries
Guangzhou Aircraft Maintenance Engineering Company Limited	PRC October 28, 1989	50%	50%	—
Southern Airlines Group Finance Company Limited	PRC June 28, 1995	34%	21.1%	12.9%
Sichuan Airlines Corporation Limited	PRC August 28, 2002	39%	39%	—
MTU Maintenance Zhuhai Co., Limited	PRC April 6, 2001	50%	50%	—
Zhuhai Xiang Yi Aviation Technology Company Limited	PRC July 10, 2002	51%	51%	—
Guangzhou China Southern Zhongmian Dutyfree Store Co., Limited	PRC September 29, 2006	50%	50%	—

#### Property, Plant and Equipment

For a discussion of the Group's aircraft, see Item 4, "Information on the Company — History and development of the Company — Aircraft Acquisitions."

The Company's headquarters in Guangzhou occupy an area of approximately 429,833 square meters of land and a total gross floor area of approximately 653,043 square meters. The Company leases from CSAHC the land in Guangzhou on which the Company's headquarters and other facilities are located. The Company also leases from CSAHC certain buildings mainly at the Haikou, Wuhan, Nanyang, Shenyang, Dalian, Jilin, Harbin and Xinjiang.

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

	Land		Buildings	
	(in square meters)		(in square meters )	
	Owned	Leased	Owned	Leased
Guangzhou	330,163	99,670	624,667	28,376
Shenzhen	208,740	—	105,040	—
Zhuhai	170,062	—	18,791	—
Changsha	138,949	—	52,552	—
Zhengzhou	290,841	—	66,542	—
Haikou	5,265	1,711	83,923	20,917
Wuhan	—	31,061	17,335	22,831
Nanyang	—	—	18,156	60,035
Sanya	106,680	—	16,968	—
Shenyang	—	167,502	79,626	93,445

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Dalian	—	14,403	20,290	33,597
Jilin	134,488	65,076	38,210	7,767
Harbin	—	286,871	36,925	3,188
Xinjiang	17,460	631,094	177,710	4,135
Guilin	72,563	—	73,379	139

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

	Land		Buildings	
	(in square meters)		(in square meters)	
	Owned	Leased	Owned	Leased
Xiamen	581,401	—	511,847	26,044
Shantou	36,931	53,000	61,468	2,773
Zhuhai	99,306	—	57,730	1,800
Guizhou	259,879	—	106,245	2,032
Chongqing	—	—	6,785	3,482

As systems for registration and transfer of land use rights and related real property interests in China have been implemented relatively recently, such systems do not yet comprehensively account for all land and related property interests. The land in Guangzhou on which the Company's headquarters and other facilities are located and the buildings that the Company uses at its route base in Wuhan and Haikou are leased by the Company from CSAHC. However, CSAHC lacks adequate documentation evidencing CSAHC's rights to such land and buildings, and, as a consequence, the lease agreements between CSAHC and the 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 the Group that lack adequate documentation. Lack of adequate documentation for land use rights and ownership of buildings may impair the ability of the Group to dispose of or mortgage such land use rights and buildings. As of May 7, 2010, the Group was 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), Xiamen, Heilongjiang, Hainan, Jilin, Dalian, Hunan, Xinjiang, Henan and Shenzhen, in which the Group has interests and for which such certificates have not been granted. The directors of the Company 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 the Group has not yet obtained the relevant land use right certificates and property title certificates.

#### ITEM 4A. UNRESOLVED STAFF COMMENTS.

Not applicable.

#### ITEM 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS.

The following discussion and analysis should be read in conjunction with the Financial Statements of the Group contained elsewhere in this Annual Report. The Group maintains its books and accounts in accordance with PRC Accounting Standards for Business Enterprises ("PRC GAAP") and prepares its financial statements in accordance with both PRC GAAP and IFRSs. The Financial Statements contained elsewhere in this Annual Report have been prepared in accordance with IFRSs.

The discussion and analysis of the Group's financial condition and results of operations are based on the consolidated financial statements, which have been prepared in accordance with IFRSs.

##### Critical Accounting Policies

The preparation of the consolidated financial statements requires the Group to make estimates and judgments that affect the reported amount of assets and liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities at the date of the consolidated financial statements. 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 2 to the consolidated financial statements. The Group believes that the following critical accounting policies involve the most significant judgments and estimates used in the preparation of our financial statements.

##### Impairment for long-lived assets

If circumstances indicate that the net book value of a long-lived asset may not be recoverable, this 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 greater of the fair value less costs to sell and value in use. In determining the value in use, expected cash flows generated by the asset are discounted to their present value, which requires significant judgment relating to the level of traffic revenue and the amount of operating costs. 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 amount of operating costs.

#### 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 regularly in order to determine the amount of depreciation expense to be recorded during any reporting period. The useful lives are based on the Group's historical experience with similar assets and taking into account anticipated technological changes. The depreciation expense for future periods is adjusted if there are significant changes from previous estimates.

## Recently Pronounced International Financial Reporting Standards

Information relating to the recently pronounced IFRSs is presented in Note 56 to the consolidated financial statements.

### Overview

2009 proved to be an unusual year. In view of the complicated and ever-changing environment of China and elsewhere throughout the year, the Group prudently analyzed the changes in the market, and made quick response by putting effective measures into practice. It assured the safe operation for the whole year under its enhanced safety management. In addition, through network structure optimization, market development, additional sales activities as well as deeper strategic transformation, the Group controlled costs stricter and took advantage of all policy supports. As such, the fast growth of its operations was ensured that led to a turnaround from loss to profit for the year.

The Group secured a record of safe operation during 2009 by highlighting the importance of safety, enhancing the training and standard of safety, and intensifying the safety information management and system control. Up to December 2009, the Company had achieved records of 122 consecutive safe flight months, 6.53 million accumulated safe flight hours and 186 consecutive months of air security.

In 2009, facing the sustainable slump in the international aviation market and new conditions such as the rapid change in the domestic aviation market, the Group endeavored to react and adjust itself to the changing market. The centralized deployment of traffic capacity was strengthened with emphasis on major and high-profit markets. Moreover, we tried hard to grasp opportunities quicker and increase our income and profitability by developing major markets and making full use of all favorable opportunities, including the Lunar New Year, Canton Fairs and high seasons for the market; and making a series of actions to explore a new operation model. Such actions included pushing on with the centralized scheduling and sales management, commencing the operation of air express, implementing the electronic ticket and transport networking system, as well as strengthening the strategic cooperation.

The Group staged the activities of “Year of Branded Services Improvement Campaign” during 2009. Through enhanced operation management and improved flight on-schedule rate, our passengers were provided with more punctual and convenient services. In addition, the Group proactively explored the control model of service system, and strengthened the standardization of services. We continued to optimize the whole process and each step of services so as to improve its service capability. Also, enhancement in both highend customer service and passenger load factor of first class and business class lounges together with the new transit business of “Through Check-In” further elevated our brand value and market influence.

In 2009, the Company successfully obtained a capital injection of RMB3 billion through a non-public issue of 721,150,000 A shares to CSAHC and another non-public issue of 721,150,000 H shares to Nan Lung a foreign wholly-owned subsidiary of CSAHC. The proceeds replenished the Company’s capital and lowered the gearing ratio, thereby laying a solid foundation for improvement in the financial position as well as the future development. To further reduce the gearing ratio and financial burden and support the strategic development with funds, the Company is planning to raise an amount of RMB10 billion through non-public issues of A shares and H shares in 2010.

In 2009, the Group continued to give back to society with love and contribution in fulfilling its responsibility of corporate citizen. During 2009, our Ten Cent Care Foundation continued to sponsor poor undergraduates and provided 22 flights for specific purposes, peacekeeping, evacuation of compatriots living abroad, etc. On our principle of “Green Flight”, we continuously increased the energy utilization rate and decreased the emission of greenhouse gases through fleet upgrade, route network optimization and aircraft weight reduction.



Nevertheless, the development of the airlines industry meets with a number of challenges, such as more factors making the recovery of global economy unstable and uncertain, faster growth in the total traffic capacity of the industry, impact of substitutive services such as Express Rail, as well as sharp fluctuation in oil price.

Since July 21, 2005, the PRC government has begun to adopt a managed floating exchange rate system based on market supply and demand of currencies, which is subject to adjustments with reference to a basket of currencies. The exchange rate of Renminbi would no longer be pegged to the U.S. dollar only and a more flexible exchange rate system was established. Because the Group finances its aircraft acquisitions mainly through capital leases or bank loans in U.S. dollars, and there are a substantial amount of transactions and obligations denominated in U.S. dollars in relation to its global purchases of jet fuel, lease and purchase of aviation equipment as well as major repairs, in addition to the landing fees of its international flights in the airports of other countries, the Group benefited from the RMB appreciation. RMB appreciation has brought a one-off exchange gain to the Group and reduced its operating costs which are denominated in foreign currencies. However, RMB appreciation also presents the Group with a challenge in price competition in international route operations.

The Group's 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 the Group's 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, the Group's airline revenue is generally higher in the second and third quarters than in the first and fourth quarters.

Like most airlines, the Group is subject to a high degree of financial and operating leverage. A significant percentage of the Group's operating expenses are fixed costs that do not vary proportionally based on the Group's 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 for flight crew, cabin crew and ground personnel. Thus, a minor change in the Group's yields or load factors would have a material effect on the Group's results of operations. In addition, certain of these expenses, primarily financing costs and operating lease payments, labor costs and depreciation do not vary based on the number of flights flown. Thus, the Group's operating results can also be substantially affected by minor changes in aircraft utilization rates. The Group is and will continue to be highly leveraged with substantial obligations denominated in foreign currencies and, accordingly, the results of its operations are significantly affected by fluctuations in foreign exchange rates, particularly for the U.S. dollar. Net exchange gain decreased by RMB2,499 million, from RMB2,592 million in 2008 to RMB93 million in 2009 because the exchange rate of RMB against USD was relatively stable in 2009 while RMB appreciated significantly against USD in 2008.

A number of other external variables, including political and economic conditions in China, tend to have a major impact on the Group's performance. The Group's financial performance is also significantly affected by factors arising from operating in a regulated industry. As substantially all aspects of the Group's airline operations are regulated by the PRC government, the Group's 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 the Group's future operations and its ability to implement its operating strategy.

#### 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, 2009, 2008 and 2007:

Traffic	Year ended December 31,			2009 vs. 2008	2008 vs. 2007
	2009	2008	2007	% increase (decrease)	% increase (decrease)
<b>RPK (million)</b>					
Domestic	80,697	70,619	68,369	14.3	3.3
Regional	1,337	1,139	1,180	17.4	(3.5)
International	10,968	11,426	12,178	(4.0)	(6.2)
<b>Total</b>	<b>93,002</b>	<b>83,184</b>	<b>81,727</b>	<b>11.8</b>	<b>1.8</b>
<b>RTK (million)</b>					
Domestic	8,342	7,392	7,219	12.9	2.4
Regional	126	110	115	14.5	(4.3)
International	1,599	1,698	1,916	(5.8)	(11.4)
<b>Total</b>	<b>10,067</b>	<b>9,200</b>	<b>9,250</b>	<b>9.4</b>	<b>(0.5)</b>
<b>Passengers carried (thousand)</b>					
Domestic	61,130	53,063	51,326	15.2	3.4
Regional	1,276	1,220	1,339	4.6	(8.9)
International	3,875	3,954	4,238	(2.0)	(6.7)
<b>Total</b>	<b>66,281</b>	<b>58,237</b>	<b>56,903</b>	<b>13.8</b>	<b>2.3</b>
<b>Cargo and mail carried (thousand tons)</b>					
Domestic	750	713	733	5.2	(2.7)
Regional	9	11	12	(18.2)	(8.3)

International	103	111	127	(7.2)	(12.6)
Total	862	835	872	3.2	(4.2)

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Capacity	Year ended December 31,			2009 vs. 2008	2008 vs. 2007
	2009	2008	2007	%increase (decrease)	%increase (decrease)
<b>ASK (million)</b>					
Domestic	105,379	93,384	89,452	12.8	4.4
Regional	1,916	1,790	1,881	7.0	(4.8)
International	16,146	17,593	18,400	(8.2)	(4.4)
Total	123,441	112,767	109,733	9.5	2.8
<b>ATK (million)</b>					
Domestic	12,425	10,985	10,440	13.1	5.2
Regional	219	200	210	9.5	(4.8)
International	2,802	3,091	3,558	(9.3)	(13.1)
Total	15,446	14,276	14,208	8.2	0.5
<b>Load Factors</b>					
<b>Passenger load factor (RPK/ASK) (%)</b>					
Domestic	76.6	75.6	76.4	1.3	(1.0)
Regional	69.8	63.6	62.7	9.7	1.4
International	67.9	64.9	66.2	4.6	(2.0)
Overall	75.3	73.8	74.5	2.0	(0.9)
<b>Overall load factor (RTK/ATK) (%)</b>					
Domestic	67.1	67.3	69.1	(0.3)	(2.6)
Regional	57.7	55.0	55.1	4.9	(0.2)
International	57.1	54.9	53.8	4.0	2.0
Overall	65.2	64.4	65.1	1.2	(1.1)
<b>Yield</b>					
<b>Yield per RPK (RMB)</b>					
Domestic	0.53	0.59	0.60	(10.2)	(1.7)
Regional	0.75	0.84	0.91	(10.7)	(7.7)
International	0.55	0.67	0.63	(17.9)	6.3
Overall	0.54	0.61	0.61	(11.5)	0.0
<b>Yield per RTK (RMB)</b>					
Domestic	5.36	5.90	5.89	(9.2)	0.2
Regional	8.30	9.23	9.91	(10.1)	(6.9)
International	4.52	5.47	5.03	(17.4)	8.7
Overall	5.26	5.86	5.75	(10.2)	1.9
<b>Financial</b>					
<b>Passenger revenue (RMB million)</b>					
Domestic	43,033	41,854	40,717	2.8	2.8
Regional	1,000	952	1,074	5.0	(11.4)
International	6,026	7,606	7,708	(20.8)	(1.3)
Total	50,059	50,412	49,499	(0.7)	1.8
Cargo and mail revenue (RMB million)	2,908	3,051	3,697	(4.7)	(17.5)

## Operating Results

The historical results of operations discussed below may not be indicative of the Group's future operating performance. In addition to the factors discussed under "Overview" above, the Group's 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.

2009 compared with 2008

The profit attributable to equity shareholders of the Company of RMB330 million was recorded in 2009 as compared to the loss attributable to equity shareholders of the Company of RMB4,823 million in 2008, mainly due to the increase in revenue excluding fuel surcharge income and the decrease in fuel costs, which exceeded the drop in fuel surcharge income. Due to the decrease of fuel cost, the Group's operating costs decreased sharply. The Group's operating revenue decreased by RMB486 million or 0.9% from RMB55,288 million in 2008 to RMB54,802 million in 2009 resulting from the decrease in fuel surcharge income. Excluding the fuel surcharge income of RMB8,197 million and RMB1,986 million for 2008 and 2009, operating revenue increased from RMB47,091 million in 2008 to RMB52,816 million in 2009. Passenger load factor increased by 1.5 percentage point, from 73.8% in 2008 to 75.3% in 2009. Passenger yield (in passenger revenue per RPK) decreased by RMB0.07 or 11.5% from RMB0.61 in 2008 to RMB0.54 in 2009. Average yield (in traffic revenue per RTK) decreased by 10.2% from RMB5.86 in 2008 to RMB5.26 in 2009. Operating expenses decreased by RMB6,416 million or 10.4% from RMB61,767 million in 2008 to RMB55,351 million in 2009 due to the decrease of fuel cost from RMB23,086 million in 2008 to RMB16,390 million in 2009. As a result of the decrease in operating expenses, operating profit of RMB1,440 million was recorded in 2009 as compared to operating loss of RMB5,646 million in 2008.

## Operating revenue

	2009		2008		Change in revenue %
	Operating revenue RMB million	Percentage %	Operating revenue RMB million	Percentage %	
	Traffic revenue	52,967	96.7%	53,913	
Including: Passenger revenue	50,059		50,412		(0.7)
– Domestic	43,033		41,854		2.8
– Hong Kong, Macau and Taiwan	1,000		952		5.0
– International	6,026		7,606		(20.8)
Cargo and mail revenue	2,908		3,501		(16.9)
Other operating revenue	1,835	3.3%	1,375	2.5%	33.5
Mainly including: Commission income	342		317		7.9
Ground service income	320		250		28.0
Expired sales in advance of carriage	350		276		26.8
Total operating revenue	54,802	100.0%	55,288	100.0%	(0.9)
Less: fuel surcharge income	(1,986)		(8,197)		(75.8)
Total operating revenue excluding fuel surcharge	52,816		47,091		12.2

## Traffic revenue composition

	2009		2008		Change in traffic revenue %
	Traffic revenue RMB million	Percentage %	Traffic revenue RMB million	Percentage %	
	Passenger Revenue	50,059	94.5%	50,412	
Cargo and Mail Revenue	2,908	5.5%	3,501	6.5%	(16.9)
Traffic revenue	52,967	100.0%	53,913	100.0%	(1.8)

## Passenger revenue composition

	2009		2008		Change in passenger revenue %
	Passenger revenue RMB million	Percentage %	Passenger revenue RMB million	Percentage %	
	Domestic	43,033	86.0%	41,854	
Hong Kong, Macao and Taiwan	1,000	2.0%	952	1.9%	5.0
International	6,026	12.0%	7,606	15.1%	(20.8)
Passenger revenue	50,059	100.0%	50,412	100.0%	(0.7)

Substantially all of the Group's operating revenue is attributable to airline and airline related operations. Traffic revenue accounted for 96.7% and 97.5% of total operating revenue in 2009 and 2008 respectively. Passenger revenue and cargo and mail revenue accounted for 94.5% and 5.5% respectively of the total traffic revenue in 2009. The other operating revenue is mainly derived from commission income, income from general aviation operations, fees charged for ground services rendered to other Chinese airlines and income from expired sales in advance of carriage.

The decrease in operating revenue was primarily due to a 0.7% decrease in passenger revenue from RMB50,412 million in 2008 to RMB50,059 million in 2009. The total number of passengers carried increased by 13.8% to 66.28 million passengers in 2009. RPKs increased by 11.8% from 83,184 million in 2008 to 93,002 million in 2009, primarily as a result of the increase in number of passengers carried. Passenger yield per RPK decreased from RMB0.61 in 2008 to RMB0.54 in 2009. Passenger revenue and passenger yield per RPK decreased mainly due to the decrease in fuel surcharge income.

Fuel surcharge income, which accounted for 3.6% and 14.8% of total operating revenue in 2009 and 2008, decreased by 75.8% or RMB6,211 million, from RMB8,197 million in 2008 to RMB1,986 million in 2009. On January 14, 2009, the National Development and Reform Commission (NDRC) and the CAAC jointly announced the suspension of the collection of passenger fuel surcharge since January 15, 2009. On November 11, 2009, the NDRC and the CAAC announced to resume the collection of fuel surcharge income and issued a new pricing mechanism, which was effective on November 14, 2009. Under the new pricing mechanism, domestic airline companies could adjust the fuel surcharge level within a prescribed range set by the pricing mechanism without prior approval of the relevant authorities. In addition, the Group reduced the fuel surcharge level of international routes in view of the decrease in fuel prices.

Domestic passenger revenue, which accounted for 86.0% of the total passenger revenue in 2009, increased by 2.8% from RMB41,854 million in 2008 to RMB43,033 million in 2009. Passenger capacity in ASKs increased by 12.8%, while domestic passenger traffic in RPKs increased by 14.3%, resulting in an increase in passenger load factor by 1.0 percentage point from 75.6% in 2008 to 76.6% in 2009. Domestic passenger yield per RPK decreased from RMB0.59 in 2008 to RMB0.53 in 2009.

Hong Kong, Macau and Taiwan passenger revenue, which accounted for 2.0% of total passenger revenue, increased by 5.0% from RMB952 million in 2008 to RMB1,000 million in 2009. For Hong Kong, Macau and Taiwan flights, passenger capacity in ASKs increased by 7.0%, while passenger traffic in RPKs increased by 17.4%, resulting in an increase in passenger load factor by 6.2 percentage points from 63.6% in 2008 to 69.8% in 2009. Passenger yield per RPK decreased from RMB0.84 in 2008 to RMB0.75 in 2009, mainly resulted from the decrease of fuel surcharge income and stronger competition in the region during the year.

International passenger revenue, which accounted for 12.0% of total passenger revenue, decreased by 20.8% from RMB7,606 million in 2008 to RMB6,026 million in 2009. For international flights, passenger capacity in ASKs decreased by 8.2%, while passenger traffic in RPKs decreased by 4.0%, resulting in a 3.0 percentage point increase in passenger load factor from 64.9% in 2008 to 67.9% in 2009. Passenger yield per RPK decreased by 17.9% from RMB0.67 in 2008 to RMB0.55 in 2009, mainly due to the decrease in fuel surcharge income and stronger competition in international routes during the year.

Cargo and mail revenue, which accounted for 5.5% of the Group's total traffic revenue and 5.3% of total operating revenue, decreased by 16.9% from RMB3,501 million in 2008 to RMB2,908 million in 2009. The decrease was attributable to reduced cargo traffic demand under global financial crisis.

Other operating revenue increased by 33.5% from RMB1,375 million in 2008 to RMB1,835 million in 2009. The increase was primarily due to the general growth in income from various auxiliary operations.

#### Operating expenses

Total operating expenses in 2009 amounted to RMB55,351 million, representing a decrease of 10.4% or RMB6,416 million over 2008, primarily due to the total effect of decreases in jet fuel costs and impairment on property, plant and equipment. Total operating expenses as a percentage of total operating revenue decreased from 111.7% in 2008 to 101.0% in 2009.

	2009		2008		Change in operating expenses %
	RMB million	Percentage	RMB million	Percentage	
Flight operations	29,296	52.9%	34,982	56.6%	(16.3)
Mainly including: Jet fuel costs	16,390		23,086		(29.0)
Operating lease charges	5,123		4,527		13.2
Flight personnel payroll and welfare	2,622		2,490		5.3
Maintenance	4,446	8.0%	4,890	7.9%	(9.1)
Aircraft and traffic servicing	9,169	16.6%	8,476	13.7%	8.2
Promotion and sales	4,170	7.5%	3,491	5.7%	19.5
General and administrative	1,844	3.3%	2,041	3.3%	(9.7)
Impairment on property, plant and equipment	26	0.1%	1,884	3.1%	(98.6)



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Depreciation and amortisation	5,971	10.8%	5,746	9.3%	3.9
Others	429	0.8%	257	0.4%	66.9
Total operating expenses	55,351	100.0%	61,767	100.0%	(10.4)

Flight operations expenses, which accounted for 52.9% of total operating expenses, decreased by 16.3% from RMB34,982 million in 2008 to RMB29,296 million in 2009, primarily as a result of significant decrease in jet fuel costs. Jet fuel costs, which accounted for 55.9% of flight operations expenses, decreased by 29.0% from RMB23,086 million in 2008 to RMB16,390 million in 2009 mainly as a result of decrease in average fuel costs by 35.3%.

Maintenance expenses, which accounted for 8.0% of total operating expenses, decreased by 9.1% from RMB4,890 million in 2008 to RMB4,446 million in 2009. The decrease was mainly due to the decrease in number of engines repaired during the year.

Aircraft and traffic servicing expenses, which accounted for 16.6% of total operating expenses, increased by 8.2% from RMB8,476 million in 2008 to RMB9,169 million in 2009. The increase was primarily due to a 10.4% rise in landing and navigation fees from RMB6,135 million in 2008 to RMB6,772 million in 2009, due to the increase in number of flights.

Promotional and sales expenses, which accounted for 7.5% of total operating expenses, increased by 19.5% from RMB3,491 million in 2008 to RMB4,170 million in 2009, which is in line with the increase in operating revenue excluding fuel surcharge income.

General and administrative expenses, which accounted for 3.3% of the total operating expenses, decreased by 9.7% from RMB2,041 million in 2008 to RMB1,844 million in 2009. The decrease was due to stricter cost control implemented by the Group in 2009.

Impairment on property, plant and equipment decreased by RMB1,858 million from RMB1,884 million in 2008 to RMB26 million in 2009. Please see Note 20(g) to the Financial Statements for more details.

Depreciation and amortization, which accounted for 10.8% of total operating expenses, increased by 3.9% from RMB5,746 million in 2008 to RMB5,971 million in 2009, mainly due to the additional depreciation charges on aircraft delivered in 2009.

#### Operating profit/(loss)

Operating profit of RMB1,440 million was recorded in 2009 as compared to operating loss of RMB5,646 million in 2008. The increase in profit was mainly due to the net effect of decrease in operating revenue by RMB486 million or 0.9% in 2009, decrease in operating expenses by RMB6,416 million or 10.4% and the receipt of CAAC Infrastructure Development Fund contributions of RMB1,328 million in 2009.

#### Other (expenses)/income

Interest expense decreased by 24.7% from RMB1,987 million in 2008 to RMB1,497 million in 2009, mainly due to the decrease in average effective interest rate of bank and other loans and obligations under finance leases.

Net exchange gain decreased by RMB2,499 million, from RMB2,592 million in 2008 to RMB93 million in 2009 because the exchange rate of RMB against USD was relatively stable in 2009 while RMB appreciated significantly against USD in 2008.

#### Taxation

Income tax credit of RMB95 million was recorded in 2009 as compared to an income tax expense of RMB62 million in 2008, mainly due to the utilization of unused tax losses not recognized in prior year.

#### 2008 compared with 2007

The loss attributable to equity shareholders of the Company of RMB4,823 million was recorded in 2008 as compared to a profit attributable to equity shareholders of the Company of RMB1,839 million in 2007. The Group experienced a

slow down of growth in traffic revenue and rising operating expenses as a result of global financial crisis and increase of jet fuel cost. The Group's operating revenue increased by RMB887 million or 1.6% from RMB54,401 million in 2007 to RMB55,288 million in 2008. Passenger load factor decreased by 0.7 percentage point, from 74.5% in 2007 to 73.8% in 2008. Passenger yield (in passenger revenue per RPK) was RMB0.61, which was unchanged from 2007. Average yield (in traffic revenue per RTK) increased by 1.9% from RMB5.75 in 2007 to RMB5.86 in 2008. Operating expenses increased by RMB8,811 million or 16.6% from RMB52,956 million in 2007 to RMB61,767 million in 2008. As a result of the increase in operating expenses which outweighed the growth in revenue, operating loss of RMB5,646 million was recorded in 2008, as compared to operating profit of RMB1,881 million in 2007.

## Operating revenue

	2008		2007		Change in revenue
	Operating revenue RMB million	Percentage %	Operating revenue RMB million	Percentage %	
Traffic revenue	53,913	97.5%	53,196	97.8%	1.3
Including: Passenger revenue	50,412		49,499		1.8
– Domestic	41,854		40,717		2.8
– Hong Kong, Macau and Taiwan	952		1,074		(11.4)
– International	7,606		7,708		(1.3)
Cargo and mail revenue	3,501		3,697		(5.3)
Other operating revenue	1,375	2.5%	1,205	2.2%	14.1
Mainly including: Commission income	317		281		12.8
Ground service income	250		241		3.7
Expired sales in advance of carriage	276		273		1.1
Total operating revenue	55,288	100.0%	54,401	100.0%	1.6
Less: fuel surcharge income	(8,197)		(5,359)		53.0
Total operating revenue excluding fuel surcharge	47,091		49,042		(4.0)

## Traffic revenue composition

	2008		2007		Change in traffic revenue
	Traffic revenue RMB million	Percentage %	Traffic revenue RMB million	Percentage %	
Passenger Revenue	50,412	93.5%	49,499	93.1%	1.8
Cargo and Mail Revenue	3,501	6.5%	3,697	6.9%	(5.3)
Traffic revenue	53,913	100.0%	53,196	100.0%	1.3

## Passenger revenue composition

	2008		2007		Change in passenger revenue
	Passenger revenue RMB million	Percentage %	Passenger revenue RMB million	Percentage %	
Domestic	41,854	83.0%	40,717	82.3%	2.8
Hong Kong, Macao and Taiwan	952	1.9%	1,074	2.1%	(11.4)
International	7,606	15.1%	7,708	15.6%	(1.3)

Passenger revenue	50,412	100.0%	49,499	100.0%	1.8
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Substantially all of the Group's operating revenue is attributable to its air transport and related operations. Traffic revenue accounted for 97.5% and 97.8% of the total operating revenue in 2008 and 2007 respectively. Passenger revenue and, cargo and mail revenue accounted for 93.5% and 6.5% respectively of the total traffic revenue in 2008. The other operating revenue is mainly derived from commission income, income from general aviation operations, fees charged for ground services rendered to other Chinese airlines and income from expired sales in advance of carriage.

The increase in operating revenue was primarily due to a 1.8% rise in passenger revenue from RMB49,499 million in 2007 to RMB50,412 million in 2008 resulting from increase in fuel surcharge income. The total number of passengers carried increased by 2.3% to 58.24 million passengers in 2008. RPKs increased by 1.8% from 81,727 million in 2007 to 83,184 million in 2008, primarily as a result of the increase in number of passengers carried. Passenger yield per RPK was RMB0.61, which was unchanged from 2007.

The Group recorded an amount of fuel surcharge income in respect of passenger operation of RMB7,497 million (2007: RMB4,910 million). Excluding fuel surcharges, the passenger revenue of the Group decreased by 3.8%, from RMB44,589 million in 2007 to RMB42,915 million in 2008, and the passenger yield per RPK (excluding fuel surcharges) decreased from RMB0.55 in 2007 to RMB0.52 in 2008.

Domestic passenger revenue accounted for 83.0% of the total passenger revenue in 2008. Domestic passenger revenue increased by 2.8% from RMB40,717 million in 2007 to RMB41,854 million in 2008 (2007: increased by 19.6% from RMB34,037 million in 2006 to RMB40,717 million in 2007). The decrease in growth in domestic passenger revenue was mainly attributable to various unfavorable factors, including large-scale natural disasters occurred in China, such as the southern China snow storms in January 2008, the May 12 earthquake in Sichuan province, and the strict security measures and visa control for foreigners for the Beijing Olympic Games. Domestic passenger traffic in RPKs increased by 3.3%, mainly due to an increase in number of passengers carried. Domestic passenger yield per RPK decreased from RMB0.60 in 2007 to RMB0.59 in 2008.

Regional passenger revenue, which accounted for 1.9% of total passenger revenue, decreased by 11.4% from RMB1,074 million in 2007 to RMB952 million in 2008, as a result of strong competition from Cathay Pacific Airways and Dragonair for routes connecting Hong Kong and domestic cities of the PRC. For regional flights, passenger traffic in RPKs decreased by 3.5%, while passenger capacity in ASKs decreased by 4.8%, resulting in an increase in passenger load factor by 0.9 percentage point from 62.7% in 2007 to 63.6% in 2008. Passenger yield per RPK decreased from RMB0.91 in 2007 to RMB0.84 in 2008, mainly resulted from stronger competition in the region during the year.

International passenger revenue, which accounted for 15.1% of total passenger revenue, decreased by 1.3% from RMB7,708 million in 2007 to RMB7,606 million in 2008, as a result of the decreased market demand due to the visa restriction for foreigners during the Beijing Olympic Games period and the global financial crisis. For international flights, passenger traffic in RPKs decreased by 6.2%, while passenger capacity in ASKs decreased by 4.4%, resulting in a 1.3 percentage point decrease in passenger load factor from 2007. Passenger yield increased by 6.3% from RMB0.63 in 2007 to RMB0.67 in 2008, mainly due to the increase in fuel surcharge income.

Cargo and mail revenue, which accounted for 6.5% of the Group's total traffic revenue and 6.3% of total operating revenue, decreased by 5.3% from RMB3,697 million in 2007 to RMB3,501 million in 2008. The decrease was attributable to reduced cargo traffic demand under global financial crisis.

Other operating revenue increased by 14.1% from RMB1,205 million in 2007 to RMB1,375 million in 2008. The increase was primarily due to the general growth in income from various auxiliary operations.

#### Operating expenses

	2008		2007		Change in operating expenses %
	RMB million	Percentage	RMB million	Percentage	
Flight operations	34,982	56.6%	29,082	54.9%	20.3
Mainly including: Jet fuel costs	23,086		18,316		26.0
Operating lease charges	4,527		4,055		11.6
Flight personnel payroll and welfare	2,490		2,226		11.9
Maintenance	4,890	7.9%	4,643	8.8%	5.3
Aircraft and traffic servicing	8,476	13.7%	8,160	15.4%	3.9
Promotion and sales	3,491	5.7%	3,421	6.5%	2.0
General and administrative	2,041	3.3%	1,874	3.5%	8.9
Impairment on property, plant and equipment	1,884	3.1%	109	0.2%	>100
Depreciation and amortisation	5,746	9.3%	5,554	10.5%	3.5

Others	257	0.4%	113	0.2%	>100
Total operating expenses	61,767	100.0%	52,956	100.0%	16.6

Total operating expenses in 2008 amounted to RMB61,767 million, representing an increase of 16.6% or RMB8,811 million over 2007, primarily due to the total effect of increases in jet fuel costs, operating lease charges of aircraft, servicing expenses, maintenance expenses and impairment losses on property, plant and equipment. Total operating expenses as a percentage of total operating revenue increased from 97.3% in 2007 to 111.7% in 2008.

Flight operations expenses, which accounted for 56.6% of total operating expenses, increased by 20.3% from RMB29,082 million in 2007 to RMB34,982 million in 2008, primarily as a result of increases in jet fuel costs and operating lease charges of aircraft. Jet fuel costs, which accounted for 66.0% of flight operations expenses, increased by 26.0% from RMB18,316 million in 2007 to RMB23,086 million in 2008 mainly as a result of increased fuel prices. Operating lease charges of aircraft increased by 11.5% from RMB3,735 million in 2007 to RMB4,166 million in 2008 primarily due to the additional rental payments for new aircraft under operating leases.

Maintenance expenses, which accounted for 7.9% of total operating expenses, increased by 5.3% from RMB4,643 million in 2007 to RMB4,890 million in 2008. The increase was mainly due to fleet expansion in recent years.

Aircraft and traffic servicing expenses, which accounted for 13.7% of total operating expenses, increased by 3.9% from RMB8,160 million in 2007 to RMB8,476 million in 2008. The increase primarily resulted from a 1.7% rise in landing and navigation fees from RMB6,030 million in 2007 to RMB6,135 million in 2008, due to an increase in number of flights.

Promotional and sales expenses, which accounted for 5.7% of total operating expenses, increased by 2.0% from RMB3,421 million in 2007 to RMB3,491 million in 2008.

General and administrative expenses, which accounted for 3.3% of the total operating expenses, increased by 8.9% from RMB1,874 million in 2007 to RMB2,041 million in 2008.

Impairment on property, plant and equipment, which accounted for 3.1% of the total operating expenses, increased by RMB1,775 million from RMB109 million in 2007 to RMB1,884 million in 2008. The impairment losses recognised in 2008 mainly comprise the following:

- During the year, in view of the age and operating efficiency of the Group's fleet of Boeing 777-200A aircraft, Airbus 300 aircraft and McDonnell Douglas 90 aircraft, the Group determined to dispose of these aircraft. The Group has commenced its process of seeking buyers for these aircraft. As a result, the Group assessed the recoverable amounts of these aircraft. Based on this assessment, the carrying amount of the aircraft and the related fleet assets was written down by RMB1,590 million. The estimates of recoverable amounts were based on the aircraft's fair value less costs to sell, determined by reference to the recent observable market prices for the respective model of aircraft.
- There has been a decrease in demand of cargo transportation services as a result of the current economic conditions. In addition, the operating efficiency of the Group's cargo freighters Boeing 747 is not satisfactory due to lack of economy of scale for the existing small fleet of cargo freighters. As such, the Group assessed the recoverable amounts of its cargo freighters and the related fleet assets. Based on this assessment, the carrying amount of the cargo freighters was written down by RMB291 million. The estimates of recoverable amounts were based on the aircraft's fair value less costs to sell, determined by reference to the recent observable market prices for the cargo freighters.

Depreciation and amortisation, which accounted for 9.3% of total operating expenses, increased by 3.5% from RMB5,554 million in 2007 to RMB5,746 million in 2008, mainly resulting from the additional depreciation charge on aircraft delivered in 2007 and 2008.

#### Operating (loss)/profit

Operating loss of RMB5,646 million was recorded in 2008 as compared to an operating profit RMB1,881 million in 2007. This was mainly because operating revenue increased by RMB887 million or 1.6% in 2008 while operating expenses increased by RMB8,811 million or 16.6% in the same period.

#### Other income/(expenses)

Interest expense decreased by 13.3% from RMB2,291 million in 2007 to RMB1,987 million in 2008, mainly due to the decrease in average effective interest rate of bank and other loans and obligations under capital leases. Interest income increased by 41.1% from RMB73 million in 2007 to RMB103 million in 2008, mainly attributable to the



increase in average bank deposits balances during 2008.

Net exchange gain decreased by 8.5% from RMB2,832 million in 2007 to RMB2,592 million in 2008. Such amount mainly represented an unrealised translation gain on retranslation of foreign currency denominated liabilities at the year end.

#### Taxation

Income tax expenses decreased by 92.7% from RMB847 million in 2007 to RMB62 million in 2008. This was mainly attributable to the net effect of the operating loss of the Group and the effect of certain deferred tax assets not recognised.

#### Liquidity and Capital Resources

Generally, the Group met its working capital and capital expenditure requirements through cash from its operations, the proceeds of certain long-term and short-term bank loans, capital lease financing and rebates available under certain of the Group's aircraft leases.

In addition, the Company received approximately RMB3 billion proceeds from its non-public offerings of 721,150,000 A shares to CSAHC and 721,150,000 H shares to Nan Lung in August 2009.

As of December 31, 2009, the Group had banking facilities with several PRC commercial banks for providing loan finance up to an approximate amount of RMB128,175 million to the Group. As of December 31, 2009, an approximate amount of RMB50,455 million was utilized. As of December 31, 2009 and 2008, the Group's cash and cash equivalents totaled RMB4,343 million and RMB4,649 million, respectively.

Net cash inflows from operating activities in 2009, 2008 and 2007 were RMB8,959 million, RMB1,155 million and RMB6,869 million, respectively. Operating cash inflows of the Group are primarily derived from the provision of air transportation and related service for customers. The vast majority of tickets are purchased prior to the day on which transportation is provided. Operating cash outflows primarily are related to the recurring operating expenses, including flight operation, maintenance, aircraft and traffic servicing, etc.

Net cash used in investing activities in 2009, 2008 and 2007 was RMB14,478 million, RMB7,790 million and RMB4,844 million, respectively. Cash capital expenditures in 2009, 2008 and 2007 were RMB15,007 million, RMB8,364 million and RMB5,502 million, respectively, reflecting predominantly additional investments in aircraft and flight equipment under the Group's fleet expansion plans and Guangzhou new airport, and, to a small extent, additional investments in other facilities and buildings used in operations.

Financing activities resulted in net cash inflows/(outflows) of RMB5,213 million, RMB7,460 million and RMB(465) million in 2009, 2008 and 2007, respectively. Net cash inflow from new bank loans, short-term financing bills and repayments amounted to RMB3,750 million, RMB9,667 million and RMB2,324 million in 2009, 2008 and 2007, respectively. The additions of bank loan were used for capital expenditures and general working capital. Repayment of capital leases in 2009, 2008 and 2007 was RMB1,750 million, RMB2,335 million and RMB3,021 million, respectively, resulting from the aircraft acquisitions under capital leases.

As of December 31, 2009, the Group's aggregate long-term bank and other loans and obligations under capital leases (including loans and capital leases obligations due within one year) totaled RMB47,633 million. In 2010, 2011, 2012, 2013 and thereafter, amounts payable under such loans and obligations will be RMB7,871 million, RMB9,718 million, RMB10,859 million, RMB3,046 and RMB16,139 million respectively. Such borrowings were denominated in United States dollars with a significant portion being floating interest rate borrowings. In the normal course of business, the Group is exposed to fluctuations in foreign currencies. The Group's exposure to foreign currencies primarily results from its foreign currency liabilities. Depreciation or appreciation of the Renminbi against foreign currencies affects the Group's results significantly because the Group's foreign currency payments generally exceed its foreign currency receipts. The Group is not able to hedge its foreign currency exposure effectively other than by retaining its foreign currency denominated earnings and receipts to the extent permitted by the SAFE, or subject to certain restrictive conditions, entering into forward foreign exchange contracts with authorized banks.

As of December 31, 2009, the Group's short-term bank loans were RMB11,012 million. The Group's weighted average interest rate on short-term bank loans was 1.18% per annum as of December 31, 2009. The primary use of the proceeds of the Group's short-term bank loans is to finance working capital and capital expenditure needs. The Group has generally been able to arrange short-term bank loans with domestic banks in China as necessary and believes it can continue to obtain them based on its well-established relationships with various lenders.

As of December 31, 2009, the Group had obligations under operating leases totaling RMB30,366 million, predominately for aircraft. Of such amount, RMB4,028 million, RMB4,103 million, RMB4,122 million, RMB3,596 million, RMB3,286 million, and RMB11,231 million respectively, is due in 2010, 2011, 2012, 2013, 2014 and thereafter.

As of December 31, 2009, the Group had a working capital deficit of RMB28,441 million, as compared to a working capital deficit of RMB32,290 million as of December 31, 2008. Historically, the Group operated in a negative

working capital position, relying on cash inflow from operating activities and renewal of short-term bank loans to meet its short-term liquidity and working capital needs. The decrease in the Group's working capital deficit from 2008 to 2009 was mainly because the Group sought increased long-term bank loans to finance its aircraft acquisitions. In 2010 and thereafter, the liquidity of the Group is primarily dependent on its ability to maintain adequate cash inflows from operations to meet its debt obligations as they fall due, and its ability to obtain adequate external financing to meet its committed future capital expenditure. At December 31, 2009, the Group entered into loan financing agreements with several PRC banks to provide financing up to RMB128,175 million, of which approximately RMB50,455 million was utilized. The directors of the Company believe that the liquidity status of the Group in 2010 will be further enhanced upon completion of the non-public share subscriptions as discussed in Business Overview under Item 4. The directors of the Company believe that sufficient financing will be available to the Group.

As the Group is subject to a high degree of operating leverage, a minor decrease in the Group's yield and/or load factor could result in a significant decrease in its operating revenue and hence its operating cash flows. This could arise in such circumstances as where competition between Chinese airlines increases or where PRC aviation demand decreases. Similarly, a minor increase in the jet fuel prices, particularly in the domestic market, could result in a significant increase in the Group's operating expenses and hence a significant decrease in its operating cash flows. This could be caused by fluctuations in supply and demand in international oil market. Currently, the Group's existing loans and lease facilities do not contain any financial covenants. Nevertheless, as the Group is subject to a high degree of financial leverage, an adverse change in the Group's operating cash flows could adversely affect its financial health and hence weaken its ability to obtain additional loans and lease facilities and to renew its short-term bank loans facilities as they fall due.

As of December 31, 2009, the Group had capital commitments as follows:

	2010	2011	2012	2013	2014 and afterwards	Total
	(RMB million)					
Acquisition of aircraft and related equipment	16,404	17,482	17,421	9,845	4,691	65,843
Others	1,068	601	192	-	-	1,861
Total capital commitments	17,472	18,083	17,613	9,845	4,691	67,704

Others mainly represent airport and office facilities and equipment, overhaul and maintenance bases and training facilities.

As of December 31, 2009, the cash and cash equivalents of the Group totaled RMB4,343 million. Of such balance, 22% was denominated in US Dollars, Hong Kong Dollars, Australian Dollars, Japanese Yen and other foreign currencies.

In view of the unutilized bank facilities of RMB77,720 million, the anticipated non-public share subscription and cash generated from operations, the Group expects that it will have sufficient funding sources to meet its cash requirements in the foreseeable future.

#### Contractual Obligations and Commitments

The following table sets forth the Group's obligations and commitments to make future payments under contracts and under commitments as of December 31, 2009.

	As of December 31, 2009 Payment due by period					As of December 31, 2008
	Total	Less than 1 year	1-3 years	3-5 years	After 5 years	Total
Short-term bank loans (note 1)	11,094	11,094	-	-	-	18,757
Long-term bank and other loans (note 1)	36,014	7,047	18,248	2,853	7,866	23,300
Short-term financing bills	-	-	-	-	-	2,094
Bills payable	3,207	3,207	-	-	-	148
Obligations under capital leases	15,812	1,972	3,812	3,432	6,596	16,036
Operating lease commitments	30,366	4,028	8,225	6,882	11,231	34,330
Aircraft purchase commitments (Note 2)	65,843	16,404	34,903	12,491	2,045	75,639
Other capital commitments	1,861	1,068	793	-	-	884
Investing commitments	-	-	-	-	-	-
Total	164,197	44,820	65,981	25,658	27,738	171,188

Note 1 Interest on variable rate loans was estimated based on the current rate in effect at December 31, 2009.

Note 2 Amounts shown are net of previously paid purchase deposits.

ITEM 6. DIRECTORS, SENIOR MANAGEMENT AND EMPLOYEES.

Directors, Senior Management and Employees

The following table sets forth certain information concerning directors, senior management and supervisors of the Company in 2009. There were certain changes in the Company's directors, senior management and supervisors subsequent to December 31, 2009, details of which are set forth below.

Name	Position	Gender	Age
Si Xian Min (1)	Chairman of the Board	Male	53
Li Wen Xin	Director	Male	60
Wang Quan Hua	Director	Male	56
Liu Bao Heng	Director	Male	60
Tan Wan Geng (2)	Director, President	Male	46
Zhang Zi Fang (3)	Director and Executive Vice President	Male	52
	Director, Executive Vice President and Chief Financial		
Xu Jie Bo	Officer	Male	45
Chen Zhen You	Director	Male	58
Wang Zhi	Independent Non-executive Director	Male	68
Sui Guang Jun	Independent Non-executive Director	Male	49
Gong Hua Zhang	Independent Non-executive Director	Male	64
Lam Kwong Yu	Independent Non-executive Director	Male	66
Sun Xiao Yi	Chairman of the Supervisory Committee	Male	56
Yang Guang Hua (4)	Former Supervisor	Male	57
Li Jia Shi (5)	Supervisor	Male	49
Zhang Wei	Supervisor	Female	44
Yang Yi Hua	Supervisor	Female	50
Liang Zhong Gao	Supervisor	Male	54
Ren Ji Dong (6)	Executive Vice President	Male	45
He Zong Kai	Executive Vice President	Male	59
Liu Qian	Executive Vice President	Male	46
Dong Su Guang	Executive Vice President	Male	56
Chen Gang (7)	Executive Vice President	Male	44
Zhang Zheng Rong	Chief pilot	Male	48
Hu Chen Jie	Chief Information Officer	Male	41
Tang Bing (8)	Former Chief Engineer	Male	43
Su Liang	Chief Economist	Male	48
Zhang He Ping (8)	Current Chief Engineer	Male	57
Chen Wei Hua	Chief Legal Adviser	Male	44
Xie Bing	Company Secretary	Male	37

(1) On 12 January 2009, Mr Si Xian Min was appointed at the extraordinary board meeting as the Chairman of the Fifth Session of the Board and his resignation as the President of the Company was also approved at the meeting.

(2) On 13 January 2009, Mr Tan Wan Geng was appointed at the extraordinary board meeting as the President of the Company.

(3) On 30 June 2009, Mr Zhang Zi Fang was appointed at the 2008 annual general meeting as a director of the Fifth Session of the Board.

(4) On 30 June 2009, the resignation of Mr Yang Guang Hua as a supervisor of the Fifth Session of the Supervisory Committee was approved at the 2008 annual general meeting.

(5) On 30 June 2009, Mr Li Jia Shi was appointed at the 2008 annual general meeting as a supervisor of the Fifth Session of the Supervisory Committee.

(6) On May 7, 2009, the Board of the Company approved the appointment of Mr. Ren Ji Dong as an Executive Vice President of the Company.

(7) On August 26, 2009, the Board of the Company approved the appointment of Mr. Chen Gang as an Executive Vice President of the Company.

(8) On June 2, 2009, the Board of the Company approved the cessation of Mr. Tang Bing as the Chief Engineer of the Company, and the appointment of Mr. Zhang He Ping as the Chief Engineer of the Company.

Save as disclosed above, since January 1, 2010 through the date of this Annual Report, there has been no change to the Directors, Senior Management or Supervisors.

#### BOARD OF DIRECTORS

Mr. Si Xian Min is the Chairman of the Board. Mr. Si graduated with a master degree of Business Administration from School of Economics and Management of Tsinghua University, EMBA Major. Mr. Si is also an expert of political science. He began his career in civil aviation in 1975. He held positions as Director of the political division of China Southern Airlines Henan Branch, Party Secretary and Vice President of Guizhou Airlines, Deputy Party Secretary and the Secretary of the Disciplinary Committee of the Company and Party Secretary of China Northern Airlines and has been the President of the Company from October 2004 to January 2009. He has been the General Manager and Deputy Party Secretary of CSAHC and the Chairman of the Board of the Company since January 2009.

Mr. Li Wen Xin is a Director of the Company. Mr. Li was a graduate majoring in economic management. He is a senior expert of political science. Mr. Li joined the civil aviation industry in 1969. He was the Secretary to the Disciplinary Committee, Deputy Party Secretary and Vice General Manager of China General Aviation Corporation successively between 1991 and 1998. He was appointed as the Party Secretary and Vice General Manager of China Eastern Airlines Company Limited Shanxi branch in February 1998. He became the Deputy Party Secretary and Secretary to the Disciplinary Committee of China Eastern Air Holding Company in June 2000. From September 2002 to September 2006, he was appointed as the Party Secretary and Vice President of China Eastern Air Holding Company. Between June 2000 and September 2006, he was the Chairman of the Supervisory Committee of China Eastern Airlines Company Limited. He has been the Party Secretary and Executive Vice President of CSAHC since September 2006.

Mr. Wang Quan Hua is a Director of the Company. Mr. Wang graduated from the Economic Management Department of the Party School of the Central Committee of CPC, and is an economist. Mr. Wang began his career in civil aviation in 1972, and successively served as the Director of Planning Department of Guangzhou Civil Aviation Administration, the Office Director of China Southern Airlines Shenzhen Company., the Director of the Planning and Operation Division of the Company, General Manager of Strategy and Development Department of the Company, Assistant President and the Director of Planning Department of CSAHC. Since September 2009, Mr. Wang has been the Executive Vice President of CSAHC. Mr. Wang currently is also the chairman of SACM and the director of Nan Lung.

Mr. Liu Bao Heng is a Director of the Company. He graduated from the Central University of Finance and Economics majoring in accounting and is an auditor. Mr. Liu began his career in 1968. He held the post of deputy director and director of the No. 3 Division of Department of Public Finance Audit of National Audit Office of the People's Republic of China (CNAO). He was the assistant and deputy commissioner to CNAO's Xian Office. He became the deputy chief, the department chief and director of the General Office of CNAO. He has been the Chief Accountant of CSAHC since February 2006.

Mr. Tan Wan Geng is a Director and president of the Company. Mr. Tan is an engineer graduated from Economic Geography Department in Sun Yatsen University, with major in regional economy, with qualification of post graduate degree, and a master degree in economics. Mr. Tan has previously served as the Head of the Infrastructure Department and Director of Human Resources Department of the Beijing Aircraft Maintenance and Engineering Corporation from 1990 to 1996, the Deputy Director of Human Resources Division (Personnel and Education Division) of CAAC from 1996 to 2000, and has been the Director General and Party Secretary of CAAC Northeastern Branch from December 2000 to January 2006. He has been Party Secretary of Chinese Communist Party Committee and Executive Vice President of the Company from February 2006 to January 2009, and the President of the Company since January 2009.

Mr. Zhang Zi Fang is a Director, the Party Secretary and an Executive Vice President of the Company. Mr. Zhang graduated with a master degree of Business Administration from School of Economics and Management of Tsinghua University, EMBA Major. Mr. Zhang is a senior expert of political science. Mr. Zhang served as the Deputy Commissar and subsequently the Commissar of the Pilot Corps of China Northern Airlines Company, and later on the Party Secretary of the Jilin Branch. He served as General Manager of Dalian Branch of CSAHC Northern Airlines and Director of Political Department of CSAHC. He also served as the Deputy Party Secretary and Secretary of the Disciplinary Committee of the Company. He has been an Executive Vice President of the Company since December 2007 and has been the Party Secretary of the Company since February 2009. Mr. Zhang is also the Vice President of SACM.

Mr. Xu Jie Bo is a Director, Executive Vice President and Chief Financial Officer of the Company. He graduated from the management department of Tianjin University majoring in infrastructure management, and was subsequently



awarded with a master degree in business administration from Hong Kong Baptist University and a master degree of Business Administration from School of Economics and Management of Tsinghua University, EMBA Major. He is also a qualified senior accountant. Mr. Xu started his career in 1986. He had ever taken up the posts of Deputy Director and Director of the Financial Department of Central and Southern China Civil Aviation Administration. He became General Manager of the Financial Department of the Company since July 1998 and Chief Financial Officer of the Company since 2001. He has been Executive Vice President and chief accountant of the Company since August 2003. Mr. Xu is also the Chairman of Guizhou Airlines, the Vice Chairman of Xiamen Airlines, and the Vice Chairman of Sichuan Airlines Corporation Limited (“Sichuan Airlines”), an associate of the Group.

Mr. Chen Zhen You is a Director and Chairman of the Labour Union of the Company. He graduated from Hua Zhong Normal University majoring in English. Mr. Chen, an economist, holds an MBA from Murdoch University in Australia. He worked as the Vice Director of the Office of International Affairs of Guangzhou Civil Aviation Administration, Vice Director of the Office of Overseas Business of the Company and General Manager of the Department of Foreign Affairs. He was the Office Director of CSAHC and the Director of the Planning and Investment Department of CSAHC. He has been the Chairman of the Labour Union of the Company since February 2005. Mr. Chen is also the Chairman of Zhuhai Airlines.

Mr. Wang Zhi has been an independent non-executive Director of the Company since May 2003. Mr. Wang graduated from the Aircraft Design Department of Harbin Institute of Technology. Mr. Wang began his career in 1965, and has successively served as the Director and Senior Engineer of Aeronautics Research Institute of China, the Vice Director of the First Research Institute of Civil Aviation, the Vice Director and Director of the Planning Bureau and the Director of the Planning Technology System Reform Department and the Planning Technology Department of CAAC. Mr. Wang is also a professor in several universities.

Mr. Sui Guang Jun has been an independent nonexecutive Director of the Company since May 2003. Mr. Sui graduated from the Economic Department of Jinan University and obtained a doctor degree in the Management of Organizations of Jinan University in 1996. He has successively served as the Vice Director of the Research Institute of Hong Kong and Macao Economies, the Dean of corporate administration department of Jinan University and the Chief of the Post-doc Committee of Applied Economics and the Dean of Management College in Jinan University. Mr. Sui is currently the Chancellor of Guangdong University of Foreign Studies.

Mr. Gong Hua Zhang has been an independent Non-Executive Director of the Company since June 2007, used to be the Chief Accountant, vice director and director of the financial bureau of China National Petroleum Corporation, the Chief Accountant of China National Petroleum Corporation and a Director of PetroChina Company Limited. Mr. Gong also acts as a part-time professor in Tsinghua University, Nankai University, Xiamen University and China University of Petroleum, and is a professor in National Accounting Institute (Beijing).

Mr. Lam Kwong Yu has been an independent nonexecutive Director of the Company since June 2007, is an expert in the field of civil aviation. Mr. Lam used to serve as the General Manager of the Hong Kong Airport, the Vice Director and Director of the Civil Aviation Department of Hong Kong, a Director of the Airport Authority Hong Kong and the Chairman of the Aviation Advisory Board of Hong Kong. Mr. Lam is currently a member of the Selection Committee for the Hong Kong Special Administrative Region.

#### SUPERVISORY COMMITTEE

As required by the Company Law of the PRC and the Articles of Association of the Company, the Company has a supervisory committee (the "Supervisory Committee") which is primarily responsible for the supervision of senior management of the Company, including the Board, executive officers and other senior management personnel, to ensure that they act in the interests of the Company, its shareholders and employees, as well as in compliance with applicable law. The Supervisory Committee consists of five Supervisors. Three of the Supervisors are appointed by shareholders, and the other two Supervisors are representatives of the Company's employees. The Supervisors serve terms of three years and may serve consecutive terms.

Mr. Sun Xiao Yi, the chairman of the Supervisory Committee of the Company, is head of Discipline Supervision Team of CSAHC. Mr. Sun graduated from the Civil Aviation University of China with a degree in Economics and Administration and is a postgraduate law student of the Party School of the Central Committee of CPC. Mr. Sun is a senior expert of political science and Economics. Mr. Sun has successively served as Vice Party Secretary of the Hubei branch of the Company, Party Secretary of the Flight Operations Department of the Company, and Vice Party Secretary of CSAHC. He has been head of Discipline Supervision Team of CSAHC since September 2002.

Mr. Li Jia Shi, a Supervisor of the Company. He graduated from the Guangdong Institute For Nationalities majoring in economic mathematics and an expert of political science. He started to work since August 1976. He served as the Head of the Organization Division of the Party Committee and the Deputy Secretary of the Disciplinary Committee of the Company from December 2003 to December 2007. He has served as the Secretary of the Disciplinary Committee of the Company since December 2007. Mr. Li currently is also the Chairman of Southern Airlines Ka Yuen (Guangzhou) Aviation Supply Company Limited and Guangzhou Nanland Air Catering Company Limited.

Ms. Zhang Wei, a Supervisor of the Company. She is the Director of the Audit Division of CSAHC. She graduated from Tianjin University majoring in investment skills & economics. She holds a master of science in chemical engineering. Ms. Zhang is a senior accountant. She served as Vice General Manager of the Finance Department of the Company, and the General Manager of Southern Airlines Group Finance Company Limited, the Vice Director of the Supervisory Bureau and the Director of the Audit Division of CSAHC. She has been the Director of the Audit Division of CSAHC since October 2008. Ms. Zhang currently is also the Chairman of the Supervisory Committee of SA Finance and SACM.

Ms. Yang Yi Hua, a Supervisor of the Company. Ms. Yang is the General Manager of the Audit Department of the Company and a Certified Internal Auditor. She has successively served as Deputy Manager of the Clearance and Settlement Office of the Financial Division of the Guangzhou Civil Aviation Administration, Manager of the Financial Office of the Company's Financial Division, and Deputy General Manager of the Company's Audit Department. Ms. Yang currently is also the Chairman of the Supervisory Committee of Xiamen Airlines, Guizhou

Airlines, Guangzhou Baiyun International Logistic Company Limited (“Baiyun Logistic”) and Nan Lung International Freight Limited and a supervisor of Chongqing Airlines, Beijing Ground Service and SA Finance.

Mr. Liang Zhong Gao, a Supervisor and the Director of the Disciplinary Supervision Department of the Company. He is an expert of political science with university qualification. Mr. Liang once served as the Party Secretary and Deputy General Manager of the Guangzhou Sales Office of the Company, Deputy Party Secretary and Secretary of the Disciplinary Committee of the Passenger Traffic Department of the Company, Party Secretary of the Passenger Traffic Department of the Company and General Manager of the Aviation Service Quality Control Department of the Company.

#### SENIOR MANAGEMENT

Mr. Ren Ji Dong is the Executive Vice President of the Company. He graduated from the School of Economics and Management of Tsinghua University with a master degree in Business Administration (EMBA), and he is a senior engineer. He served as the Deputy Director of Urumqi Civil Aviation Administration, the Vice President of Xinjiang Airlines, the Party Secretary and the Vice President of the Xinjiang Branch of the Company, the Executive Vice President of the Company from February 2005 to January 2007, and the President of the Xinjiang Branch of the Company from January 2007 to April 2009. He has served as the Executive Vice President of the Company since May 2009.

Mr. He Zong Kai is the Executive Vice President of the Company. Mr. He graduated from Beijing Foreign Language Institute majoring in French, and he is a senior economist. Mr. He served as the Deputy Manager of the Operation Department of the Company, Manager of Passenger Transportation Department, Head of Seats Arrangement Department, Vice General Manager of the Marketing Department and General Manager of the Ground Services Department. He assumed the offices of the President and Deputy Party Secretary of Hubei Branch. Mr. He has been an Executive Vice President of the Company since March 2005. Currently, Mr. He is also the Chairman of Chongqing Airlines.

Mr. Liu Qian is currently the Executive Vice President of the Company. Mr. Liu graduated from China Civil Aviation Flying College with majoring in aircraft piloting. Mr. Liu served the CAAC as an assistant researcher of the piloting skills supervision division of the piloting standards department, an assistant researcher of the operation supervision division, an assistant researcher of the piloting standards department, the Deputy Head of the Piloting Standards Division of the Piloting Standards Department, and the Deputy Chief Pilot and Chief Pilot of the Company. He has been an Executive Vice President of the Company since August 2007. Mr. Liu served as the Chairman of Zhuhai Xiang Yi Aviation Technology Company Limited, a jointly-controlled entity of the Company.

Mr. Dong Su Guang is the Executive Vice president of the Company. He graduated from Northwestern Polytechnical University majoring in aircraft design, and he is an engineer. He is an Executive Vice President of the Company. Mr. Dong used to be a Deputy General Manager of Guangzhou Aircraft Maintaining and Engineering Co., Ltd., as well as Chief Engineer and the General Manager of Aircraft Engineering Department of the Company. He has been an Executive Vice President of the Company since December 2007. Mr. Dong is also the Chairman of Shantou Airlines and Guangzhou Aircraft Maintenance and Engineering Co., Ltd. ("GAMECO", a jointly-controlled entity of the Company).

Mr. Chen Gang, the Executive Vice President of the Company. He graduated from Zhongnan Finance and Economics University majoring in Industrial Enterprise Management and the School of Economics and Management of Tsinghua University with a master degree in Advanced Business Administration (EMBA). He began his career in 1987. He served as the Vice Director of the Enterprise Management Department, the Manager of the Planning Enterprise Management Department, the Manager of Operation Department of Henan Branch of the Company, the Vice General Manager of Henan Branch of the Company, the General Manager of Hubei Branch of the Company, and the Director and Vice Party Secretary of the Marketing Management Committee of the Company from November 2005 to August 2009. He served as the Vice General Manager of the Company since August 2009. Currently, Mr. Chen is also the Chairman of CSN – ETC E-commerce Limited and Baiyun Logistics.

Mr. Zhang Zheng Rong is the Chief Pilot of the Company. He graduated from China Civil Aviation Flying College majoring in aircraft piloting and the School of Economics and Management of Tsinghua University with a master degree in Advanced Business Administration (EMBA). Mr. Zhang used to serve as the Captain of the First Squadron of CAAC, the Deputy General Manager of the Flight Operations Division and the Captain of the First Squadron as well as the General Manager of the Aviation Safety Monitoring Division of the Company. He has been the General Manager and Deputy Party Secretary of the Guangzhou Flight Operations Division of the Company. He has been the Chief Pilot of the Company since August 2007.

Mr. Hu Chen Jie is the Chief Information Officer of the Company and graduated from Beijing University Aeronautics and Astronautics majoring in information management. Mr. Hu used to be a software engineer in the Computer Center of CAAC, a senior software engineer in Wei Hong International Technology Company (Singapore), Deputy Director of the Computer Center of the Company, a senior project manager of SITA INC. (US) and the General Manager of CSN-ETC e-Commerce Limited. He has been the Chief Information Officer of the Company since June 2007.

Mr. Su Liang is the Chief Economist of the Company, and graduated from the University of Cranfield, United Kingdom with a master degree in Air Transport Management Engineering. Mr. Su was in charge of the flight operations, planning and international cargo project of the Company. From July 2000 to November 2007, Mr. Su was the Company Secretary of the Company. He has been the Chief Economist of the Company since December 2007. Mr. Su was the Chairman of China Southern West Australian Flying College Pty Ltd (a subsidiary of the Company) and the Director of Sichuan Airlines (an associate of the Company).

Mr. Zhang He Ping is the Chief Engineer of the Company. Mr. Zhang is an engineer with university qualification. From January 2003 to May 2009, he served as the General Manager and Vice Party Secretary of the Hunan Branch of the Company. He has served as the Chief Engineer and the General Manager of the Aircraft Engineering Department of the Company since June 2009. Mr. Zhang was also the Director of GAMECO (a joint controlled entity of the Company) and the Chairman of Shenyang Northern Aircraft Maintenance Co., Ltd.

Mr. Chen Wei Hua is the Chief Legal Adviser. Mr. Chen graduated from the school of law of Peking University and the School of Economics and Management of Tsinghua University with a master degree in Advanced Business Administration (EMBA). He is a qualified solicitor in the PRC and a qualified corporate legal counsellor. Mr. Chen joined the Civil Aviation Administration of China in 1988. He then joined the CSAHC in January 1991. From 1997 to 2003, he served as Vice Director and Director of the Legal Affairs Office of the Company. Currently, he is the General Manager of the Legal Department of the Company. Mr. Chen has been the Chief Legal Adviser to the Company since January 2004. Currently, Mr. Chen is also a director of Xiamen Airlines.

Mr. Xie Bing, the Company Secretary of the Company. He graduated from Nanjing University of Aeronautics and Astronautics, majoring in civil aviation management. He subsequently received a master degree of business administration and a master degree of international finance from Jinan University and the University of Birmingham, Britain respectively. Mr. Xie used to work in the Planning and Development Department, Company Secretary Office of the Board of Director of the Company and Office of CSAHC. He has been the Secretary of the Board of Directors and the Company Secretary of the Company since November 2007.

Save as disclosed above, none of the above Director or Supervisor or senior management of the Company has any relationship with any Directors, Supervisors, senior management, substantial shareholders of the Company.

### Compensation

The aggregate compensation paid to all Directors, Supervisors and Senior Management for 2009 was RMB14,913,000. For the year ended December 31, 2009, the Company paid an aggregate of approximately RMB922,000 on behalf of its executive Directors, Supervisors and Senior Management pursuant to the SA Pension Scheme and the retirement plans operated by various municipal governments in which the Company participates.

Details of Directors' and Supervisors' emoluments for the year ended December 31, 2009 are set out below:

	Directors' fees RMB'000	Salaries, allowances and benefits in kind RMB'000	Discretionary bonus RMB'000	Retirement scheme contributions RMB'000	Total RMB'000
<b>Executive directors</b>					
Si Xian Min	-	698	-	40	738
Li Wen Xin	-	608	-	40	648
Wang Quan Hua	-	550	-	40	590
Liu Bao Heng	-	550	-	40	590
Tan Wan Geng	-	672	-	38	710
Xu Jie Bo	-	572	-	38	610
Chen Zhen You	-	572	-	38	610
Zhang Zi Fang	-	590	-	38	628
<b>Supervisors</b>					
Sun Xiao Yi	-	550	-	40	590
Yang Guang Hua	-	407	-	17	424
Zhang Wei	-	345	-	40	385
Yang Yi Hua	-	266	-	38	304
Liang Zhong Gao	-	269	-	38	307
Li Jia Shi	-	118	-	19	137

Independent non-executive directors					
Wang Zhi	50	-	-	-	50
Sui Guang Jun	100	-	-	-	100
Gong Hua Zhang	100	-	-	-	100
Lam Kwong Yu	88	-	-	-	88
Total	338	6,767	-	504	7,609

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## Board Practices

Each Director's service contract with the Company or any of its subsidiaries provides prorated monthly salary upon termination of employment in accordance with his contract. The Director is entitled to paid leave in accordance with his contract. The term of office of a Director is three years. The term of office of the current Directors will end in 2010. A Director may serve consecutive terms upon re-election.

## Audit Committee

The audit committee is appointed by the Board of Directors and consists of three independent non-executive Directors. The current members of the audit committee are Gong Hua Zhang, Wang Zhi and Sui Guang Jun. Gong Hua Zhang is the chairman of the audit committee. The term of office of each member will end in 2010. A member may serve consecutive terms upon re-election. At least once a year, the committee is required to meet with the Company's external auditors without any executive members of the Board in attendance. The quorum necessary for the transaction of any business is two committee members. The Audit Committee held ten meetings in 2009, which were attended by all members.

The Audit Committee is required, amongst other things, to oversee the relationship with the external auditors, to review the Group's interim results and annual financial statements, to monitor compliance with statutory and listing requirements, to review the scope, if necessary, to engage independent legal or other advisers as it determines is necessary and to perform investigations. In addition, the Audit Committee also examines the effectiveness of the Company's internal controls, which involves regular reviews of the internal controls of various corporate structures and business processes on a continuous basis, and takes into account their respective potential risks and severity, in order to ensure the effectiveness of the Company's business operations and the realization of its corporate objectives and strategies. The scope of such examinations and reviews includes finance, operations, regulatory compliance and risk management. The Audit Committee also reviews the Company's internal audit plan, and submits relevant reports and concrete recommendations to the Board on a regular basis.

The Company has an internal audit department which reviews procedures in all major financial and operational activities. This department is led by the head of internal audit.

## Remuneration and Assessment Committee

The Remuneration and Assessment Committee is comprised of three members. Currently, the Remuneration and Assessment Committee is chaired by independent non-executive Director Sui Guang Jun with independent non-executive Director Gong Hua Zhang and executive Director Wang Quan Hua as members. The term of office of each member is three years. The term of office of the current members will end in 2010. A member may serve consecutive terms upon re-election. The Remuneration and Assessment Committee held one meeting in 2009, which were attended by all members.

The responsibilities of the Remuneration and Assessment Committee are to make recommendations on the remuneration policy and structure for Directors and senior management of the Company, to establish regular and transparent procedures on remuneration policy development and improvement and submit the Company's "Administrative Measures on Remuneration of Directors" and "Administrative Measures on Remuneration of Senior Management". In particular, the Remuneration and Assessment Committee has the duty to ensure that the Directors or any of their associates shall not be involved in the determination of their own remuneration packages.

The Remuneration and Assessment Committee consulted, when appropriate, the Chairman and/or the President about its proposals relating to the remuneration of other executive Directors. The Remuneration and Assessment Committee is provided with sufficient resources to discharge its duties and professional advice is available if necessary. The



Remuneration and Assessment Committee is also responsible for assessing performance of executive Directors and approving the terms of executive Directors' service contracts. The Remuneration and Assessment Committee has performed all its responsibilities under its terms of reference in 2009.

#### Nomination Committee

The Nomination Committee was established on June 28, 2007. Before that, nomination of directors and other senior management was mainly undertaken by the Board. According to the Articles of Association, the Board has the authority to appoint from time to time any person as director to fill a vacancy or as additional director. In selecting candidate directors, the Board focuses on their qualifications, technical skills, experiences (in particular, the experience in the industry in which the Group operates in case of candidates of executive directors) and expected contributions to the Group.

As at December 31, 2009, the Nomination Committee consists of three members, including Si Xian Min as chairman and Wang Zhi (Independent non-executive director) and Gong Hua Zhang (Independent non-executive director) as members. The responsibilities of the Nomination Committee are to make recommendations to the Board in respect of the size and composition of the Board based on the operational activities, assets and shareholding structure of the Company; study the selection criteria and procedures of Directors and executives and give advice to the Board; identify qualified candidates for Directors and executives; investigate and propose candidates for Directors and managers and other senior management members to the Board.

In accordance with relevant laws and regulations as well as the provisions of the Articles of Association of the Company, the Nomination Committee shall study and resolve on the selection criteria, procedures and terms of office for directors and managers with reference to the Company's actual situation. Any resolution made in this regard shall be filed and proposed to the Board for approval and shall be implemented accordingly. The Nomination Committee is provided with sufficient resources to discharge its duties and independently engages intermediate agencies to provide professional advice on its proposals if necessary.

The Nomination Committee held six meeting in 2009, which was attended by all members.

#### Employees

As of December 31, 2009, the Group had 50,412 employees, including 4,006 pilots, 7,521 flight attendants, 7,324 maintenance personnel, 6,257 sales and marketing personnel, 2,039 ground service personnel, 1,691 flight operation officers, 1,636 financial personnel and 9,860 administrative and 10,078 other personnel. All of the Group's pilots, flight attendants, maintenance personnel, administrative personnel and sales and marketing personnel are contract employees.

The Company's employees are members of a trade union organized under the auspices of the All-China Federation of Trade Unions, which is established in accordance with the Trade Union Law of China. A representative of the Company labor union currently serves on the Supervisory Committee of the Company. Each of the Company's subsidiaries has its own trade union. The Group has not experienced any strikes, slowdowns or labor disputes that have interfered with its operations, and the Group believes that its relations with its employees are good.

All employees of the Group receive cash remuneration and certain non-cash benefits. Cash remuneration consists of salaries, bonuses and cash subsidies provided by the Group. Salaries are determined in accordance with the national basic wage standards. The total amount of wages payable by the Group to its employees is subject to a maximum limit based on the profitability of the Group and other factors. Bonuses are based on the profitability of the Group. Cash subsidies are intended as a form of cost-of-living adjustment. In addition to cash compensation, the Group's contract employees receive certain non-cash benefits, including housing, education and health services, and the Group's temporary employees receive limited health services, but not housing or education.

#### Employee benefits

Employee benefits are all forms of considerations given and other related expenditures incurred in exchange for services rendered by employees. Except for termination benefits, employee benefits are recognized as a liability in the period in which the associated services are rendered by employees, with a corresponding increase in cost of relevant assets or expenses in the current period.

##### (a) Retirement benefits

Pursuant to the relevant laws and regulations of the PRC, the Group has joined a defined contribution basic retirement scheme for the employees arranged by local Labor and Social Security Bureaus. The Group makes contributions to the retirement scheme at the applicable rates ranging from 10% to 25% (2008: 9% to 24%) as required by the government organization. The contributions are charged to profit or loss on an accrual basis. When employees retire, the local Labor and Social Security Bureaus are responsible for the payment of the basic retirement benefits to the retired employees.

In addition, the Group has established a supplementary defined contribution retirement scheme for the benefit of employees in accordance with relevant regulations in the PRC. Under such supplementary scheme, the Group is required to make contributions not exceeding one-twelfth of the prior year's total salaries.

(b) Housing fund and other social insurances

Besides the retirement benefits, pursuant to the relevant laws and regulations of the PRC, the Group has joined defined social security contributions for employees, such as a housing fund, basic medical insurance, unemployment insurance, injury insurance and maternity insurance. The Group makes contributions to the housing fund and other social insurances mentioned above at the applicable rates based on the employees' salaries. The contributions are recognized as cost of assets or charged to profit or loss on an accrual basis.

(c) Termination benefits

When the Group terminates the employment relationship with employees before the employment contracts have expired, or provides compensation as an offer to encourage employees to accept voluntary redundancy, a provision for the termination benefits provided, is recognized in profit or loss when both of the following conditions have been satisfied:

The Group has a formal plan for the termination of employment or has made an offer to employees for voluntary redundancy, which will be implemented shortly;

- The Group is not allowed to withdraw from termination plan or redundancy offer unilaterally.

#### Workers' Compensation

There is no workers' compensation or other similar compensation scheme under the Chinese labor and employment system. As required by Chinese law, however, the Group, subject to certain conditions and limitations, pays for the medical expenses of any contract employee who suffer a work-related illness, injury or disability and continues to pay the full salary of, and provides all standard cash subsidies to, such employee during the term of such illness, injury or disability. The Group also pays for certain medical expenses of its temporary employees.

#### Share Ownership

As of the date of this Annual Report, no Director, Senior Management or Supervisor of the Company is a beneficial owner of any shares of the Company's capital stock. As of the date of this Annual Report, no arrangement has been put in place involving issue or grant of options or shares or securities of the Company to any of the Director, Senior Management, Supervisor or employees of the Company.

### ITEM 7. MAJOR SHAREHOLDERS AND RELATED PARTY TRANSACTIONS.

#### Major Shareholders

##### Share Capital Structure

As of May 7, 2010 the total share capital of the Company was divided into 8,003,567,000 shares, of which approximately 50.24% (4,021,150,000 A Shares) was directly held by CSAHC, approximately 18.74% (1,500,000,000 A Shares) was held by other domestic shareholders, and approximately 31.02% (2,482,417,000 H Shares) was held by Hong Kong and overseas shareholders (among which, approximately 29.27% (726,500,000 H Shares) was indirectly held by CSAHC). CSAHC owns, directly and indirectly, 59.32% of the total share capital of the Company, therefore it is entitled to exercise all the rights of a controlling shareholder, including the election of executive Directors.

##### Substantial Shareholders

As of May 7, 2010, the following shareholders had an interest of 5% or more in the Company's shares:

Name	Number of Shares	Approximate Percentage of the Total Number of Shares
CSAHC	4,021,150,000 A Shares (1)	50.24%
HKSCC Nominees Limited	1,744,633,398 H Shares (2)	21.80%
Nan Lung	721,150,000 H Shares	9.01%

The table below sets forth, as of May 7, 2010, the following entities hold 5% or more of the total number of H Shares issued by the Company.

Name	Number of H Shares	Approximate Percentage of
------	--------------------	---------------------------

the Total  
Number of H  
Shares

HKSCC Nominees Limited	1,744,633,398(2)	70.27%
Nan Lung	721,150,000(2)	29.05%

A Shares and H Shares have identical voting rights.

(1) CSAHC has right to acquire not more than 132,510,000 A Shares and through Nan Lung Holding Limited (a wholly-owned subsidiary of CSAHC), to acquire not more than 312,500,000 H Shares, pursuant to the A Shares subscription agreement dated March 8, 2010 entered into between the Company and CSAHC and the H Shares subscription agreement dated March 8, 2010 entered into between the Company and Nan Lung, respectively. Both of the subscription agreements were approved by the shareholders of the Company. 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 and are pending approval from the relevant security regulatory authorities.

- (2) Among the 1,744,633,398 H Shares held by HKSCC Nominees Limited, CSAHC had an interest in an aggregate of 5,350,000 H Shares through Asia Travel Investment Company Limited, a wholly-owned subsidiary of CSAHC in Hong Kong (representing approximately 0.2% of the then total issued H Shares).

#### Related Party Transactions

The Company enters into transactions from time to time with CSAHC and its associates. For a description of such transactions, see Note 45 to the Financial Statements. In particular, the following arrangements, which the Company believes are material to its operations, have been made between the Company and CSAHC and its associates during the year ended December 31, 2009 and up to the latest practicable date. The Company believes that these arrangements have been entered into by the Company in the ordinary course of business and in accordance with the agreements governing such transactions.

#### Arrangements with CSAHC

##### Non-Public Subscriptions

On August 20, 2009 and August 21, 2009, the Company issued 721,150,000 A shares to CSAHC and 721,150,000 H shares to Nan Lung for net cash considerations of RMB2,259 million and RMB721 million, respectively.

On March 8, 2010, the board of the Company approved (i) the placement of not more than 1,766,780,000 new A shares to not more than 10 specific investors (subject to the maximum number as permitted by PRC laws and regulations at the time of the issuance) including CSAHC, at the same subscription price of not less than RMB5.66 per A share; and (ii) the placement of not more than 312,500,000 new H shares to Nan Lung, at the subscription price of not less than HKD2.73 per H share.

On the same date, the Company entered into the A shares subscription agreement with CSAHC, pursuant to which CSAHC conditionally agreed to subscribe and the 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, the Company and Nan Lung entered into the H shares subscription agreement, pursuant to which Nan Lung conditionally agreed to subscribe and the 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 HKD2.73 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 and are pending approval from the relevant security regulatory authorities.

#### Trademark License Agreement

The Company and CSAHC entered into a ten year trademark license agreement dated May 22, 1997 pursuant to which CSAHC acknowledges that the Company has the right to use the name "China Southern" and "China Southern Airlines" in both Chinese and English, and grants the Company a renewable royalty free license to use the kapok logo on a worldwide basis in connection with the Company's airline and airline-related businesses. As CSAHC did not give a written notice of termination three months before the expiration of the agreement, the agreement is automatically renewed for another ten year term. In May of 2007, the Trademark License Agreement has been renewed by the two parties for another ten-year term till 2017.

#### Leases

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

- (1)

On December 19, 2006, the Company entered into a master lease agreement with CSAHC with a term valid from January 1, 2006 to December 31, 2008 (“Lease Agreement”). The Company renewed the Lease Agreement with CSAHC on December 29, 2008. Pursuant to the Lease Agreement, CSAHC agrees to continue to lease to the Company certain parcels of land, properties, and civil aviation structures and facilities at existing locations in Guangzhou, Haikou, Wuhan, Hengyang, Jingzhou (previously known as “Shashi”) and Nanyang as well as some additional locations in Beijing, Shanghai, Changsha, Shenyang, Dalian, Harbin and Changchun, etc.. The Lease Agreement is valid from January 1, 2009 to December 31, 2011 and the annual rents payable to CSAHC under the Lease Agreement for 2009, 2010 and 2011 are RMB37,148,660, RMB39,006,093 and RMB40,956,397.65 respectively.

For the year ended December 31, 2009, the rent incurred by the Group amounted to RMB37,148,660 pursuant to such Lease Agreement.

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

(3) Due to the expiration on December 31, 2007 of the Land Use Rights Lease Agreement between the Company and CSAHC, the Property Lease Agreement between the Company and CSAHC, and China Northern Airlines, as well as the Property Lease Agreement between the Company and CSAHC and Xinjiang Airlines on November 12, 2004, and in order to ensure normal operation of the Company, the Company, based on the actual leasing conditions of both parties, consolidate the three agreements into two agreements by the type of the leased properties, namely the Land Lease Agreement and the Property Lease Agreement. Those two agreements were entered into between the Company and CSAHC on January 10, 2008 and effective for a period from January 1, 2008 to December 31, 2010. As provided for in the Land Lease Agreement and the Property Lease Agreement, the lease areas of the related lands and properties were changed to 1,104,209.69 square meters and 197,010.37 square meters respectively, and their annual rentals were adjusted to RMB21,817,145.00 and RMB48,474,632.77, or an aggregate of RMB70,291,777.77 for each of the years from 2008 to 2010. The rentals were determined by reference to the market rents of the same district and on the basis that unit rental and payment terms remained unchanged.

For the year ended December 31, 2009, the rents for land lease and property lease incurred by the Group amounted to RMB21,817,145.00 and RMB48,474,632.77 respectively pursuant to such lease agreement.

#### Arrangements with CSAHC's Associates

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

On January 10, 2008, the Company entered into an Import and Export Agency Framework Agreement with SAIETC, pursuant to which the parties shall cooperate on the following business domains: import and export, customs clearance, customs declaration and inspection, tendering and agency, etc. The agreement is valid from January 1, 2008 to December 31, 2010, and the annual cap for the commission should not exceed RMB90,000,000.

For the year ended December 31, 2009, the agency fee incurred by the Group to SAIETC in respect of the import and export of above service was RMB67,936,000.

Southern Airlines Culture and Media Co., Ltd. ("SACM"), which is 50% owned by the Company and 50% owned by CSAHC

On April 12, 2007, the Company and SACM entered into an Advertising Agency Framework Agreement for a term of three years commencing from the date of the agreement. Under the agreement, SACM will produce advertisement script, graphic and music for the Company with the copyrights of such products belonging to the Company, subject to compliance with the relevant provisions of the Listing Rules. The parties have determined the various rates for providing advertising services after negotiations on a fair and equitable basis, and SACM has promised that the advertising fees for which they charged the Company were all based on the prevailing market prices for similar business which were accepted by the Company. As set forth in the agreement, the transaction cap for 2007, 2008 and 2009 were RMB16,000,000, RMB20,500,000 and RMB25,500,000, respectively.

As the Advertising Agency Framework Agreement had expired and the transactions contemplated under the Advertising Agency Framework Agreement would continue to be entered into on a recurring basis with an expansion of scope between the parties, the Company has entered into the Media Services Framework Agreement on May 11, 2010 for a term of three years from January 1, 2010 to December 31, 2012. Pursuant to the agreement, SACM will provide the following services to the Group: (1) exclusive advertising agency services, including the design, production, broadcast and agency of international and domestic screen, print, outdoor and other forms of advertisement; (2) the plotting, purchase and production of in-flight TV and movie program agency services; (3) public relations services relating to recruitment of airhostess, including organising and implementation of the promotional recruitment activities, on-site recruitment activities, and production of promotional advertising program;



and (4) services relating to the distribution of newspapers and magazines issued by SACM within places of the Company services. As set forth in the agreement, the revised transaction cap for 2010, 2011 and 2012 were RMB40,000,000, RMB48,000,000 and RMB58,000,000, respectively.

For the year ended December 31, 2009, the advertising fees incurred by the Group to SACM for the advertising services amounted to RMB20,868,000.

SA Finance which is 66% controlled by CSAHC, 21% owned by the Company and 13% owned in aggregate by four subsidiaries of the Company

On November 15, 2007, the Company renewed the Financial Services Framework Agreement with SA Finance for a term of three years starting from January 1, 2008 to December 31, 2010.

Under such agreement, SA Finance agrees to provide to the Group deposit and loan services. SA Finance shall pay interests to the Company regularly at a rate not lower than the current deposit rates set by the People's Bank of China. The Group's deposits placed with SA Finance were re-deposited in a number of banks. SA Finance has agreed that the loans it provided to CSAHC and its subsidiaries other than the Group should not exceed the aggregate of share capital, reserves and total deposits of other companies (excluding the Group). The rates should be determined on an arm's length basis and based on fair market rate, and should not be higher than those available from independent third parties. The parties agreed that the balance of the Group's deposits placed with SA Finance (including accrued interests) should not at any time exceed RMB2,600,000,000, nor should the balance of loans borrowed from SA Finance at any time exceed the above-mentioned level. The annual cap of fees payable to SA Finance for the other financial services should not exceed RMB5,000,000.

As of December 31, 2009, the Group's deposits placed with SA Finance amounted to RMB862,015,000.

#### Freight Agency Agreement

The Company has entered into Ticket Agency Agreements with several subsidiaries of CSAHC (the "Agents") for the sale of the Group's air tickets. The Agents charge commission with reference to the prevailing market rate. Besides, the Company has other air ticket sales agents in China who also charge commission at the same rates. The Agents also act as the ticket sales agents of other airline companies in China, and charge commission at the same rates offered to the Group.

The Company and China Southern Airlines Group Passenger and Cargo Agent Company Limited ("PCACL"), a wholly-owned subsidiary of CSAHC have entered into the Framework Agreement on Expanded Businesses Including the Sale of Air Tickets, the Airfreight Forwarding Services, Chartered Flight and Pallets Agency Services, Delivery Services For the Outside Storage Area and the Relevant Internal Operation Services For the Inside Storage Area of China Southern Airlines Company Limited dated January 10, 2008 (the "Freight Agency Agreement"), which is valid from January 1, 2008 to December 31, 2010. Pursuant to the Freight Agency Agreement, the cooperative scope of both parties thereto mainly comprises extended businesses including air ticket sales agency services, airfreight forwarding sales agency services, chartered flight and pallets agency services, internal operation services for the inside storage area, and delivery services for the outside storage area and chartered flight and pallets sales agency business. The annual transaction cap of the sales value shall not exceed RMB250,000,000.

For the year ended December 31, 2009, the amount of ticket and cargo sales of the Group conducted through the above Agents was RMB182,019,000.

Guangzhou China Southern Airlines Property Management Company Limited (the "GCSAPMC"), which is 100% owned by CSAHC

The Company and GCSAPMC entered into a Framework Agreement for the Engagement of Property Management ("Property Management Framework Agreement") dated January 1, 2006 to engage GCSAPMC to provide property management and improvement service for a term of three years. Pursuant to the agreement, the Company has appointed GCSAPMC to provide management and maintenance services for the Company's headquarters in Guangzhou and to provide maintenance and management services for the 110KV transformer substation to ensure the ideal working conditions of the Company's production and office facilities and physical environment, and the normal operation of equipment. The fee charging schedule (or charge standard) shall be determined on an arm's length basis between both parties, and shall not be higher than the one charged by any independent third parties in the similar industry. The annual cap for the Property Management Framework Agreement is set at RMB47,010,000. The Company renewed the Property Management Framework Agreement with GCSAPMC on December 29, 2008 for a term of three years from January 1, 2009 to December 31, 2011, and there is no change in the scope of services and

the annual caps.

For the year ended December 31, 2009, the property management and maintenance fee incurred by the Group amounted to RMB19,471,000 pursuant to the Property Management Framework Agreement.

#### Disposal of Equity Interest

A resolution was passed at the board meeting of the Company on September 28, 2009, pursuant to which the Company was approved to transfer its 50% equity interests in MTU to CSAHC by way of agreement. The resolution also authorized the Executive Directors of the Company to execute the relevant equity interest transfer agreement. The Company entered into an equity interest transfer agreement with CSAHC on September 28, 2009. The transfer was considered and approved by the Independent Shareholders of the Company at the second extraordinary general meeting in 2009. Pursuant to the agreement, the Company transferred its 50% equity interests in MTU to CSAHC at a consideration of RMB1,607,850,000.

As at December 31, 2009, the sale was approved by the State Owned Assets Supervision and Administration Commission of the PRC and shareholders of the Company and was pending approval by the Ministry of Commerce of the PRC. The sale was subsequently approved by the Ministry of Commerce of the PRC in January 2010, and the Company received the acquisition consideration from CSAHC in full in February 2010.

#### Others

On May 7, 2009, the Company entered into the Airline Service Agreement with TravelSky Technology Limited (“TravelSky”) for the period from January 1, 2009 to December 31, 2009. In December 2009, the Company and TravelSky agreed to extend the term of the Airline Service Agreement for the period from January 1, 2010 to December 31, 2010. Mr. Wang Quan Hua, a director of the Company also serves directorship in TravelSky, which is a provider of information technology solutions for aviation and travel industry. Pursuant to the agreement, TravelSky agrees to provide to the Company with flight control system services, electronic travel distribution system services, ticket-reservation system extended services and civil aviation and commercial data network services. In return, the Company pays service fees to TravelSky with reference to the standard rate set by CAAC. Such transaction has been approved by the Board of the Company and will be submitted for approval at the General Meeting of the Shareholders. The total service fee paid by the Company to TravelSky for 2009 was RMB357 million.

All related party transactions have been approved by Independent Non-executive Directors.

#### Interests of Experts and Counsel

Not applicable.

### ITEM 8. FINANCIAL INFORMATION.

#### Consolidated Statements and Other Financial Information

Our audited consolidated financial statements are set forth beginning on page F-1, which can be found after Item 19.

#### Significant Changes

No significant changes have occurred since the date of the financial statements.

#### Legal Proceedings

A writ of summons was issued on May 30, 2007 by the High People's Court of Guangdong Province relating to a claim that certain sales agents in Taiwan (the "plaintiffs") against the Company for the alleged breach of certain terms and conditions of a cooperative agreement (the "cooperative agreement"). The plaintiffs have made a claim against the Company for a total sum of approximately HKD107 million and an unspecified compensation for early termination of the cooperative agreement.

In May 2008, The High People's Court of Guangdong Province rejected the claims made by the plaintiffs, and the plaintiffs were ordered to bear all litigation expenses in respect of the first trial. The plaintiffs submitted an appeal to The Supreme People's Court of the People's Republic of China.

The directors considered that the claim was without merit and had no material adverse effect on the financial position of the Group, and accordingly no provision in respect of the claims was made in the financial statements.

In May 2009, the Company has received the civil judgment from the Supreme People's Court of the PRC, pursuant to which the plaintiffs were allowed to withdraw their appeal. Accordingly, the verdict brought in by the High People's Court of Guangdong Province became legally effective and such verdict is final and conclusive on the parties.

#### Dividend Information

No interim dividend was paid during the year ended December 31, 2009. The Board of Directors does not recommend the payment of a final dividend in respect of the year ended December 31, 2009.

### ITEM 9. THE OFFER AND LISTING.

#### Offer and Listing Details

The principal trading market for the Company's H Shares is the Hong Kong Stock Exchange, and the Company's trading code is "1055". The Company completed its initial public offering of H Shares on July 30, 1997. The ADRs, each representing 50 H Shares, are evidenced by ADRs issued by the Bank of New York as the depository. The ADRs have been listed for trading on the New York Stock Exchange since July 31, 1997, under the symbol "ZNH".

The principal trading market for the Company's A Shares is the Shanghai Stock Exchange with trading code of "600029". On July 25, 2003, the Company completed its initial public offering of A Shares.

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

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The Hong Kong  
Stock Exchange  
Price per H Share  
(HK\$)

The New York  
Stock Exchange  
Price per ADR  
(US\$)

The Shanghai  
Stock Exchange  
Price per A Share  
(RMB)

High

Low

High

Low

High

Low