

CHINA EASTERN AIRLINES CORP LTD
Form 20-F
June 11, 2009

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549
FORM 20-F

- .. REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR 12(g)
OF THE SECURITIES EXCHANGE ACT OF 1934
OR
- b ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2008
OR
- .. TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934
- .. SHELL COMPANY REPORT PURSUANT TO SECTION 13 OR 15(d) OF
THE SECURITIES EXCHANGE ACT OF 1934

Commission file number 1-14550

(Exact Name of Registrant as Specified in Its Charter)

China Eastern Airlines Corporation Limited
(Translation of Registrant's Name Into English)

The People's Republic of China
(Jurisdiction of Incorporation or Organization)

2550 Hongqiao Road
Hongqiao Airport
Shanghai 200335
The People's Republic of China
(8621) 6268-6268
(Address and Telephone Number of Principal Executive Offices)

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 |
|--|--|
| American Depositary Shares | The New York Stock Exchange |
| Ordinary H Shares, par value RMB1.00 per share | The New York Stock Exchange* |

* Not for trading, but only in connection with the registration of American Depositary Shares. The Ordinary H Shares are also listed and traded on The Stock Exchange of Hong Kong Limited.

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

None
(Title of Class)

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.

As of December 31, 2008, 3,300,000,000 Ordinary Domestic Shares, par value RMB1.00 per share, were issued and outstanding, and 1,566,950,000 Ordinary H Shares par value RMB1.00 per share, were issued and outstanding. H Shares are Ordinary Shares of the Company listed on The Stock Exchange of Hong Kong Limited.

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

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

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

Indicate by check mark whether the registrant 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.

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 as issue by the International Accounting Standards Board Other

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

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

| | | |
|-----------------|--|----|
| PART I | | |
| Item 1. | Identity of Directors, Senior Management and Advisers | 5 |
| Item 2. | Offer Statistics and Expected Timetable | 5 |
| Item 3. | Key Information | 5 |
| Item 4. | Information on the Company | 15 |
| Item 4A. | Unresolved Staff Comments | 37 |
| Item 5. | Operating and Financial Review and Prospects | 37 |
| Item 6. | Directors, Senior Management and Employees | 55 |
| Item 7. | Major Shareholders and Related Party Transactions | 62 |
| Item 8. | Financial Information | 67 |
| Item 9. | The Offer and Listing | 68 |
| Item 10. | Additional Information | 69 |
| Item 11. | Quantitative and Qualitative Disclosures About Market Risk | 85 |
| Item 12. | Description of Securities Other than Equity Securities | 86 |
| PART II | | |
| Item 13. | Defaults, Dividend Arrearages and Delinquencies | 86 |
| Item 14. | Material Modifications to the Rights of Security Holders and Use of Proceeds | 86 |
| Item 15. | Controls and Procedures | 86 |
| Item 16A. | Audit Committee Financial Expert | 87 |
| Item 16B. | Code of Ethics | 87 |
| Item 16C. | Principal Accountant Fees and Services | 87 |
| Item 16D. | Exemptions from the Listing Standards for Audit Committees | 88 |
| Item 16E. | Purchase of Equity Securities by the Issuer and Affiliated Purchasers | 88 |
| Item 16G. | Corporate Governance | 88 |
| PART III | | |
| Item 17. | Financial Statements | 89 |
| Item 18. | Financial Statements | 89 |
| Item 19. | Exhibits | 89 |

SUPPLEMENTAL INFORMATION AND EXCHANGE RATES

In this Annual Report, unless otherwise specified, the term “dollars”, “U.S. dollars” or “US\$” refers to United States dollars, the legal tender currency of the United States of America, or the United States or the U.S.; the term “Renminbi” or “RMB” refers to Renminbi, the legal tender currency of The People’s Republic of China, or China or the PRC; and the term “Hong Kong dollars” or “HK\$” refers to Hong Kong dollars, the legal tender currency of the Hong Kong Special Administrative Region of China, or Hong Kong.

In this Annual Report, the term “we”, “us”, “our”, “our Company” or “China Eastern” refers to China Eastern Airlines Corporation Limited, a joint stock limited company incorporated under the laws of the PRC on April 14, 1995, and, unless the context otherwise requires, its subsidiaries, or, in respect of references to any time prior to the incorporation of China Eastern Airlines Corporation Limited, the core airline business carried on by its predecessor, China Eastern Airlines, which was assumed by China Eastern Airlines Corporation Limited pursuant to the restructuring described in this Annual Report. The term “CEA Holding” refers to our parent, China Eastern Air Holding Company, which was established on October 11, 2002 as a result of the merger of our former controlling shareholder, Eastern Air Group Company, or EA Group, with China Northwest Airlines Company and Yunnan Airlines Company.

For the purpose of this Annual Report, references to The People’s Republic of China, China and the PRC do not include Hong Kong, the Macau Special Administrative Region of China, or Macau, or Taiwan.

See “Item 3. Key Information - Exchange Rate Information” for details of exchange rates.

CAUTIONARY STATEMENT WITH RESPECT TO FORWARD-LOOKING STATEMENTS

Certain information contained in this Annual Report may be deemed to constitute forward-looking statements. These forward-looking statements include, without limitation, statements relating to:

- our fleet development plans, including, without limitation, related financing, schedule, intended use and planned disposition;
 - the planned expansion of our cargo operations;
- the impact of changes in the policies of the Civil Aviation Administration of China, or the CAAC, regarding route rights;
 - the impact of the CAAC policies regarding the restructuring of the airline industry in China;
- certain statements with respect to trends in prices, volumes, operations, margins, risk management, overall market trends and exchange rates;
 - our expansion plans, including acquisition of other airlines;
 - our marketing plans, including the establishment of additional sales offices;
 - our plan to add new pilots; and
 - the impact of unusual events on our business and operations.

The words or phrases “aim”, “anticipate”, “believe”, “continue”, “could”, “estimate”, “expect”, “going forward”, “intend”, “plan”, “potential”, “predict”, “project”, “seek”, “should”, “will”, “would”, and similar expressions, as they relate to our Company management, are intended to identify “forward-looking statements” within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities and Exchange Act of 1934, as amended, or the Exchange Act. These forward-looking statements are based on current plans and estimates, and speak only as of the date they are made. We undertake no obligation to update or revise any forward-looking statement in light of new information, future events or otherwise. Forward-looking statements are, by their nature, subject to inherent risks and uncertainties, some of which are beyond our control, and are based on assumptions and analyses made by us in light of our experience and our perception of historical trends, current conditions and expected future developments, as well as other factors we believe are appropriate in particular circumstances. We caution you that a number of important factors could cause actual outcomes to differ, or to differ materially, from those expressed in any forward-looking statement, including, without limitation:

- any changes in the regulatory policies of the CAAC;
- the effects of competition on the demand for and price of our services;
- the availability of qualified flight personnel and airport facilities;
- any significant depreciation of Renminbi or Hong Kong dollars against U.S. dollars, Japanese yen or Euro, the currencies in which the majority of our borrowings are denominated;
- the availability and cost of aviation fuel, including but not limited to pricing trends and risks associated with fuel hedging;
 - changes in political, economic, legal and social conditions in China;
 - the fluctuation of interest rates;
- our ability to obtain adequate financing, including any required external debt and acceptable bank guarantees; and
 - general economic conditions in markets where our Company operates.

GLOSSARY OF TECHNICAL TERMS

Capacity measurements

ATK (available tonne-kilometers) the number of tonnes of capacity available for the carriage of revenue load (passengers and cargo) multiplied by the distance flown

ASK (available seat kilometers) the number of seats made available for sale multiplied by the distance flown

AFTK (available freight tonne-kilometers) the number of tonnes of capacity available for the carriage of cargo and mail multiplied by the distance flown

Traffic measurements

revenue passenger-kilometers or RPK the number of passengers carried multiplied by the distance flown

revenue freight tonne-kilometers or RFTK cargo and mail load in tonnes multiplied by the distance flown

revenue passenger tonne-kilometers or RPTK passenger load in tonnes multiplied by the distance flown

revenue tonne-kilometers or RTK load (passenger and cargo) in tonnes multiplied by the distance flown

Load factors

overall load factor tonne-kilometers expressed as a percentage of ATK

passenger load factor passenger-kilometers expressed as a percentage of ASK

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

Yield and cost measurements

passenger yield (revenue per passenger-kilometer) revenue from passenger operations divided by passenger-kilometers

cargo yield (revenue per cargo tonne-kilometer) revenue from cargo operations divided by cargo tonne-kilometers

average yield (revenue per total tonne-kilometer) revenue from airline operations divided by tonne-kilometers

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 selected financial data from the consolidated income statements for the years ended December 31, 2006, 2007 and 2008 and the selected financial data from the balance sheets as of December 31, 2007 and 2008 have been derived from our audited consolidated financial statements, which have been prepared in accordance with International Financial Reporting Standards, or IFRS, as adopted by the International Accounting Standards Board (“IASB”) and audited by PricewaterhouseCoopers, an independent registered public accounting firm in Hong Kong. PricewaterhouseCoopers’ reports in respect of the consolidated income statements for the years ended December 31, 2006, 2007 and 2008 and the consolidated balance sheets as of December 31, 2007 and 2008 and the related footnotes are included in this Annual Report.

Pursuant to SEC Release 33-8879 “Acceptance from Foreign Private Issuers of Financial Statements Prepared in Accordance with International Financial Reporting Standards without Reconciliation to U.S. GAAP” eliminating the requirement for foreign private issuers to reconcile their financial statements to U.S. GAAP, we prepare our financial statements based on the IFRS and no longer provide a reconciliation between IFRS and U.S. GAAP.

The following information should be read in conjunction with, and is qualified in its entirety by our audited consolidated financial statements included in this Annual Report.

| | Year Ended December 31, | | | | |
|--|-------------------------|---------|---------|---------|------|
| | 2004(1) | 2005(1) | 2006(2) | 2007(2) | 2008 |
| | RMB | RMB | RMB | RMB | RMB |

(in millions, except per share or per ADS data)

Consolidated Income Statements Data:

IFRS:

| | | | | | |
|--|----------|----------|----------|----------|----------|
| Revenues | 21,328 | 27,380 | 37,557 | 42,534 | 41,073 |
| Other operating income and gains | 85 | 245 | 499 | 488 | 672 |
| Operating expenses | (20,117) | (27,562) | (40,795) | (42,894) | (56,828) |
| Operating profit / (loss) | 1,296 | 63 | (2,740) | 128 | (15,083) |
| Finance income / (costs), net | (641) | (578) | (731) | 162 | (267) |
| Profit / (loss) before income tax | 650 | (528) | (3,338) | 378 | (15,256) |
| Profit / (loss) for the year attributable to equity holders of the Company | 385 | (418) | (3,035) | 379 | (15,269) |
| | 0.08 | (0.09) | (0.62) | 0.08 | (3.14) |

Basic and fully diluted earnings / (loss) per share(2)

| | | | | | |
|---|------|--------|---------|--------|----------|
| Basic and fully diluted earnings / (loss) per ADS | 7.91 | (8.58) | (62.35) | (7.78) | (313.72) |
|---|------|--------|---------|--------|----------|

| | Year Ended December 31, | | | | |
|--|-------------------------|---------|---------|---------|------|
| | 2004(1) | 2005(1) | 2006(2) | 2007(2) | 2008 |
| | RMB | RMB | RMB | RMB | RMB |
| | (in millions) | | | | |

Balance Sheet Data:

IFRS:

| | | | | | |
|---------------------------|----------|----------|----------|----------|----------|
| Cash and cash equivalents | 2,114 | 1,864 | 1,987 | 1,655 | 3,451 |
| Net current liabilities | (12,472) | (25,548) | (24,588) | (26,098) | (43,458) |
| Non-current assets | 35,918 | 52,106 | 51,725 | 57,949 | 62,652 |

5

| | Year Ended December 31, | | | | |
|--|-------------------------|----------------|----------------|----------------|-------------|
| | 2004(1) RMB | 2005(1) RMB | 2006(2) RMB | 2007(2) RMB | 2008 RMB |
| | (in millions) | | | | |
| Long term borrowing, including current portion | (10,736) | (12,659) | (14,932) | (14,675) | 15,628 |
| Obligations under finance lease, including current portion | (8,662) | (10,588) | (11,949) | (16,452) | (20,809) |
| Total share capital and reserves | 5,897 | 5,561 | 2,534 | 2,361 | (13,097) |

- (1) The figures for the years ended December 31, 2004 and 2005 have been restated as a result of the changes of accounting policy.
- (2) The figures for the years ended December 31, 2006 and 2007 have been restated as a result of the changes of accounting policy. Please refer to Note 2(b) of the Financial Statements attached to this annual report on Form 20-F for more details.
- (3) The calculation of (loss)/earnings per share is based on the consolidated (loss)/profit attributable to shareholders and the weighted average number of shares of 4,866,950,000 in issue during the year.

Exchange Rate Information

We present our historical consolidated financial statements in Renminbi. For the convenience of the reader, certain pricing information is presented in U.S. dollars and certain contractual amounts that are in Renminbi or Hong Kong dollar amounts include a U.S. dollar equivalent at the exchange rates in New York City for cable transfers in foreign currencies as certified for customs purposes by the Federal Reserve Bank of New York on December 31, 2008 of RMB6.8225=US\$1.00 and HK\$7.7499=US\$1.00. We make no representation that the Renminbi, Hong Kong dollar or U.S. dollar amounts referred to in this Annual Report could have been or could be converted into U.S. dollars, Hong Kong dollars or Renminbi, as the case may be, at any particular rate or at all.

The exchange rates in New York City for cable transfers as certified for customs purposes by the Federal Reserve Bank of New York were RMB6.8278 = US\$1.00 and HK\$7.7519 =US\$1.00 on May 29, 2009. The following table sets forth information concerning exchange rates between the RMB, Hong Kong dollar and the U.S. dollar for the periods indicated based on the exchange rate in New York City for cable transfers of in foreign currencies as certified for customs purposes by the Federal Reserve Bank of New York.

| | RMB per US\$1.00 | | HK\$ per US\$1.00 | |
|---------------|------------------|--------|-------------------|--------|
| | High | Low | High | Low |
| November 2008 | 6.8373 | 6.8220 | 7.7560 | 7.7497 |
| December 2008 | 6.8842 | 6.8225 | 7.7522 | 7.7497 |
| January 2009 | 6.8403 | 6.8225 | 7.7618 | 7.7504 |
| February 2009 | 6.8470 | 6.8241 | 7.7551 | 7.7511 |
| March 2009 | 6.8438 | 6.8240 | 7.7593 | 7.7494 |
| April 2009 | 6.8361 | 6.8180 | 7.7508 | 7.7495 |
| May 2009 | 6.8326 | 6.8176 | 7.7526 | 7.7500 |

The following table sets forth the average rates between Renminbi and U.S. dollars and between Hong Kong dollars and U.S. dollars for each of 2004, 2005, 2006, 2007 and 2008, calculated by averaging the exchange rates on the last day of each month during the relevant year:

| | RMB per US\$1.00 | HK\$ per US\$1.00 |
|------|---------------------|----------------------|
| 2004 | 8.2768 | 7.7899 |
| 2005 | 8.1826 | 7.7755 |
| 2006 | 7.9579 | 7.7685 |
| 2007 | 7.5806 | 7.8008 |
| 2008 | 6.9193 | 7.7814 |

Selected Operating Data

The following table sets forth certain operating data of our Company for the five years ended December 31, 2008, which are not audited. All references in this Annual Report to our cargo operations, cargo statistics or cargo revenues include figures for cargo and mail.

| | Year Ended December 31, | | | | |
|---|-------------------------|----------|----------|----------|----------|
| | 2004 | 2005 | 2006 | 2007 | 2008 |
| Selected Airline Operating Data: | | | | | |
| Capacity: | | | | | |
| ATK (millions) | 7,071.2 | 8,751.5 | 11,065.6 | 12,085.9 | 11,642.2 |
| ASK (millions) | 41,599.1 | 52,427.9 | 70,468.3 | 77,717.2 | 75,964.3 |
| AFTK (millions) | 3,327.3 | 4,033.0 | 4,723.4 | 5,091.3 | 4,805.4 |
| Traffic: | | | | | |
| Revenue passenger-kilometers (millions) | 27,580.8 | 36,380.6 | 50,271.9 | 57,182.6 | 53,785.3 |
| Revenue tonne-kilometers (millions) | 4,340.7 | 5,395.2 | 6,931.0 | 7,713.9 | 7,219.0 |
| Revenue passenger tonne-kilometers (millions) | 2,466.0 | 3,243.7 | 4,487.0 | 5,099.8 | 4,798.9 |
| Revenue freight tonne-kilometers (millions) | 1,874.7 | 2,151.5 | 2,444.0 | 2,614.1 | 2,420.1 |
| Kilometers flown (millions) | 242.8 | 287.7 | 434.6 | 478.1 | 467.0 |
| Hours flown (thousands) | 360.4 | 467.8 | 678.3 | 756.0 | 755.2 |
| Number of passengers carried (thousands) | 17,711.0 | 24,290.5 | 35,039.7 | 39,161.4 | 37,231.5 |
| Weight of cargo carried (millions of kilograms) | 663.6 | 775.5 | 893.2 | 940.1 | 889.5 |

| | Year Ended December 31, | | | | |
|--|-------------------------|---------|---------|---------|---------|
| | 2004 | 2005 | 2006 | 2007 | 2008 |
| Average distance flown (kilometers per passenger) | 1,557.3 | 1,497.7 | 1,434.7 | 1,460.2 | 1,444.6 |
| Load Factor: | | | | | |
| Overall load factor (%) | 61.4 | 61.7 | 62.6 | 63.8 | 62.0 |
| Passenger load factor (%) | 66.3 | 69.4 | 71.3 | 73.6 | 70.8 |
| Break-even load factor (based on ATK) (%) | 62.2 | 66.0 | 71.1 | 67.7 | 90.7 |
| Yield and Cost Statistics (RMB): | | | | | |
| Passenger yield (passenger revenue/passenger-kilometers) | 0.56 | 0.57 | 0.61 | 0.62 | 0.62 |
| Cargo yield (cargo revenue/cargo tonne-kilometers) | 2.36 | 2.31 | 2.30 | 2.10 | 2.21 |
| Average yield (passenger and cargo revenue/tonne-kilometers) | 4.60 | 4.79 | 5.20 | 5.27 | 5.38 |
| Unit cost (operating expenses/ATK) | 2.86 | 3.16 | 3.70 | 3.57 | 4.88 |

B. Capitalization and Indebtedness

Not applicable.

C. Reasons for the Offer and Use of Proceeds

Not applicable.

D. Risk Factors

An investment in our Company involves a number of risks, some of which may be special or significantly different from risks that are normally associated with an investment in a U.S. company. You should carefully consider the

following information about the risks in investing in our Company, along with the other information presented in this Annual Report.

Significant losses in 2008

We incurred significant losses in 2008, which materially weakened our financial condition. Although we earned an operating profit of RMB128 million in 2007, our operating loss in 2008 was approximately RMB15.1 billion, which included losses on fair value movements amounting to approximately RMB6,256 million on our aviation fuel hedging contracts. Our net cash generated from operations decreased by approximately RMB225 million from RMB3,080 million in 2007 to RMB2,856 million in 2008. We cannot assure you that we will not continue to experience significant losses in the future. As a result of our weakened financial condition, we may be more vulnerable to the impact of unexpected events, the deterioration of the global and domestic economies and any significant increase in competition.

Impairments for Property Plant and Equipment

In accordance with the relevant accounting standards, we are required to test certain of our intangible assets for impairment on an annual basis, or more frequently if conditions indicate that an impairment may have occurred. In addition, we are required to test certain of our tangible assets for impairment if conditions indicate that an impairment may have occurred. In view of the decline in demand on the air transportation market under the current economic environment, we performed an impairment test on property, plant and equipment as of December 31, 2008, based on which an impairment provision of RMB1,442 million was made against certain aircraft model and the related equipment which reflects their relatively lower operational efficiency and management's intention to retire these aircraft in the near future. In determining the recoverable amounts of the related assets, our management has compared the value in use and the fair value less costs to sell of the related assets, primarily determined by reference to estimated market values. After assessing the fair value less costs to sell as at the balance sheet date which was primarily determined by reference to estimated market value, we made an additional impairment loss of RMB235 million against certain aircraft and related flight equipment which have been classified as "non-current assets held for sale".

We may be required to recognize additional impairments in the future due to, among other factors, extreme fuel price volatility, tight credit markets, a decline in the fair value of certain tangible or intangible assets, unfavorable trends in historical or forecasted operating or cash flow losses and the uncertain economic environment, as well as other uncertainties. We cannot guarantee that a material impairment charge of tangible or intangible assets will not occur in any future period. The value of our aircraft could be adversely affected in future periods by changes in the market for these aircraft. An impairment charge could have a material adverse effect on our financial position and result of operations in the period of recognition.

Liquidity

We have substantial debts, and will continue to have substantial debts in the future. In addition, we added, in 2008, a total of 19 aircraft to our fleet, including one A320 purchased by us and seven A320, five A321, one A330-200, three A330-300, one B737-700 and one B737-800 held under finance leases. In addition, we surrendered the lease of two aircraft, including one B737-300 and one B747F. See the section headed "Item 4. Information on the Company — Property, Plant and Equipment — Fleet". As of December 31, 2008, our total outstanding debt was RMB85,691 million. As of the same date, our current liabilities exceeded our current assets by RMB43,458 million. Short-term bank loans outstanding totaled RMB19,474 million as of December 31, 2008. Our substantial indebtedness and other obligations could make us more vulnerable to economic recessions and reduce our flexibility in responding to increased competition and changing business and economic conditions.

Moreover, we are largely dependent upon cash flows generated from our operations and external financing (including short-term bank loans) to meet our debt repayment obligations and working capital requirements, which may reduce the funds available for other business purposes. 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. We have arranged financing with domestic and foreign-funded banks in China as necessary to meet our working capital requirements. We have also tried to ensure our liquidity by structuring a substantial portion of our short-term bank loans to be rolled over upon maturity. These efforts, however, may ultimately prove insufficient. Our ability to obtain financing may be affected by our financial position and leverage and our credit rating, as well as by prevailing economic conditions and the cost of financing in general. If we are unable to obtain adequate financing for our capital requirements, our liquidity and operations would be materially and adversely affected.

Future Financing Requirements

We require significant amounts of external financing to meet our capital commitments for adding and upgrading aircraft and flight equipment and for other business expansion needs. We generally acquire aircraft through either long-term capital leases or operating leases. In the past, we have obtained, sometimes with the assistance of the CAAC, guarantees from Bank of China and other Chinese banks in respect of payments under our foreign loan and capital lease obligations. However, we cannot assure you that we will be able to continue to obtain bank guarantees in the future. The unavailability of guarantees from Bank of China or other acceptable banks or the increased cost of such guarantees may materially and adversely affect our ability to borrow internationally or enter into international aircraft lease financings on acceptable terms. The current economic recession has severely disrupted the global capital markets, resulting in a diminished availability of financing and higher cost for financing that is obtainable. Our ability to obtain financing may also be impaired by our financial position and leverage and our credit rating. If we were unable to obtain financing for a significant portion of our capital requirements, our ability to acquire new aircraft or expand our operations may be impaired. We have and in the future will likely continue to have substantial debts. As a result, the interest cost associated with these debts might impair our future profitability and cause our earnings to be subject to a higher degree of volatility.

Weaker Demand for Air Travel as a Result of the Global Economic Recession

The airline industry is highly cyclical, and the level of demand for air travel is correlated to the strength of the domestic and global economies. Robust demand for our air transportation services depends largely on favorable general economic conditions, including the strength of the global and local economies, low unemployment levels, strong consumer confidence levels and the availability of consumer and business credit. As a result of the severe global economic downturn, we experienced significantly weaker demand for air travel, especially internationally, in the fourth quarter of 2008 and into 2009. To offset the decline in passenger volume, we reduced our international flights and reallocated our capacity by focusing more on the domestic market. Demand for air travel could continue to fall if the global economic recession continues, and overall demand may fall much lower than we are able prudently to reduce capacity. Continuation or worsening of the current global recession may lead us to further reduce domestic or international capacity, which would have a material adverse effect on our revenues, results of operations and liquidity.

In addition, the airline industry is characterized by a high degree of operating leverage. Due to high fixed costs, including payments made in connection with aircraft leases, the expenses relating to the operation of any given flight do not vary proportionately with the number of passengers carried, while revenues generated from a particular flight are directly related to the number of passengers carried and the fare structure of the flight. Accordingly, a decrease in revenues may result in a proportionately higher decrease in profits.

Fuel Supply and Costs

The availability and cost of aviation fuel has a significant impact on our financial condition and results of operations. In the past, jet fuel shortages have occurred in China and, on limited occasions, required us to delay or cancel flights. Although jet fuel shortages have not occurred since the end of 1993, we cannot assure you that jet fuel shortages will not occur in the future. Fuel prices continue to be susceptible to, among other factors, political unrest in various parts of the world, Organization of Petroleum Exporting Countries policies, the rapid growth of the economies in China and India, the levels of inventory carried by industries, the amounts of reserves built by governments, disruptions to production and refining facilities and weather conditions. These and other factors that impact the global supply and demand for aircraft fuel may affect our financial performance due to its sensitivity to fuel prices.

Fuel costs constitute a significant portion of our operating costs and, in 2008, accounted for approximately 32.5% of our operating expenses. Between 2007 and 2008, our fuel expenses rose by 22.3%, partially as a result of increased

weighted average domestic and international fuel prices. Between 2007 and 2008, the weighted average fuel prices that we paid increased by approximately 28.0%. Due to the highly competitive nature of the airline industry and government regulation on airfare pricing, we may be unable to fully or effectively pass on to our customers any increased fuel costs we may encounter in the future. Any jet fuel shortages or any increase in domestic or international jet fuel prices may materially and adversely affect our financial condition and results of operations.

Fuel Hedging Arrangements

As a form of protection against potential spikes in fuel price, we from time to time hedge a portion of our future fuel requirements through various financial derivative instruments 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. As of December 31, 2008, the loss of fair value of the aviation fuel hedging contracts entered into by our Company has contributed to the loss incurred by our Company in 2008 in the amount of approximately RMB6,256 million. 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.

Intensified Competition

We face intense competition in each of the domestic, regional and international markets that we serve. In our domestic markets, we compete against smaller domestic airline companies that operate with costs that are lower than ours. In our regional and international markets, we compete against international airline companies that have significantly longer operating histories, greater name recognition, more resources or larger sales networks than we do, or utilize more developed reservation systems than ours. See the section headed “Item 4. Information on the Company — Business Overview — Competition” for more details. The public’s perception of the safety records of Chinese airlines also materially and adversely affects our ability to compete against our international competitors. In response to competition, we have, from time to time in the past, lowered our airfares for certain of our routes, and we may be required to do the same in the future. Increased competition and pricing pressures from competition may have a material adverse effect on our financial condition and results of operations.

Government Regulation

The Chinese civil aviation industry is subject to a high degree of regulation by the CAAC. Regulatory policies issued or implemented by the CAAC encompass virtually every aspect of airline operations, including, among other things:

- route allocation;
- pricing of domestic airfares;
- the administration of air traffic control systems and certain airports; and
- aircraft registration and aircraft airworthiness certification.

As a result, we may face significant constraints on our flexibility and ability to expand our business operations or to maximize our profitability.

Government Ownership and Control of Our Company

Most of the major airline companies in China are currently majority-owned either by the central government of China or by provincial or municipal governments in China. CEA Holding currently holds 59.67% of our Company’s equity interests on behalf of the PRC Government. As a result, CEA Holding could potentially elect the majority of our Board of Directors and otherwise be able to control us. CEA Holding also has sufficient voting control to effect transactions without the concurrence of our minority shareholders. The interests of the PRC Government as the ultimate controlling person of our Company and most of the other major Chinese airlines could conflict with the

interests of our minority shareholders. Although the CAAC currently has a policy of equal treatment of all Chinese airlines, we cannot assure you that the CAAC will not favor other Chinese airlines over our Company.

On December 10, 2008, CEA Holding entered into the A Share Subscription Agreement with our Company and on December 29, 2008, CEA Holding entered into a revised A Share Subscription Agreement. Pursuant to the revised A Share Subscription Agreement, CEA Holding will, at the subscription price of RMB3.87 per share, subscribe in cash for 1,437,375,000 new A Shares with a total subscription price of approximately RMB5,563 million. Simultaneously with the entering into of the A Share Subscription Agreement and the revised A Share Subscription Agreement, CES Global Holdings (Hong Kong) Limited (“CES Global”), a wholly owned subsidiary of CEA Holding, entered into the H Share Subscription Agreement and the revised H Share Subscription Agreement with our Company. Pursuant to the revised H Share Subscription Agreement, CES Global will, at the subscription price of RMB1.0 per share, subscribe in cash for 1,437,375,000 new H Shares with a total subscription price of approximately RMB1,437 million. Immediately after completion of both subscriptions, CEA Holding will, directly and indirectly hold in aggregate 5,778,750,000 shares in our Company (including 4,341,375,000 A Shares and 1,437,375,000 H Shares), representing approximately 74.64% of the enlarged total share capital of our Company. On February 26, 2009, we convened a class meeting of A Share Shareholders, a class meeting of H Share Shareholders, and an extraordinary general meeting of shareholders, at which special resolutions were passed to approve both the non-public issuance of 1,437,375,000 new A Shares at subscription price of approximately RMB5,563 million to CEA Holding and the issuance of 1,437,375,000 new H Shares at subscription price of approximately RMB1,437 million to CES Global.

On May 22, 2009, we received an approval issued by CSRC dated May 19, 2009 in relation to our proposed issue of 1,437,375,000 new H Shares at a price of RMB1.00 per share to CES Global. Pending the final approval to be issued by CSRC in relation to the issuance of the new A Shares, we will arrange for the new H Shares and the new A Shares to be issued.

As a controlling shareholder, CEA Holding has the ability to exercise a controlling influence over our business and affairs, including, but not limited to, decisions with respect to:

- mergers or other business combinations;
- the acquisition or disposition of assets;
- the issuance of any additional shares or other equity securities;
- the timing and amount of dividend payments; and