

CHINA SOUTHERN AIRLINES CO LTD  
Form 20-F  
April 27, 2012

**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, 2011**

**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**

(Address of principal executive offices)

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**PEOPLE'S REPUBLIC OF CHINA**

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

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

Title of each class	Name of each exchange on which registered
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Ordinary H Shares of par value RMB1.00 per share represented by American Depository Receipts	New York Stock Exchange
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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. 7,022,650,000 ordinary A Shares of par value RMB1.00 per share and 2,794,917,000 ordinary H Shares of par value RMB1.00 per share were issued and outstanding as of December 31, 2011.

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 has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes  No



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

Large accelerated filer  Accelerated filer  Non-accelerated filer

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  Other   
as issued by the International Accounting Standards Board

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 “estimate”, “project”, “expect”, “intend”, “believe”, “plan”, “anticipate”, “may”, or their negatives or other comparable words. Also look for discussions of strategy that involve risks and uncertainties. Forward-looking statements include statements regarding the outlook for our future operations, forecasts of future costs and expenditures, evaluation of market conditions, the outcome of legal proceedings (if any), the adequacy of reserves, or other business plans. You are cautioned that such forward-looking statements are not guarantees and involve risks, assumptions and uncertainties. Our 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;

- the impact of unusual events on our business and operations;

- actions by government authorities, including changes in government regulations, and changes in the CAAC’s regulatory policies;

- our relationship with China Southern Air Holding Company (the “CSAHC”);

- uncertainties associated with legal proceedings;

- technological development;

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

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", "we", "us" and "our" 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 53.07% interest in the Company as of April 20, 2012.

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, 2011 (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 = RMB6.3009, 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, 2011. 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

#### *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

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.

#### A. Selected Financial Data.

The following tables present selected financial data for the five-year period ended December 31, 2011. The selected consolidated income statement data for the three-year period ended December 31, 2009, 2010 and 2011 and selected consolidated statement of financial position data as of December 31, 2010 and 2011 excluding basic and diluted earnings 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, 2007 and 2008 and selected consolidated statement of financial position data as of December 31, 2007, 2008 and 2009 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,**

2011	2011	2010	2009	2008	2007
US\$	RMB	RMB	RMB	RMB	RMB

(in million, except per share and per ADR data)

**Consolidated Income Statement Data:**

Operating revenue	14,346	90,395	76,495	54,802	55,288	54,401
Operating expenses	(13,817)	(87,063)	(70,689)	(55,355)	(61,771)	(52,960)
Operating profit/(loss)	691	4,353	6,282	1,436	(5,650)	1,877
profit/(loss) before taxation	1,099	6,930	8,089	428	(4,728)	2,875
profit/(loss) for the year	966	6,090	6,412	524	(4,789)	2,029
profit/(loss) attributable to:						
Equity shareholders of the Company	810	5,110	5,792	327	(4,826)	1,836
Non-controlling interests	156	980	620	197	37	193
Basic and diluted earnings/(loss) per share	0.08	0.52	0.70	0.05	(0.74)	0.28
Basic and diluted earnings/(loss) per ADR	4.13	26.02	34.83	2.31	(36.78)	13.99

**Year ended December 31,**

2011	2011	2010	2009	2008	2007
US\$	RMB	RMB	RMB	RMB	RMB

(in million)

**Consolidated Statement of Financial Position Data:**

Cash and cash equivalents	1,565	9,863	10,404	4,343	4,649	3,824
Other current assets	1,527	9,622	5,455	4,785	4,599	4,966
Asset classified as held for sale	-	-	-	529	-	-
Property, plant and equipment, net	13,920	87,711	80,214	63,673	53,237	58,441
Total assets	20,539	129,412	111,335	94,856	83,151	82,118
Bank and other loans, including long-term bank and other loans due within one year	2,982	18,789	9,324	17,452	22,178	24,948
Short-term financing bills	-	-	-	-	2,000	-
Obligations under capital leases due within one year	283	1,784	1,654	1,431	1,781	2,877
Bank and other loans, excluding balance due within one year	4,608	29,037	31,876	27,875	17,429	9,074
Obligations under capital leases, excluding balance due within one year	2,230	14,053	12,776	11,887	11,157	12,858
Total equity	5,995	37,777	30,316	13,368	9,588	14,422
Number of shares (in million)	9,818	9,818	9,818	8,003	6,561	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, 2011 have been derived from consolidated financial statements prepared in accordance with IFRSs and other data provided by the Group which have not been audited.

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,**

	2011	2010	2009	2008	2007
Capacity					
ASK (million)	151,064	140,498	123,441	112,767	109,733
ATK (million)	20,795	19,140	15,446	14,276	14,208
Kilometers flown (thousand)	939,233	872,899	746,133	686,236	675,127
Hours flown (thousand)	1,507	1,392	1,195	1,106	1,075
Number of landing and take-offs	702,264	686,223	616,296	556,914	543,789
Traffic					
RPK (million)	122,344	111,328	93,002	83,184	81,727
RTK (million)	14,461	13,104	10,067	9,200	9,250
Passengers carried (thousand)	80,677	76,456	66,281	58,237	56,903
Cargo and mail carried (tons)	1,135,000	1,117,000	862,000	835,000	872,000
Load Factors					
Passenger load factor (RPK/ASK) (%)	81.0	79.2	75.3	73.8	74.5
Overall load factor (RTK/ATK) (%)	69.5	68.5	65.2	64.4	65.1
Breakeven load factor (%)	69.4	65.3	68.1	73.8	64.8
Yield					
Yield per RPK (RMB)	0.67	0.62	0.54	0.61	0.61
Yield per cargo and mail ton kilometers (RMB)	1.61	1.70	1.63	1.96	1.87
Yield per RTK (RMB)	6.03	5.66	5.26	5.86	5.75
Fleet					
— Boeing	223	208	194	179	177
— Airbus	208	191	157	133	119
— McDonnell Douglas	-	12	16	25	25
— Others	13	11	11	11	11
Total aircraft in service at period end	444	422	378	348	332
Overall utilization rate (hours per day)	9.8	9.6	9.4	9.1	9.4

**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 <sup>(1)</sup> (RMB per US\$)	High	Low
Annual Exchange Rate				
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
2010	6.6000	6.7696	6.8330	6.6000
2011	6.2939	6.4630	6.6364	6.2939

(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		
October 2011	6.3825	6.3534
November 2011	6.3839	6.3400
December 2011	6.3733	6.2939
January 2012	6.3330	6.2940
February 2012	6.3120	6.2935
March 2012	6.3315	6.2975
April 2012 (up to April 20, 2012)	6.3150	6.2975

#### B. Capitalization and Indebtedness.

Not applicable.

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

Not applicable.

D. Risk Factors.

**Risks Relating to our Business**

*We are indirectly majority owned by the Chinese government, which may exert influence in a manner that may conflict with the interests of holders of 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 53.07% of the equity of the Company. On March 8, 2010, we 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 shares. In addition, the Company and Nan Lung, a wholly-owned subsidiary of CSAHC, entered into an H shares subscription agreement, pursuant to which Nan Lung has conditionally agreed to subscribe and we have conditionally agreed to allot and issue new H shares of not more than 312,500,000 shares. The foregoing subscriptions of 123,900,000 A shares by CSAHC and 312,500,000 H shares by Nan Lung were completed on October 29, 2010 and November 1, 2010, respectively. 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 disproportionately 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 disproportionately 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 by fluctuations in the Renminbi-U.S. dollar exchange rate. Net exchange gain increased by RMB1,009 million, from RMB1,746 million in 2010 to RMB2,755 million in 2011 mainly attributable to the exchange gain arising from retranslation and settlement of bank and other loans balances and finance lease obligations denominated in U.S. dollars, as a result of the significant appreciation of Renminbi against U.S. dollar in 2011.



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

We have a substantial amount of debt, lease and other obligations, and will continue to have a substantial amount of debt, lease and other obligations in the future. As of December 31, 2011, the Group's current liabilities exceeded its current assets by RMB24,928 million. The Group generally maintains sound operating cash flow. However, our substantial indebtedness and other obligations 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 2011 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. If our operating cash flow is materially and adversely affected by factors such as increased competition, a significant decrease in demand for our services, or a significant increase in jet fuel prices, our liquidity would be materially and adversely affected. Moreover, 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 availability of external financing on acceptable terms are inaccurate. In particular, our ability to obtain adequate external funding may be impacted by the economic stagnation globally. If we are unable to obtain adequate financing for our capital requirements, our liquidity and operations would be materially and adversely affected.

As of December 31, 2011, the Group had banking facilities with several PRC commercial banks for providing loan finance up to approximately RMB127,448 million, of which approximately RMB36,414 million was utilized. Our directors believe that sufficient financing will be available to the Group in 2012. However there can be no assurance that such loan financing will be available on terms acceptable to the Group or at all.

*CSAHC will continue to be our controlling shareholder, and its interests may conflict with those of the Group. CSAHC and certain of its affiliates will continue to provide certain important services to the Group. Any disruption of the provision of services by CSAHC or its affiliates 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 affiliates 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 ticket selling services, property management services, leasing of properties and financial services, and repair, overhaul and maintenance services on jet engines. The interests of CSAHC may conflict with those of the Group. In addition, any disruption of the provision of services by CSAHC's affiliates 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 certain amount of demand deposits after independent shareholders' approval 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, we have 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, 2010 and 2011, the Group had deposits of RMB1,111 million and RMB2,493 million, respectively, with SA Finance.

*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.*

Both international and domestic economic fluctuations and Chinese macroeconomic controls affect the demand for air travel. For example, US subprime crisis, an adverse impact on the global economy beginning in 2007 and lasting several years has significantly weakened the demand for air travel during the past few years. Although the macroeconomic environment showed overall improvement in the first half of fiscal 2011, the development of certain economic indicators as well as the recent turbulences in the financial markets in the second half of fiscal 2011, primarily as a result of the ongoing sovereign debt crisis in the Eurozone, still indicate a highly volatile macroeconomic environment. It is uncertain how long these effects will last. The continuing global economic slowdown may have a negative effect on 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.

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 labor 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.

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 behavior.*

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 behavior in the future, it could have a material adverse impact on us.

In 2011, a number of large-scale natural disasters occurred globally, such as the nuclear meltdown in Japan caused by earthquakes and subsequent tsunami, the hurricane on the East Coast of the United States, the flooding in Thailand and the typhoon in the Philippines. 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 us 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 Group leased certain properties and buildings from CSAHC which are located in Guangzhou, Wuhan, Haikou and other PRC cities. 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.

As of the date of this Annual Report, we have 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. We 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 us 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, travelers between Taiwan and Mainland 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, Mainland China and Taiwan agreed to regular direct passenger charter flights across the Taiwan Strait. On August 31, 2009, Mainland China and Taiwan extended the number of regular cross-Strait direct passenger flights from 108 to 270 a week. From October 31, 2010, cross-Strait direct passenger flights increased to 370 per week. On June 15, 2011, the transport departments on both sides of the Strait decided that the number of weekly cross-Strait direct passenger flights would significantly increase to 558, representing an increase of over 50% from the previous number.

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. Terrorist attacks could also affect the aviation industry in China. Notably, on March 7, 2008, on a China Southern Airlines flight boarding in Urumqi, crew members discovered a suspected terrorist. On July 15, 2010, a passenger jet en route from Urumqi to Guangzhou was forced to make an emergency landing due to a bomb scare. CAAC has enhanced security measures, but the effectiveness of such measures cannot be ascertained. 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 aviation industry. Among possible effects that terrorist attacks could have on the Company 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 significant decrease in traffic measured in revenue passenger kilometer.

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

An accident or incident involving one of our aircraft could require repair or replacement of a damaged aircraft, its consequential temporary or permanent loss from service and/or significant liability to injured passengers and others. Although we believe that we currently maintain liability insurance in amounts and of the types generally consistent with industry practice, the amounts of such coverage may not be adequate to fully cover the costs related to the accident or incident, which could result in harm to our results of operations and financial condition. In addition, any aircraft accident or incident, even if fully insured, could cause a public perception that we are not as safe or reliable as other airlines, which would harm our competitive position and result in a decrease in our operating revenues. Moreover, a major accident or incident involving the aircraft of any of our competitors may cause demand for air travel in general to decrease, which would adversely affect our results of operations and financial condition.

*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 launched the computerized flight operations control system 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 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 those systems. Any substantial or repeated failure of those systems could adversely affect 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 effect on our operations and our business.

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

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

Our independent registered public accounting firm or PRC Auditor may not be satisfied with our internal controls, the level at which our controls are documented, designed, operated and reviewed. Our independent registered public accounting firm or PRC Auditor may also interpret the requirements, rules and regulations differently, and reach a different conclusion regarding the effectiveness of our internal control over financial reporting. Although our management have concluded that our internal control over financial reporting as of December 31, 2011 was effective, we may discover deficiencies in the course of our future evaluation of our internal control over financial reporting and may be unable to remediate such deficiencies in a timely manner. If we fail to maintain the adequacy of our internal control over financial reporting, we may not be able to conclude that we have effective internal control over financial reporting on an ongoing basis, as required under the above mentioned rules and regulations. Moreover, effective internal control is necessary for us to produce reliable financial reports and is important to prevent fraud. As a result, our failure to achieve and maintain effective internal control over financial reporting could result in the loss of investor confidence in the reliability of our financial statements, which in turn could harm our business and negatively impact the trading prices of our 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 2011. However, there can be no assurance that we will not be a PFIC for the taxable year 2012 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 we were a PFIC, you would generally be subject to additional taxes and interest charges on certain “excess” distributions the Company makes regardless of whether we continue 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”.

*We may be unable to retain key management personnel.*

We are dependent on the experience and industry knowledge of our key management employees, and there can be no assurance that we will be able to retain them. Any inability to retain our key management employees, or attract and retain additional qualified management employees, could have a negative impact on us.

## **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 relevant government agencies, particularly CAAC, which encompasses substantially all aspects of the Chinese commercial aviation industry, such as the approval of route allocation and pricing of domestic air fare, the administration of certain 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 government 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 2011 accounted for 67.6% 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, which are supervised by the CAAC. Chinese airlines may also purchase jet fuel 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 adjustments thereafter. The NDRC further adjusted domestic price for jet fuel for multiple times in 2010, which have resulted in an increase in jet fuel price. In addition, the NDRC has recently lowered the rate of fuel surcharge from 0.00002691 per km to 0.00002541 per km, starting from April 1, 2012 and ending on March 31, 2013. Based on that rate, for every RMB100 by which the cost of jet fuel exceeds RMB4,140 per ton, the airlines are allowed to charge RMB0.00002541 per km for the flight distance. The Group's net income may suffer from an unexpected change in the fuel surcharge collection policies and other factors beyond our control.

(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 operation and financial 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 2011, a reasonable possible increase or decrease of 10% in jet fuel price with volume of fuel consumed and all other variables held constant, would have increased or decreased the Group's annual fuel costs by approximately RMB3,268 million. 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 RMB4,140 per ton (i.e., the benchmark price of jet fuel), airlines should not charge fuel surcharge. When the purchase cost of jet fuel exceeds RMB4,140 per ton, the airlines may charge appropriate fuel surcharge provided that such airlines should digest at least 20 percent of the increased 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 trains (as discussed below), the construction of nationwide high-speed railway

network and the improvement of inter-city expressway network, the commercial aviation sector as a whole faces increasing competition from the alternative means of transportation such as railways and highways.

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

The PRC government is aggressively implementing the expansion of its high-speed rail network, which will provide train services at a speed of up to 350km per hour connecting major cities such as Beijing, Shanghai, Wuhan, Qingdao, Guangzhou, Dalian and Hong Kong. The expansion of the coverage of this network and improvements in railway service quality, increased passenger capacity and stations located closer to urban centers than competing airports could enhance the relative competitiveness of the railway service and affect our market share on some of our key routes, in particular our routes of between 500km to 800km. Increased competition and pricing pressures from railway service may have a material adverse effect on our financial condition and results of operations.

*Due to limitation on foreign ownership imposed by Chinese government policies, the Company may have limited access to the international equity capital markets.*

Chinese government policies limit foreign ownership in Chinese airlines. Under these policies, the percentage ownership of our 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 28.47% 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, we will have limited access to the international equity capital markets.

*The European Emissions Trading Scheme may increase operational cost of the Group.*

Starting on January 1, 2012, aviation sector will be included in the European Emissions Trading Scheme (ETS), EU’s mandatory cap-and-trade system for reduction of GHG emissions. Airline operators arriving and departing in the EU will receive tradable emission permits (aviation allowances) covering a certain level of their CO<sub>2</sub> emissions per year for their flights operating to and from EU airports. If an airline fails to obtain free-of-charge emission permits from the EU, it will have to buy around EUR10 million (RMB 100 million) worth of CO<sub>2</sub> emissions allowances from other greener industries. The China Air Transport Association estimated that Chinese carriers will be forced to pay an estimated RMB743 million annually to comply with the ETS. Recently, a group representing China’s largest airlines sent a formal notice to the EU expressing strong opposition to non-member-state airlines’ inclusion in the EU’s Emissions Trading Scheme. Also, in early February 2012, CAAC issued instructions to various airlines announcing that without approval from the relevant government authorities, the major airlines are prohibited from joining the ETS and the transport airlines are also prohibited from raising the freight price or increasing fee items by adducing this reason. There can be no assurance that the formal notice and instructions would change the position of the EU on the non-member-state airlines’ inclusion in the ETS.



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

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

### **Risks Relating to the PRC**

*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, the Renminbi is fully convertible for current account transactions, but is not freely convertible for capital account transactions. All foreign exchange transactions involving Renminbi must take place either through the People's Bank of China or other institutions authorized to buy and sell foreign exchange or at a swap centre.

The Group has significant exposure to foreign currency risk as substantially all of the Group's obligations under leases, bank and other loans and operating lease commitment 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, which were fully settled in 2011, 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 may in the future deprive us of preferential income tax rates, which we currently enjoy.*

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 to 25% with effect starting from January 1, 2008. Prior to enactment of the new tax law, certain branches and subsidiaries of the Company 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. To the extent that there are any withdrawals of, or changes in, the preferential tax treatment that we currently enjoy, our tax liability may increase correspondingly and our results of operations and financial condition may be adversely affected.

*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%. Dividend income received by any foreign individual that holds overseas shares in Chinese enterprise is generally subject to individual income tax at a flat rate of 20%, subject to exemption or reduction by an applicable double-taxation treaty.

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

As a public company, our auditor is required by law to undergo regular Public Company Accounting Oversight Board ("PCAOB") inspection to assess its compliance with US law and professional standards in connection with its audits of our financial statements filed with the SEC. The PCAOB, however, is currently unable to inspect the audit work and practices of our auditor, which prevents PCAOB from regularly evaluating our auditor's audits and its quality control procedures. As a result, our investors in the US cannot rely on PCAOB's oversight of our audited financial statements.

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

##### A. History and Development of the Company.

We are a joint stock company incorporated in China on March 25, 1995, and is 53.07% owned by CSAHC. Our registered address is Guangzhou Economic & Technology Development Zone, People's Republic of China (telephone no: (86)20-8612-4462, website: [www.csair.com](http://www.csair.com)).

In July 1997, we issued 1,174,178,000 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.

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

In July 2003, we issued 1,000,000,000 A Shares with a par value of RMB1.00 each and listed these shares on the Shanghai Stock Exchange.

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

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

On August 14, 2007, we 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.

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

In June 2009, we 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, we entered into an agreement with CSAHC to dispose of its 50% equity interest in Zhuhai MTU Maintenance Zhuhai Co., Ltd (“Zhuhai 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.

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

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

#### Aircraft Acquisitions

Pursuant to an aircraft acquisition agreement dated April 18, 2008 between Xiamen Airlines and The Boeing Company (“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\$1.5 billion, including the purchase 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 an A320 Series Aircraft Purchase Agreement dated January 20, 2010 between the Company and Airbus SNC, we will acquire 20 Airbus 320 series aircraft from Airbus SNC. According to the information provided by Airbus SNC, the catalogue price of an Airbus 320 aircraft is around US\$76.9 million including price for airframe and engines. 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.

On September 30, 2010, Xiamen Airlines entered into a supplemental agreement with Boeing to purchase additional 10 Boeing B737 series aircraft. The aggregate catalogue price for those aircraft is around US\$699 million, including price for airframe and engines. According to the information provided by Boeing, 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 2015 to October 2016.

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

On May 31, 2011, we entered into an aircraft acquisition agreement with Boeing to purchase six Boeing B777F freighters. According to the information provided by Boeing, the catalogue price for one aircraft is US\$264 million, including the price for the airframe and engines. The aggregate consideration for the Acquisition will be partly payable by cash and partly by financing arrangements with banking institutions. The six Boeing B777F freighters will be delivered in stages to us during the period commencing from 2013 to 2015.

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

On February 28, 2012, we entered into an agreement with the Boeing Company to purchase 10 Boeing 777-300ER aircraft. According to the information provided by Boeing, the catalogue price of one Boeing B777-300ER aircraft is around US\$298 million, including price for airframe and engines. The aggregate consideration for the acquisition will be partly payable in cash and partly through financing arrangements with banking institutions. The Boeing aircraft will be delivered in stages to the Company during the period from 2013 to 2016.

#### Capital Expenditure

The Group had RMB23,428 million, RMB17,082 million and RMB17,178 million capital expenditures in 2011, 2010 and 2009, respectively. Of such capital expenditures in 2011, RMB3,349 million was financed by capital leases, RMB13,032 million was financed by bank borrowings while the remaining RMB7,047 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.

## B. Business Overview.

### General

The Group provides commercial airline services throughout Mainland 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 the year end of 2011, 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, 2011, the Group's RPKs increased at a compound annual growth rate of 14.7% from 93,002 million in 2009 to 111,328 million in 2010, and to 122,344 million in 2011, while its capacity, measured in terms of ASKs, increased at a compound annual growth rate of 10.6%, from 123,441 million in 2009 to 140,498 million in 2010, and to 151,064 million in 2011. In 2011, the Group carried 80.68 million passengers and had passenger revenue of RMB81,492 million (US\$12,933 million).

The Group conducts a portion of its airline operations through its airline subsidiaries, namely Xiamen 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 2011, the Airline Subsidiaries carried 22.17 million passengers and had passenger revenue of RMB19,251 million (US\$3,055 million) and accounted for 27% and 24% 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 increased by 6% to RMB5,760 million (US\$914 million) in 2011 as compared with that of 2010. 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 2011, the Group operated 720 routes, of which 576 were domestic, 106 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 and Zhuhai Shantou and etc.

In December 2005, we established a branch company in Beijing and have added wide-body airplanes to our 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 2011, the Group had 38 regional routes and 106 international routes. The Group's regional operations include flights between destinations in Mainland China Hong Kong, Macau and Taiwan. The Group's international operations include scheduled services to cities in Australia, Bangladesh, Canada, France, Georgia, India, Japan, Kazakhstan, Korea, Kyrgyzstan, Maldives, Nepal, Netherlands, Nigeria, Pakistan, Russia, Saudi Arabia, Tajikistan, Turkey, UAE, USA and Southeast Asian destinations.

After joining Skyteam Alliance, the Group has established a network reaching 926 destinations globally, connecting 173 countries of regions and covering major cities around the world.

As of December 31, 2011, the Group had a fleet of 444 aircraft, consisting primarily of Boeing 737 series, 747, 757, 777, Airbus 320 series, 330, 380 etc. The average age of the Group's registered aircraft was 6.20 years as of the year end of 2011.

#### 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 then 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 our initial public offering. The restructuring was effective 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 affiliates existing on the date of the De-merger Agreement and may continue to operate the businesses of such associates. Under the De-merger Agreement, 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 us.

In July 1997, we completed a private placement of 32,200,000 H Shares to certain limited partnership investment funds affiliated with Goldman Sachs & Co. and an initial public offering of 1,141,978,000 H Shares, par value RMB1.00 per share, and 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 our issued and outstanding shares of capital stock, consisting of 2,200,000,000 non-tradable domestic shares (“Domestic Shares”), par value RMB1.00 per share, were owned by 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 became entitled to elect all the directors of the Company and to control the management and policies of the Group. The Domestic Shares and H Shares are both ordinary shares of the Company.

In July 2003, we 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, we 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, our shareholders 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 of 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, we 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, we received the formal approval from CSRC for the proposed non-public issue of H Shares. On August 14, 2009, we 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, our board approved the placement of up to 1,766,780,000 new A shares to not more than 10 specific investors including CSAHC and the placement of not more than 312,500,000 new H shares to Nan Lung, a wholly-owned subsidiary of CSAHC. 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. On September 8, 2010, we received the formal approval from CSRC for the proposed non-public issue of H Shares. On September 15, 2010, we received the formal approval from CSRC for the proposed non-public issue of A Shares. In November 2010, we completed the placements of 1,501,500,000 new A shares and 312,500,000 H shares, among which 123,900,000 new A shares were issued to CSAHC at the subscription price of RMB6.66 per share, and 312,500,000 H shares were issued to Nan Lung at the subscription price of HKD2.73 per share.

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

On April 18, 2008, our 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, our shareholders approved such proposed bill issue at the annual general meeting for the year 2007. We believe 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 us, and is in the interests of us 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 were jointly underwritten by China CITIC Bank Cooperation Limited and Bank of China Limited. In October 2008, we 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 banks, lower the finance costs of borrowings for us and improve our debt structure. As of the date of this Annual Report, We have not issued any medium term notes as approved by the Board and shareholders.

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 millions)	Increase (decrease) over previous year (%)	Total (in thousands)	Increase (decrease) over previous year (%)	Total (in millions)	Increase (decrease) over previous year (%)
2009	66.28	13.8	862.0	3.2	10,067.0	9.4
2010	76.46	15.4	1,117.0	29.6	13,104.0	30.2
2011	80.68	5.5	1,135.0	1.6	14,461.0	10.4

#### Route Network

##### *Overview*

The Group operates the most extensive route network among all Chinese airlines. As of December 31, 2011, the Group operated 720 routes consisting of 576 domestic routes, 106 regional routes and 38 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 China Airlines, Mandarin Airlines, Japan Airlines, Korean Air, Asiana Airlines, Malaysia Airlines, PT. Garuda Indonesia, Kenya Airways, Pakistan International Airlines, Czech Airlines, Vietnam Airlines, Aeroflot-Russian Airlines, Air France, KLM Royal Dutch Airlines and Delta Air Lines. 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 926 destinations globally, connecting 173 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 2011, the Group's most profitable domestic routes were between: Guangzhou-Beijing, Beijing-Guangzhou, Shenzhen-Beijing, Beijing-Shenzhen, Urumqi-Beijing, Fuzhou-Beijing, Guangzhou-Shanghai, Shanghai-Guangzhou, Beijing-Urumqi and Xiamen-Shanghai.

### *Regional Routes*

The Group offers scheduled service between Hong Kong and Guangzhou, Shenyang, Wu Yi Shan, Changchun, Xiamen, Shantou, Beijing, Guilin, Meixian, Wuhan, Zhengzhou, Zhanjiang, Luoyang and Nanning; between Macau and Hangzhou, Fuzhou, Xiamen and Quanzhou; between Taipei and Guangzhou, Shanghai, Fuzhou, Hangzhou, Xiamen, Shenyang, Changsha, Wuhan, Dalian, Guilin, Harbin, Guiyang, Changchun, Nanning, Zhengzhou and Shenzhen; between Kaohsiung and Fuzhou, Xiamen; between Taichung and Xiamen. In 2011, the most profitable scheduled regional routes were between: Xiamen-Hong Kong, Taipei-Guangzhou, Guangzhou-Taipei, Xiamen-Taoyuan, Shanghai-Taipei, Fuzhou-Taoyuan, Hong Kong-Beijing, Taipei-Shanghai, Hong Kong -Guangzhou- Changchun and Xiamen-Songshan.

In 2011, the Group conducted a total of 15,382 flights on its regional routes, accounting for approximately 23.2% of all passengers carried by Chinese airlines on routes between Hong Kong, Macau or Taiwan and destinations in Mainland 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 Korea, Japan, Australia, The United Arab Emirates, Russia, Holland, New Zealand, India, France, Kazakhstan, Nepal, the United States, Kirghizstan, Iran, Turkmenistan, Tajikistan, Pakistan, Canada, Georgia, Azerbaijan, Bangladesh, Maldives and Uzbekistan.

After joining Skyteam Alliance, the Group has established a network reaching 926 destinations globally, connecting 173 countries of regions and covering major cities around the world.

In 2011, the Group's most profitable international routes were: Guangzhou-Osaka, Seoul-Shenyang, Seoul-Dalian, Shenyang-Seoul, Guangzhou-Los Angeles, Tianjin-Xiamen-Singapore, Beijing-Guangzhou-Phnom Penh, Dalian-Seoul, Guangzhou-Sydney and Osaka-Guangzhou.

#### 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, 2011, the Group operated a fleet of 444 aircraft with an average age of 6.20 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, 237 aircraft operated by the Group are leased pursuant to various types of leasing arrangements.

Model	Number of Aircraft	Average age (years)	Average Passenger Capacity
Boeing 777-200A	4	15.74	373
Boeing 777-200B	6	13.38	282
Boeing 757-200	21	13.11	192/197/204
Boeing 747F	2	9.56	n/a
Boeing 737-800	109	4.04	160/163/170
Boeing 737-700	50	6.53	120/128/138
Boeing 737-300	25	17.38	137/145
Boeing 777F	6	1.43	n/a
Airbus 319-100	44	5.39	121
Airbus 380-800	2	0.13	506
Airbus 320-200	84	5.36	151/156
Airbus 321-200	57	4.10	178/182
Airbus 330-200	13	3.40	216/256
Airbus 330-300	8	3.60	283
EMB190	7	0.27	98
EMB145	6	7.33	50

Total 444

In 2011, the Group continued to expand and modernize its aircraft fleet. During the year, the Group: (i) took scheduled delivery of twenty-nine aircraft, including seven A320-200 aircraft, four A330-200 aircraft, two A380 aircraft, six B737-700 aircraft, one B777F aircraft and nine B737-800 aircraft; (ii) purchased one originally operating leased B757-200 aircraft; (iii) took scheduled delivery of twenty-three aircraft under operating leases, including eleven A320-200 aircraft, five B737-800 aircraft and seven E190 aircraft; (iv) returned five aircraft under operating leases upon expiry, including two B757-200 aircraft and three A320-200 aircraft; (v) disposed twenty-five aircraft, including twelve MD90 aircraft, four A300-600 aircraft, five ATR-72 aircraft, two B757-200 aircraft and two B737-700 aircraft; (vi) exercised the purchase options stipulated in the aircraft finance lease agreements and two A321-200 aircraft were reclassified as owned aircraft from finance leased aircraft.

In May 2011, we entered into one agreement for the acquisition of six Boeing B777F freighters and Xiamen Airlines entered into one purchase agreement for the acquisition of six Boeing B787 series aircraft. In February 2012, we entered into one agreement for the acquisition of ten Boeing 777-300ER aircraft. Aircraft under those acquisition agreements are scheduled for delivery during the period from 2013 to 2016.

#### 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, 2011, 76 of the Group's 444 aircraft were operated under capital leases, 161 were operated under operating leases, 207 were either owned aircraft financed by long-term mortgage loans, or acquired either with cash proceeds or acquired by exercising the purchase options upon expiry of the respective capital leases. 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, 2011, 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	1.11
Boeing 757-200	0	2	0.39
Boeing 737-700	12	15	3.93
Boeing 737-800	15	47	4.91
Boeing 737-300	0	4	1.22
Boeing 777F	2	0	8.03
Airbus 319-100	6	30	4.31
Airbus 320-200	22	22	7.71
Airbus 321-200	11	20	7.61
Airbus 330-200	8	2	8.19
Airbus 330-300	0	8	8.83
EMB190	0	7	7.85
Total	76	161	

*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 2012 to 2023. As of December 31, 2011, the Group's aggregate future minimum lease payments (including future finance charges) required under its capital leases were RMB17,952 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, 2011, the Group's aggregate future minimum lease payments required under its operating leases were RMB25,139 million. As of the year end of 2011, the Group's operating leases had original terms generally ranging from five to fifteen years from the date of delivery of the relevant aircraft, and the remaining terms of these leases ranged from one to twelve 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 0% to 11.6% 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 RMB172 million, RMB318 million and RMB198 million during 2011, 2010 and 2009 respectively, has been included as part of the lease charges.



## 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 74 and 79 spare jet engines for its fleet as of the year end of 2011 and 2010, 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, an entity jointly controlled 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 other nine Chinese airlines and 23 international airlines. GAMECO provides heavy maintenance services to 10 other Chinese airlines and 18 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 Zhuhai MTU, a former 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 Zhuhai 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 RMB2,018 million RMB1,742 million and RMB1,344 million for the years ended December 31, 2011, 2010 and 2009, 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, 2011. 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, 0.008 and 0.089 in 2011, 2010 and 2009, respectively. In comparison, CAAC's published maximum acceptable Accident Signs Per Ten Thousands Hours Ratio was 0.6, 0.6 and 0.6 in 2011, 2010 and 2009, respectively. This ratio is defined as the occurrence of one incident for every 10,000 hours of flight time. In 2011, 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 2011, the Company's continuous safe flight span totaled to 8.98 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 37.5%, 33.2% and 29.6% of the Group's operating expenses for the years ended December 31, 2011, 2010 and 2009, 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 increased from RMB23,492 million in 2010 to RMB32,675 million in 2011 as a result of increase in average jet fuel price by 28.4%.

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 22% and 19% of the Group's total jet fuel consumption in 2011 and 2010, respectively.

## Fuel Surcharge

The NDRC has recently lowered the rate of fuel surcharge from 0.00002691 per km to 0.00002541 per km, starting from April 1, 2012 and ending on March 31, 2013. Based on that rate, for every RMB100 by which the cost of jet fuel exceeds RMB4,140 per ton, the airlines are allowed to charge RMB0.00002541 per km for the flight distance. The Group's net income may suffer from an unexpected change in the fuel surcharge collection policies and other factors beyond our control.

## Flight Operations

Flight operations for the Group's flights originating in Guangzhou are managed by our flight operations and marketing divisions, which are responsible for formulating flight plans and schedules consistent with route and flight approvals received from the CAAC. 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. Our 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 University of Aeronautics and Aviation (the "BUAA") 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 BUAA. After successful completion of academic and physical examinations, the trainees receive flight training for a period of approximately 20 months at Flying College, a company that is 48.12% owned by the Company, 4.76% owned by CSAHC and 47.12% owned by a third party investor. Each trainee at the Flying College is required to fly at least 230 hours before being awarded a flight certificate. Graduates of the BUAA and the Flying 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 1,624 trainees as of April 20, 2012 about 636 trainees are expected to graduate in 2012 .

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 majority 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 proficiency check. 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 funded 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, August 27, 2009, August 26, 2010 and September 9, 2011, 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 RMB 90,858,000, not more than RMB213,600,000, not more than RMB184,750,000, not more than RMB179,269,600 and not more than RMB83,850,000, respectively. On December 29, 2009, Xiamen Airlines, a now 51%-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 up to December 31, 2011. As of December 31, 2011, the Group has provided guarantees with joint liability for the loans of such self-sponsored pilots in an aggregate amount of RMB395,000,000, under which an aggregate of personal bank loans of RMB293,000,000 were drawn down from the banks. During the year, the Group has made repayments of RMB4,000,000 due to the default of payments of certain pilot trainees.

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 choice to repay their loans in advance or in installments.

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 International Airport (the "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 its customer airlines that operate in Guangzhou Baiyun Airport.

Ground services at the airports in Shenzhen, Changsha, Wuhan, Zhengzhou, Haikou, Zhuhai, Xiamen, Fuzhou, Guilin, Shantou, Guiyang, Shenyang, Harbin, Dalian, Urumqi and etc. are primarily operated directly by the Group. Ground services at the airport in Beijing have been primarily provided by Beijing Ground Service, which became a wholly-own subsidiary of the Company in June 2009. 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

We own a 55% equity interest in Guangzhou Nanland Air Catering Company Limited (“Nanland”) as of December 31, 2011. 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.

In order to optimize assets structure, tighten cost control, reduce the number of connected transactions and enhance the independence of 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 provides in-flight meals for flights of the Company originating or stopping at 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 six Boeing 777 freighters, mainly servicing six international cargo routes, Shanghai to Amsterdam, Frankfurt, Vienna, Los Angeles, Chicago, Vancouver and Guangzhou to Amsterdam.

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

## 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 affiliates. 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, Baku, Bangkok, Bishkek, Brisbane, Busan, Chicago, Daegu, Daejeon, Delhi, Dubai (Sharjah), Dushanbe,

Frankfurt, Fukuoka, Hanoi, Hiroshima, Ho Chi Minh City, Irkutsk, Islamabad, Jakarta, Jeddah, Kathmandu, Khabarovsk, Kitakyushu, Kuala Lumpur, London, Los Angeles, Manila, Melbourne, Moscow, Nagoya, Niigata, Novosibirsk, Oakland, Osaka, Osh, Paris, Penang, Perth, Phnom Penh, Phuket, Sapporo, Sendai, Seoul, Siem Reap, Singapore, Sydney, Tashkent, Tehran, Tokyo, Toyama, 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 2011, approximately 12% of all ticket sales for the Group's scheduled flights were made by the Group's network of sales offices and CSAHC's affiliates. 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 5%-6% 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 2011, independent sales agents accounted for approximately 88% 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. The Group is among the first to launch premium economy class of seating. 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. In 2010, the Group successfully completed its missions to deliver quality services for the 16th Asian Games held in Guangzhou and the World Exposition Shanghai. In preparation for the hosting of the Asian Games, Guangzhou has made a huge investment in urban renovation and the construction of sports facilities. In addition, there has been high consumption before, during and after the Asian Games. Ever since the successful bidding for hosting the Asian Games in 2004, Guangzhou has achieved a faster growth and improvement in its economy. Even though during the Asian Games, the aviation market did not show a marked growth trend due to a stricter security policy and there was little change in the pattern of the cycle of travelers entering and leaving Guangzhou, which was basically following the trend in the normal cycle, in the long run, the Asian Games will have a positive impact on the tourism and the aviation market in Guangzhou to a certain extent.

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 parties, expand their route network worldwide, increase their freight load factors, reduce labor and operating costs, and enhance the competitiveness of both airlines in the global air travel market.

To enhance relationships with 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 2011, the Group had approximately 14,206,800 members (including those of Xiamen Airlines) under these programs.

## Regulation

The Chinese commercial aviation industry is subject to a high degree of regulation and oversight by the CAAC. Regulations and policies issued or implemented by the CAAC encompass substantially all aspects of airline operations, including route allocation, pricing of domestic airfare, the administration of air traffic control systems and certain airports, air carrier certifications and air operator certification and aircraft, registration and aircraft airworthiness certification. The Civil Aviation Law, which became effective in March 1996, provides a framework for regulation of many of these aspects of commercial aviation activities. Although 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, airport facilities and related support services.

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

*Regional Routes.* Hong Kong and Macau routes and landing rights are derived from agreements between the Chinese government and the government of the Hong Kong SAR, and between the Chinese government and the government of Macau SAR. The rights to fly between Beijing and Hong Kong, Beijing and Macau, Shanghai and Hong Kong and Shanghai and Macau are allocated by the CAAC among the four Chinese airlines. 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 Mainland 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 during a specific season, the average load factor is more than 75%, or for a particular international route, if the flight capacity provided by Chinese airlines is 50% less than that provided by foreign 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 supervised by the CAAC, are the only jet fuel supply companies in China, with the exception of the joint venture jet fuel supply companies that supply Shenzhen, Zhuhai, Sanya, Haikou, Shanghai Pudong and other small airports, 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.

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 Limited (the "Air China") and China Eastern Airlines Corporation Limited (the "China Eastern Airlines"). In 2011, these three airlines together controlled approximately 74.5% 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 may not increased proportionately. In some years, this has resulted in a reduction in our passenger load factors. As a result, we are required to be more competitive with respect to, for example, quality of service, including ticketing and reservations, in-flight services, flight scheduling and timeliness.

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.

In June 2011, the Beijing-Shanghai High-Speed Railway was opened. We currently have only one daily flight on the Beijing-Shanghai aviation route. The opening of the Beijing-Shanghai High-Speed Railway has had a little direct impact on us. The aviation routes along the way, in particular, short-haul routes have experienced a greater loss of customers, but such losses are within our expectations and have had minimal impact on the entire industry. Meanwhile, the main arteries of Beijing-Shanghai, Beijing-Guangzhou, Beijing-Harbin, the "Four Vertical Lines" on the coastal areas (except the Xiamen-Shenzhen High-Speed Rail) will be all opened in 2012, and the travelling time between provinces and cities along the routes will have nearly saved approximately 50% over travel on the existing railways, and a number of regional intercity high-speed railways will also be opened during the year. With enormous expansion of the territory covered by the High-Speed Rail, the effect of network operation should be visible in the early stage.

From the perspective of long term development, with the continuous improvement in the high-speed railway lines and services, the domestic flights of the airlines will face competition from all sides, which spurs the airlines to constantly improve its network of aviation routes while stepping up efforts to upgrade service quality and brand influence for the



enhancement of its competitiveness as a whole.

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 will make an effort for a stronger 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 (in millions)	Group's Share (% of total)	Industry Total (in thousands)	Group's Share (% of total)	Industry Total (in billions)	Group's Share (% of total)
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
2010	267.7	28.6	5,630	19.8	53.8	24.3
2011	292.2	27.6	5,528	20.5	57.3	25.2

*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 other major 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 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 2011.

Airport	Passenger carried (% of total)	Cargo and Mail carried (% of total)	Departing flight (% of total)
Beijing	17.4	12.5	17.3
Guangzhou	50.2	28.4	50.6
Shanghai Pudong	9.1	6.3	9.7
Shanghai Hongqiao	13.6	17.8	14.1
Shenzhen	27.8	16.3	26.8
Chengdu	12.4	12.5	12.0
Kunming	15.7	19.0	14.5
Xi'an	17.8	20.0	17.6
Hangzhou	33.4	26.4	33.3
Chongqing	25.1	22.0	25.2

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 2011.

Airport	Passenger carried (% of total )	Cargo and Mail carried (% of total)	Departing flight (% of total)
Changsha	40.5	53.6	40.8
Wuhan	39.7	43.7	37.3
Sanya	29.1	33.6	29.1
Haikou	26.4	27.8	27.0
Zhengzhou	50.6	52.6	48.8
Nanning	34.6	38.5	32.2

Guilin	38.7	47.6	38.9
Zhuhai	49.0	59.0	48.8

### *Regional Routes*

In 2011, the Group conducted a total of 15,382 flights on its regional routes, accounting for approximately 23.2% 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 Airlines 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 Airlines 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 Airlines, 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. As of December 31, 2011, the Company owns a 51% or 60% equity interest in each of the Airline Subsidiaries.

As of December 31, 2011, Xiamen Airlines operated under its own "MF" code with a fleet of 76 aircraft on 102 domestic routes, 5 international routes and 14 regional routes. In 2011, Xiamen Airlines carried a total of about 15.32 million passengers, or approximately 19% of the passengers carried by the Group in that year, and had RMB13,651 million in traffic revenue.

As of December 31, 2011, Shantou Airlines operated under the Group's "CZ" code with a fleet of ten aircraft. In 2011, under the centralized allocation of flight routes of the Group, Shantou Airlines carried a total of about 2.32 million passengers, or 3% of the passengers carried by the Group in that year. Total traffic revenue of Shantou Airlines for the year ended December 31, 2011 was RMB1,979 million.

As of December 31, 2011, Chongqing Airlines operated under the "OQ" code with a fleet of seven aircraft. In 2011, under the centralized allocation of flight routes of the Group, Chongqing Airlines carried a total of about 1.63 million passengers, or 2% 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, 2011 was RMB1,313 million ..

As of December 31, 2011, Zhuhai Airlines operated under the "CZ" code with a fleet of five aircraft. In 2011, under the centralized allocation of flight routes of the Group, Zhuhai Airlines carried a total of about 1.05 million passengers, or approximately 1% 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, 2011 was RMB1,043 million.

As of December 31, 2011, Guizhou Airlines operated under the “CZ” code with a fleet of eight aircraft. In 2011, under the centralized allocation of flight routes of the Group, Guizhou Airlines carried a total of about 1.85 million passengers, or approximately 2% of the total number of passengers carried by the Group in that year. Total traffic revenue of Guizhou Airlines was approximately RMB1,777 million for the year ended December 31, 2011.

## 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\$63,483) 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.

We own various trademarks and tradenames related to our business. The names "China Southern" and "China Southern Airlines" contain Chinese words of common usage and are therefore not eligible for registration as 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 affiliates 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.

### **C. Organizational Structure.**

The following chart illustrates the corporate structure of the Group as of December 31, 2011 and the aggregate effective equity interest of the Company in each of its principal subsidiaries, associates and jointly controlled entities.

Note a: Including 12.89% ownership interest held by CSA's subsidiaries.



The particulars of the Group's principal subsidiaries as of December 31, 2011 are as follows:

Name of company	Place and date of establishment /operation	Proportion of ownership interest held by the Company	
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	51	%
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	%
Guangzhou Baiyun International Logistic Company Limited	PRC July 23, 2002	61	%
Xinjiang Civil Aviation Property Management Limited	PRC February 12, 2002	51.84	%
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 Services Company Limited	PRC April 1, 2004	100	%

The particulars of the Group's principal associates and jointly controlled entities as of December 31, 2011 are as follows:

Name of company	Place and date of Establishment /operation	Proportion of ownership interest held by			
		Group effective interest	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	33.98 %	21.09 %	12.89 %	%
Sichuan Airlines Corporation Limited	PRC August 28, 2002	39 %	39 %	—	
Zhuhai Xiang Yi Aviation Technology Company Limited	PRC July 10, 2002	51 %	51 %	—	
Southern Airlines Culture and Media Co., Ltd.	PRC May 13, 2004	40 %	40 %	—	
China Southern West Australian Flying College Pty Ltd.	Australia January 26, 1971	48.12 %	48.12 %	—	
Guangzhou China Southern Zhongmian Dutyfree Store Co., Limited	PRC September 29, 2006	50 %	50 %	—	

D. 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 1,272,201 square meters of land and a total gross floor area of approximately 705,323 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, Xinjiang and other PRC cities.

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.

	<b>Land</b> <b>(in square meters)</b>		<b>Buildings</b> <b>(in square meters )</b>	
	Owned	Leased	Owned	Leased
Guangzhou	1,172,531	99,670	693,860	11,463
Shenzhen	246,397	—	101,311	—
Zhuhai	170,062	—	18,791	—
Changsha	173,351	6,629	70,338	12,536
Zhengzhou	425,336	—	56,915	—
Haikou	5,265	1,711	83,923	20,917
Wuhan	16,712	47,882	29,893	46,167
Nanyang	—	—	18,156	60,035
Sanya	106,680	—	16,968	—
Shenyang	135,455	103,715	101,224	6,674
Dalian	—	14,403	36,188	32,911
Jilin	134,488	65,076	42,312	7,767
Harbin	2,499	278,973	36,925	25,513
Xinjiang	—	631,094	122,818	3,396
Guilin	120,705	—	53,080	6,805

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

	<b>Land</b> <b>(in square meters)</b>		<b>Buildings</b> <b>(in square meters)</b>	
	Owned	Leased	Owned	Leased
Xiamen Airlines	871,137	—	551,730	31,641
Shantou Airlines	36,931	53,000	37,998	2,407
Zhuhai Airlines	99,306	—	57,730	1,800
Guizhou Airlines	259,879	—	106,245	2,032
Chongqing Airlines	82,449	—	6,785	4,484

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 April 20, 2012, 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 Airport), Xiamen, Heilongjiang, Jilin, Dalian, Hunan, Xinjiang, Henan, Shenzhen, Beijing, Shanghai, Sanya, Zhuhai and Shenyang 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 the Accounting Standards for Business Enterprises-Basic Standard and 38 Specific Standards, application guidance, bulletins and other relevant accounting regulations (collectively “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 position 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 carrying amount of a long-lived asset may not be recoverable, the asset may be considered “impaired”, and an impairment loss may be recognized in accordance with IAS 36, Impairment of Assets. The carrying amounts of long-lived assets are reviewed periodically in order to assess whether the recoverable amounts have declined below the carrying amounts. These assets are tested for impairment whenever events or changes in circumstances indicate that their recorded carrying amounts may not be recoverable. When such a decline has occurred, the carrying amount is reduced to the recoverable amount. The recoverable amount is the 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 annually in order to determine the amount of depreciation expense to be recorded during any financial year. The useful lives are based on the Group’s historical experience with similar assets and 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

In 2011, due to the deepening sovereign debt crisis of the developed economies and slowdown in economic growth of the emerging economies, difficulties were encountered in the course of the global economic recovery. China implemented a proactive fiscal policy and prudent monetary policy, continued to strengthen and refine its macroeconomic control and ensured the steady and relatively fast growth of the economy while allowing a gradual fall in commodity prices. Benefitted from the steady and relatively fast growth of the PRC economy and the growing household consumption demand, the domestic aviation passenger demand maintained growth. However, due to the slow recovery of the developed economies, intense political situations in some regions and unexpected events such as the earthquake in Japan, in 2011, the growth of the international aviation market was slow, the aviation cargo market was also affected and underwent a downturn, and the domestic aviation demand grew at a slower pace compared to 2010. Facing the serious and complicated economic environment, the Company effectively responded to the challenges brought by the sluggish international aviation market and cargo market by making full use of the advantage of the steady growth in domestic civil aviation demand. Through strengthening safety management, accelerating the strategic transformation and internationalization process, reinforcing market expansion while continuing to improve the operational quality and significantly raising its service standards, the Company made progress in safety, operations, transformation, services and other aspects, maintained the best safety record among airlines in China, and once again achieved good results in production and operation, thereby effectively enhancing our brand image and our comprehensive competitiveness.

In 2011, we strictly performed standardized management, strengthened the building of safety management system, brought the alert functions of the safety management system into full play, and averted safety risks effectively on a timely basis, thus achieving the best safety performance ever in its history and significantly improving our safety quality. In 2011, the Group completed a total of 1,507,000 safe flight hours, including 8,777 general flight hours, representing an increase of 1,060 hours as compared with the previous year, and maintained 146 consecutive months of aviation safety and 210 consecutive months of aviation security. The Group maintained the best safety record among airlines in China and realized the excellent results of “Two Zeros”, i.e. zero company responsibility incidents and zero human error incidents.

In 2011, facing the adverse factors, such as the slowdown in the civil aviation market and the sluggish cargo market, we actively strengthened marketing and cooperation, and continued to enhance the quality of the passenger operations by seizing opportunities in the market, strengthening high-end marketing, developing frequent-flyers and enhancing the control of channels. During the reporting period, operating indicators of the Company, including passenger load factor, revenue per seat/ kilometer and average fare continued to increase. Facing the serious situation of the overall cargo transport, the Company actively developed the cargo transport market and effectively reduced cargo transport losses. In addition, during the reporting period, the Company successfully introduced and operated aircraft A380 and became the sole airline that operated aircraft A380 in the aviation industry of China, thereby effectively enhancing the profile, social influence and brand recognition of the Company. We sped up the structural adjustment of the fleet and further optimized our fleet structure by disposing of the older aircraft. In 2011, the Company’s major production and operation indicators remained steady on the rise with and created a new high.

In 2011, we continued to promote the energy conservation and emission reduction programs and further optimized the structure of the fleet by disposing of older aircraft. In 2011, we recorded a 3.3% decrease in fuel consumption per tonne kilometer as compared with the previous year with a reduction in carbon dioxide emission of 80,000 tonnes, and was ranked 21st at the “China Corporate Social Responsibility List( )”, awarded the honor as “China 2011 Top Companies(2011 )”, “Green Company of the Year( )”, “Green Action China 2011 Ten Leading Companies Most Socially Responsible Listed Company( )” (20844;21496;). Moreover, responding to the needs of the State, we successfully accomplished the special transportation tasks, including the evacuation of PRC citizens from Libya and Japan following the earthquake as well as to ensure the safe air transportation for the 26th Summer Universiade and the 1st Asia-Europe Expo. In 2011, the Company’s Ten Cent Care Foundation donated RMB 13.97 million and effectively fulfilled our social responsibility.

Nevertheless, the development of the airline industry has a number of challenges, such as the uncertain recovery of global economy, faster growth in the total traffic capacity of the industry, the impact of substitutive services such as Express Rail, and sharp fluctuation in oil prices.

Since July 21, 2005, the PRC government has adopted 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 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 increased by RMB1,009 million, from RMB1,746 million in 2010 to RMB2,755 million in 2011, mainly attributable to the exchange gain arising from retranslation and settlement of bank and other loans balances and financial lease obligations denominated in U.S. dollars, as a result of the significant appreciation of Renminbi against U.S. dollars in 2011.

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, 2011, 2010 and 2009:



	Year ended December 31,			2011 vs. 2010	2010 vs. 2009
	2011	2010	2009	% increase (decrease)	% increase (decrease)
Traffic					
RPK (million)					
Domestic	99,674	94,014	80,687	6.0	16.5
Regional	2,082	1,788	1,337	16.4	33.7
International	20,588	15,526	10,968	32.6	41.6
Total	122,344	111,328	93,002	9.9	19.7
RTK (million)					
Domestic	10,195	9,715	8,342	4.9	16.5
Regional	198	171	126	15.8	35.7
International	4,068	3,218	1,599	26.4	101.3
Total	14,461	13,104	10,067	10.4	30.2
Passengers carried (thousand)					
Domestic	72,926	69,727	61,130	4.6	14.1
Regional	1,767	1,573	1,276	12.3	23.3
International	5,984	5,156	3,875	16.1	33.1
Total	80,677	76,456	66,281	5.5	15.4
Cargo and mail carried (thousand tons)					
Domestic	857	874	750	(1.9)	16.5
Regional	13	12	9	8.3	33.3
International	265	231	103	14.7	124.3
Total	1,135	1,117	862	1.6	29.6
	Year ended December 31,			2011 vs. 2010	2010 vs. 2009
	2011	2010	2009	%increase (decrease)	%increase (decrease)
Capacity					
ASK (million)					
Domestic	120,462	117,383	105,379	2.6	11.4
Regional	2,753	2,353	1,916	17.0	22.8
International	27,849	20,762	16,146	34.1	28.6
Total	151,064	140,498	123,441	7.5	13.8
ATK (million)					
Domestic	14,145	13,890	12,425	1.8	11.8
Regional	316	269	219	17.5	22.8
International	6,334	4,981	2,802	27.2	77.8
Total	20,795	19,140	15,446	8.6	23.9
Load Factors					
Passenger load factor (RPK/ASK) (%)					
Domestic	82.7	80.1	76.6	3.2	4.6
Regional	75.7	76.0	69.8	(0.4)	8.9
International	73.9	74.8	67.9	(1.2)	10.2
Overall	81.0	79.2	75.3	2.3	5.2
Overall load factor (RTK/ATK) (%)					
Domestic	72.1	69.9	67.1	3.1	4.2
Regional	62.6	63.6	57.7	(1.6)	10.2
International	64.2	64.6	57.1	(0.6)	13.1

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Overall	69.5	68.5	65.2	1.5	5.1	
Yield						
Yield per RPK (RMB)						
Domestic	0.68	0.62	0.53	9.7	17.0	
Regional	0.88	0.85	0.75	3.5	13.3	
International	0.56	0.58	0.55	(3.4	)	5.5
Overall	0.67	0.62	0.54	8.1	14.8	
Yield per RTK (RMB)						
Domestic	6.90	6.20	5.36	11.3	15.7	
Regional	9.69	9.29	8.30	4.3	11.9	
International	3.67	3.84	4.52	(4.4	)	(15.0)
Overall	6.03	5.66	5.26	6.5	7.6	
Financial						
Passenger revenue (RMB million)						
Domestic	68,222	58,155	43,033	17.3	35.1	
Regional	1,834	1,521	1,000	20.6	52.1	
International	11,436	9,028	6,026	26.7	49.8	
Total	81,492	68,704	50,059	18.6	37.2	
Cargo and mail revenue (RMB million)	5,760	5,436	2,908	6.0	86.9	

## A. 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.

## 2011 compared with 2010

The profit attributable to equity shareholders of the Company of RMB5,110 million was recorded in 2011 as compared to the profit attributable to equity shareholders of the Company of RMB5,792 million in 2010. The Group's operating revenue increased by RMB13,900 million or 18.2% from RMB76,495 million in 2010 to RMB90,395 million in 2011. Passenger load factor increased by 1.8 percentage points from 79.2% in 2010 to 81.0% in 2011. Passenger yield (in passenger revenue per RPK) increased by RMB0.05 or 8.1% from RMB0.62 in 2010 to RMB0.67 in 2011. Average yield (in traffic revenue per RTK) increased by 6.5% from RMB5.66 in 2010 to RMB6.03 in 2011. Operating expenses increased by RMB16,374 million or 23.2% from RMB70,689 million in 2010 to RMB87,063 million in 2011. As a result of the increase in operating expenses, operating profit of RMB4,353 million was recorded in 2011 as compared to operating profit of RMB6,282 million in 2010, down by RMB1,929 million.

*Operating revenue*

	2011 Operating revenue	Percentage	2010 Operating revenue	Percentage	Change in revenue
	RMB million	%	RMB million	%	%
Traffic revenue	87,252	96.5	74,140	96.9	17.7
Including: Passenger revenue	81,492		68,704		18.6
– Domestic	68,222		58,155		17.3
– Hong Kong, Macau and Taiwan	1,834		1,521		20.6
– International	11,436		9,028		26.7
Cargo and mail revenue	5,760		5,436		6.0
Other operating revenue	3,143	3.5	2,355	3.1	33.5
Mainly including: Commission income	643		469		37.1
Hotel and travel services income	614		477		28.7
Ground service income	368		390		(5.6)
Expired sales in advance of carriage	309		249		24.1

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Aircraft wet lease income	319		50		>100.0
Total operating revenue	90,395	100.0	76,495	100.0	18.2
Less: fuel surcharge income	(11,699 )		(5,583 )		
Total operating revenue excluding fuel surcharge	78,696		70,912		

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*Traffic revenue composition*

	2011		2010		Change in traffic revenue
	Traffic revenue		Traffic revenue		
	RMB million	Percentage %	RMB million	Percentage %	%
Passenger Revenue	81,492	93.4	68,704	92.7	18.6
Cargo and Mail Revenue	5,760	6.6	5,436	7.3	6.0
Traffic revenue	87,252	100.0	74,140	100.0	17.7

*Passenger revenue composition*

	2011		2010		Change in passenger revenue
	Passenger revenue	Percentage	Passenger revenue	Percentage	
	RMB million	%	RMB million	%	%
Domestic	68,222	83.7	58,155	84.7	17.3
Hong Kong, Macau and Taiwan	1,834	2.3	1,521	2.2	20.6
International	11,436	14.0	9,028	13.1	26.7
Passenger revenue	81,492	100.0	68,704	100.0	18.6

Substantially all of the Group's operating revenue is attributable to airline and airline-related operations. Traffic revenue accounted for 96.5% and 96.9% of total operating revenue in 2011 and 2010 respectively. Passenger revenue and cargo and mail revenue accounted for 93.4% and 6.6% respectively of the total traffic revenue in 2011. The other operating revenue is mainly derived from commission income, hotel and travel services income, fees charged for ground services rendered to other Chinese airlines, income from expired sales in advance of carriage and aircraft wet lease income.

The increase in operating revenue was primarily due to an 18.6% increase in passenger revenue from RMB68,704 million in 2010 to RMB81,492 million in 2011. The total number of passengers carried increased by 5.5% to 80.68 million passengers in 2011. RPKs increased by 9.9% from 111,328 million in 2010 to 122,344 million in 2011, primarily as a result of the increase in number of passengers carried. Passenger yield per RPK increased from

RMB0.62 in 2010 to RMB0.67 in 2011.

Domestic passenger revenue, which accounted for 83.7% of the total passenger revenue in 2011, increased by 17.3% from RMB58,155 million in 2010 to RMB68,222 million in 2011. Domestic passenger traffic in RPKs increased by 6.0%, while passenger capacity in ASKs increased by 2.6%, resulting in an increase in passenger load factor by 2.6 percentage points from 80.1% in 2010 to 82.7% in 2011. Domestic passenger yield per RPK increased from RMB0.62 in 2010 to RMB0.68 in 2011, mainly resulted from the increase of domestic passenger revenue and fuel surcharge income during the year.

Hong Kong, Macau and Taiwan passenger revenue, which accounted for 2.3% of total passenger revenue, increased by 20.6% from RMB1,521 million in 2010 to RMB1,834 million in 2011. For Hong Kong, Macau and Taiwan flights, passenger traffic in RPKs increased by 16.4%, while passenger capacity in ASKs increased by 17.0%, resulting in a decrease in passenger load factor by 0.3 percentage points from 76.0% in 2010 to 75.7% in 2011. Passenger yield per RPK increased from RMB0.85 in 2010 to RMB0.88 in 2011, mainly resulted from the increase of Hong Kong, Macau and Taiwan passenger revenue.

International passenger revenue, which accounted for 14.0% of total passenger revenue, increased by 26.7% from RMB9,028 million in 2010 to RMB11,436 million in 2011. For international flights, passenger traffic in RPKs increased by 32.6%, while passenger capacity in ASKs increased by 34.1%, resulting in a 0.9 percentage point decrease in passenger load factor from 74.8% in 2010 to 73.9% in 2011. Passenger yield per RPK decreased from RMB0.58 in 2010 to RMB 0.56.

Cargo and mail revenue, which accounted for 6.6% of the Group's total traffic revenue and 6.4% of total operating revenue, increased by 6.0% from RMB5,436 million in 2010 to RMB5,760 million in 2011. The increase was attributable to the increase in cargo traffic volume and fuel surcharge income.

Other operating revenue increased by 33.5% from RMB2,355 million in 2010 to RMB3,143 million in 2011. The increase was primarily due to the general growth in income from various auxiliary operations.

#### *Operating expenses*

Total operating expenses in 2011 amounted to RMB87,063 million, representing an increase of 23.2% or RMB16,374 million over 2010, primarily due to the total effect of increases in jet fuel costs, landing and navigation fees, maintenance expenses and other operating costs. Total operating expenses as a percentage of total operating revenue increased from 92.4% in 2010 to 96.3% in 2011.

	2011		2010		Change in operating expenses %
	RMB million	Percentage	RMB million	Percentage	
Flight operations	48,344	55.5	38,593	54.6	25.3
Mainly including: Jet fuel costs	32,675		23,492		39.1
Operating lease charges	4,654		5,298		(12.2 )
Flight personnel payroll and welfare	4,412		3,420		29.0
Maintenance	7,531	8.7	5,586	7.9	34.8
Aircraft and traffic servicing	12,337	14.2	10,968	15.5	12.5
Promotion and sales	6,568	7.5	5,555	7.9	18.2
General and administrative	2,807	3.2	2,266	3.2	23.9
Impairment on property, plant and equipment	584	0.7	212	0.3	>100.0
Depreciation and amortization	7,689	8.8	7,065	10.0	8.8

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Others	1,203	1.4	444	0.6	>100.0
Total operating expenses	87,063	100.0	70,689	100.0	23.2

Flight operations expenses, which accounted for 55.5% of total operating expenses, increased by 25.3% from RMB38,593 million in 2010 to RMB48,344 million in 2011, primarily as a result of increase in jet fuel costs because of greater consumption of jet fuel and increase in average fuel prices. Jet fuel costs, which accounted for 67.6% of flight operations expenses, increased by 39.1% from RMB23,492 million in 2010 to RMB32,675 million in 2011.

Maintenance expenses, which accounted for 8.7% of total operating expenses, increased by 34.8% from RMB5,586 million in 2010 to RMB7,531 million in 2011. The increase was mainly due to the increase in number of engines repaired and routine maintenance during the year.

Aircraft and traffic servicing expenses, which accounted for 14.2% of total operating expenses, increased by 12.5% from RMB10,968 million in 2010 to RMB12,337 million in 2011. The increase was primarily due to an 8.1% rise in landing and navigation fees from RMB7,792 million in 2010 to RMB8,426 million in 2011, resulted from the increase in number of flights.

Promotion and sales expenses, which accounted for 7.5% of total operating expenses, increased by 18.2% from RMB5,555 million in 2010 to RMB6,568 million in 2011.

General and administrative expenses, which accounted for 3.2% of the total operating expenses, increased by 23.9% from RMB2,266 million in 2010 to RMB2,807 million in 2011.



Impairment on property, plant and equipment increased by RMB372 million from RMB212 million in 2010 to RMB584 million in 2011.

Depreciation and amortization, which accounted for 8.8% of total operating expenses, increased by 8.8% from RMB7,065 million in 2010 to RMB7,689 million in 2011, mainly due to the additional depreciation charges on aircraft delivered in 2011.

#### *Operating profit*

Operating profit of RMB4,353 million was recorded in 2011 (2010: RMB6,282 million). The decrease in profit was mainly due to the net effect of increase in operating revenue by RMB13,900 million or 18.2% in 2011 and increase in operating expenses by RMB16,374 million or 23.2%.

#### *Other net income*

Other net income increased by RMB545 million from RMB476 million in 2010 to RMB1,021 million in 2011, mainly due to the increase of government grants and gain on disposal of aircraft.

Interest expense decreased by RMB198 million from RMB1,265 million in 2010 to RMB1,067 million in 2011 was mainly due to the decrease in weighted average bank and other loans balances during the year.

Net exchange gain of RMB2,755 million was recorded in 2011, an increase of RMB1,009 million from RMB1,746 million in 2010, mainly due to Renminbi appreciated significantly against US dollar in 2011.

#### *Income tax*

Income tax expense of RMB840 million was recorded in 2011, decrease by RMB837 million from RMB1,677 million in 2010, mainly due to the utilization of unrecognized deductible temporary differences and unused tax losses balance brought forward from prior years and the recognition of deductible temporary differences in 2011.

2010 compared with 2009

The profit attributable to equity shareholders of the Company of RMB5,792 million was recorded in 2010 as compared to the profit attributable to equity shareholders of the Company of RMB327 million in 2009, owing to the Group's operating revenue increased substantially. The Group's operating revenue increased by RMB21,693 million or 39.6% from RMB54,802 million in 2009 to RMB76,495 million in 2010. Passenger load factor increased by 3.9 percentage point from 75.3% in 2009 to 79.2% in 2010. Passenger yield (in passenger revenue per RPK) increased by RMB0.08 or 14.8% from RMB0.54 in 2009 to RMB0.62 in 2010. Average yield (in traffic revenue per RTK) increased by 7.6% from RMB5.26 in 2009 to RMB5.66 in 2010. Operating expenses increased by RMB15,334 million or 27.7% from RMB55,355 million in 2009 to RMB70,689 million in 2010. As a result of the increase in operating revenue, operating profit of RMB6,282 million was recorded in 2010 as compared to operating profit of RMB1,436 million in 2009, up by RMB4,846 million.

#### *Operating revenue*

	2010		2009		Change in revenue %
	Operating revenue	Percentage	Operating revenue	Percentage	
	RMB million	%	RMB million	%	
Traffic revenue	74,140	96.9	52,967	96.7	40.0
Including: Passenger revenue	68,704		50,059		37.2
– Domestic	58,155		43,033		35.1
– Hong Kong, Macau and Taiwan	1,521		1,000		52.1
– International	9,028		6,026		49.8
Cargo and mail revenue	5,436		2,908		86.9
Other operating revenue	2,355	3.1	1,835	3.3	28.3
Mainly including: Commission income	469		342		37.1
Hotel and travel services income	477		172		>100.0
Ground services income	390		320		21.9
Expired sales in advance of carriage	249		350		(28.9 )
Aircraft wet lease income	50		83		(39.8 )
Total operating revenue	76,495	100.0	54,802	100.0	39.6
Less: fuel surcharge income	(5,583 )		(1,986 )		
Total operating revenue excluding fuel surcharge	70,912		52,816		

*Traffic revenue composition*

	2010		2009		Change in traffic revenue %
	Traffic revenue RMB million	Percentage %	Traffic revenue RMB million	Percentage %	
Passenger Revenue	68,704	92.7	50,059	94.5	37.2
Cargo and Mail Revenue	5,436	7.3	2,908	5.5	86.9
Traffic revenue	74,140	100.0	52,967	100.0	40.0

*Passenger revenue composition*

	2010		2009		Change in passenger revenue %
	Passenger revenue RMB million	Percentage %	Passenger revenue RMB million	Percentage %	
Domestic	58,155	84.7	43,033	86.0	35.1
Hong Kong, Macau and Taiwan	1,521	2.2	1,000	2.0	52.1
International	9,028	13.1	6,026	12.0	49.8
Passenger revenue	68,704	100.0	50,059	100.0	37.2

Substantially all of the Group's operating revenue is attributable to airline and airline related operations. Traffic revenue accounted for 96.9% and 96.7% of total operating revenue in 2010 and 2009, respectively. Passenger revenue and cargo and mail revenue accounted for 92.7% and 7.3%, respectively of the total traffic revenue in 2010. The other operating revenue is mainly derived from commission income, hotel and travel services income, income from general aviation operations, fees charged for ground services rendered to other Chinese airlines, income from expired sales in advance of carriage and aircraft wet lease income.

The increase in operating revenue was primarily due to a 37.2% increase in passenger revenue from RMB50,059 million in 2009 to RMB68,704 million in 2010. The total number of passengers carried increased by 15.4% to 76.46 million passengers in 2010. RPKs increased by 19.7% from 93,002 million in 2009 to 111,328 million in 2010, primarily as a result of the increase in number of passengers carried. Passenger yield per RPK increased from RMB0.54 in 2009 to RMB0.62 in 2010.

Domestic passenger revenue, which accounted for 84.7% of the total passenger revenue in 2010, increased by 35.1% from RMB43,033 million in 2009 to RMB58,155 million in 2010. Domestic passenger traffic in RPKs increased by 16.5%, while passenger capacity in ASKs increased by 11.4%, resulting in an increase in passenger load factor by 3.5 percentage point from 76.6% in 2009 to 80.1% in 2010. Domestic passenger yield per RPK increased from RMB0.53 in 2009 to RMB0.62 in 2010, mainly resulted from the increase of domestic passenger revenue and fuel surcharge income during the year.

Hong Kong, Macau and Taiwan passenger revenue, which accounted for 2.2% of total passenger revenue, increased by 52.1% from RMB1,000 million in 2009 to RMB1,521 million in 2010. For Hong Kong, Macau and Taiwan flights, passenger traffic in RPKs increased by 33.7%, while passenger capacity in ASKs increased by 22.8%, resulting in an increase in passenger load factor by 6.2 percentage points from 69.8% in 2009 to 76.0% in 2010. Passenger yield per RPK increased from RMB0.75 in 2009 to RMB0.85 in 2010, mainly resulted from the increase of Hong Kong, Macau and Taiwan passenger revenue.

International passenger revenue, which accounted for 13.1% of total passenger revenue, increased by 49.8% from RMB6,026 million in 2009 to RMB9,028 million in 2010. For international flights, passenger traffic in RPKs increased by 41.6%, while passenger capacity in ASKs increased by 28.6%, resulting in a 6.9 percentage point increase in passenger load factor from 67.9% in 2009 to 74.8% in 2010. Passenger yield per RPK increased from RMB0.55 in 2009 to RMB0.58 in 2010, mainly resulted from the increase in international passenger revenue and fuel surcharge income during the year.

Cargo and mail revenue, which accounted for 7.3% of the Group's total traffic revenue and 7.1% of total operating revenue, increased by 86.9% from RMB2,908 million in 2009 to RMB5,436 million in 2010. The increase was attributable to the increase in cargo traffic volume and fuel surcharge income.

Other operating revenue increased by 28.3% from RMB1,835 million in 2009 to RMB2,355 million in 2010. The increase was primarily due to the general growth in income from various auxiliary operations.

*Operating expenses*

Total operating expenses in 2010 amounted to RMB70,689 million, representing an increase of 27.7% or RMB15,334 million over 2009, primarily due to the total effect of increases in jet fuel costs, landing and navigation fees, maintenance expenses and other operating costs. Total operating expenses as a percentage of total operating revenue decreased from 101.0% in 2009 to 92.4% in 2010.

	2010		2009		Change in operating expenses
	RMB million	Percentage	RMB million	Percentage	%
Flight operations	38,593	54.6	29,296	52.9	31.7
Mainly including: Jet fuel costs	23,492		16,390		43.3
Operating lease charges	5,298		5,123		3.4
Flight personnel payroll and welfare	3,420		2,622		30.4
Maintenance	5,586	7.9	4,446	8.0	25.6