THIS CIRCULAR IS IMPORTANT AND REQUIRES YOUR IMMEDIATE ATTENTION

If you are in any doubt as to any aspect of this circular, you should consult your stockbroker or other registered dealer in securities, bank manager, solicitor, professional accountant or other professional adviser.

If you have sold or transferred all your shares in Air China Limited, you should at once hand this circular along with the form of proxy and the notice of attendance to the purchaser or the transferee or to the bank, stockbroker or other agent through whom the sale or transfer was effected for transmission to the purchaser or transferee.

中國國際航空股份有限公司
AIR CHINA LIMITED

(a joint stock limited company incorporated in the People's Republic of China with limited liability)

(Stock Code: 00753)

CONTINUING CONNECTED TRANSACTIONS AND DISCLOSEABLE TRANSACTION AND NOTICE OF EGM

Independent Financial Adviser to the Independent Board Committee and the Independent Shareholders

SOMERLEY CAPITAL LIMITED

A letter from the Board is set out on pages 4 to 25 of this circular.

A letter from the Independent Board Committee, containing its advice to the Independent Shareholders of the Company, is set out on pages 26 to 27 of this circular.

A letter from the Independent Financial Adviser, containing its advice to the Independent Board Committee and the Independent Shareholders of the Company is set out on pages 28 to 64 of this circular.

A notice convening the EGM to be held at 9:00 a.m. on Thursday, 19 December 2019 at The Conference Room C713, No. 30, Tianzhu Road, Airport Industrial Zone, Shunyi District, Beijing, the PRC, is set out on pages 69 to 70 of this circular. Whether or not you are able to attend the EGM, you are requested to complete and return the form of proxy in accordance with the instructions printed thereon as soon as possible but in any event not less than 24 hours before the time appointed for convening the EGM or any adjournment thereof. Completion and return of the form of proxy will not preclude you from attending and voting in person at the EGM or any adjournment should you so wish.

4 November 2019

CONTENTS

In this circular, unless the context otherwise requires, the following expressions have the following meanings:

"Bellyhold Space Business"	all the freight business operated through the utilization of the bellyhold space of passenger aircraft, including but not limited to the sale and pricing in relation to the bellyhold space
"ACC Framework Agreement"	the framework agreement dated 30 August 2016 entered into between the Company and Air China Cargo in respect of the ACC Transactions
"ACC Group"	Air China Cargo, its subsidiaries and 30%-controlled companies (as defined under Hong Kong Listing Rules)
"ACC Transactions"	the continuing connected transactions contemplated under the ACC Framework Agreement and the New ACC Framework Agreement, as applicable, between any member of the Group on the one hand, and any member of the ACC Group on the other hand
"Air China Cargo"	Air China Cargo Co., Ltd., a company established under the laws of the PRC with limited liability
"Board"	the board of directors of the Company
"Company"	Air China Limited, a company incorporated in the PRC, whose H shares are listed on the Hong Kong Stock Exchange as its primary listing venue and on the Official List of the UK Listing Authority as its secondary listing venue, and whose A shares are listed on the Shanghai Stock Exchange
"Cathay Pacific"	Cathay Pacific Airways Limited, a company incorporated in Hong Kong and listed on the Hong Kong Stock Exchange, the principal activity of which is the operation of scheduled airline services
"CNAHC"	China National Aviation Holding Corporation Limited, a company established under the laws of the PRC and the controlling shareholder of the Company, and is primarily engaged in managing its state-owned assets and its equity interest in investees, charter of aircraft and maintenance of aviation equipment
"CNACG"	China National Aviation Corporation (Group) Limited, a company incorporated under the laws of Hong Kong and a wholly-owned subsidiary of CNAHC
"CNACG Group"	CNACG, its subsidiaries and 30%-controlled companies (as defined under Hong Kong Listing Rules)

"CNACG Framework Agreement"	the framework agreement dated 30 August 2016 entered into between the Company and CNACG in respect of the CNACG Transactions
"CNACG Transactions"	the continuing connected transactions contemplated under the CNACG Framework Agreement and the New CNACG Framework Agreement, as applicable, between any member of the Group on the one hand, and any member of the CNACG Group on the other hand, but excluding the various services, such as airline catering service, housing rental, etc., that have been included or will be included in the continuing connected transaction framework agreements entered into between the Company and CNAHC
"Director(s)"	the director(s) of the Company
"Group"	the Company and its subsidiaries
"Hong Kong Listing Rules"	the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited
"Hong Kong Stock Exchange"	The Stock Exchange of Hong Kong Limited
"Independent Board Committee"	a board committee comprising Mr. Wang Xiaokang, Mr. Liu Deheng, Mr. Stanley Hui Hon-chung and Mr. Li Dajin, all being the independent non-executive Directors of the Company
"Independent Shareholders"	In terms of ACC Transactions, the Shareholders of the Company excluding CNAHC, CNACG, Cathay Pacific and its associates; in terms of CNACG Transactions, the Shareholders of the Company excluding CNAHC and CNACG
"Latest Practicable Date"	30 October 2019, being the latest practicable date prior to the printing of this circular for ascertaining certain information contained herein
"New ACC Framework Agreement"	the framework agreement dated 30 October 2019 entered into between the Company and Air China Cargo in respect of the ACC Transactions
"New CNACG Framework Agreement"	the framework agreement dated 30 October 2019 entered into between the Company and CNACG in respect of the CNACG Transactions
"PBOC"	People's Bank of China

"Somerley" or "Independent Financial Adviser"	Somerley Capital Limited, a licensed corporation licensed to carry out Type 1 (dealing in securities) and Type 6 (advising on corporate finance) regulated activities under the SFO, as the Independent Financial Adviser to the Independent Board Committee and the Independent Shareholders to advise on (i) the transactions contemplated under the New ACC Framework Agreement and the proposed annual caps thereunder; (ii) the transactions contemplated under the New CNACG Framework Agreement and the proposed annual caps thereunder
"RMB"	the lawful currency of the PRC
"SFO"	the Securities and Futures Ordinance (Chapter 571 of the Laws of Hong Kong), as amended and modified from time to time
"Shanghai Listing Rules"	the Listing Rule of Shanghai Stock Exchange
"Shareholder(s)"	the shareholder(s) of the Company

中國國際航空股份有限公司

AIR CHINA LIMITED

(a joint stock limited company incorporated in the People's Republic of China with limited liability)

(Stock Code: 00753)

Directors:
Non-executive Directors:
Cai Jianjiang *(Chairman)*
Cao Jianxiong
Xue Yasong
John Robert Slosar

Executive Director:
Song Zhiyong *(President)*

Independent Non-Executive Directors:
Wang Xiaokang
Liu Deheng
Hui Hon-chung, Stanley
Li Dajin

Registered Address:
Blue Sky Mansion
28 Tianzhu Road
Airport Industrial Zone
Shunyi District
Beijing, the PRC

Principal Place of Business in Hong Kong:
5th Floor, CNAC House
12 Tung Fai Road
Hong Kong International Airport
Hong Kong

4 November 2019

To the Shareholders

Dear Sir or Madam,

CONTINUING CONNECTED TRANSACTIONS AND DISCLOSEABLE TRANSACTION AND NOTICE OF EXTRAORDINARY GENERAL MEETING

I. INTRODUCTION

Reference is made to the announcement of the Company dated 30 August 2016 in relation to the ACC Transactions and the CNACG Transactions. The current term of the ACC Framework Agreement and the CNACG Framework Agreement will expire on 31 December 2019. As the Company expects that the ACC Transactions and the CNACG Transactions will continue to be conducted after 31 December 2019, on 30

October 2019 (after trading hours), the Company entered into the New ACC Framework Agreement and the New CNACG Framework Agreement with Air China Cargo and CNACG, respectively, to renew and amend the ACC Framework Agreement and the CNACG Framework Agreement.

The purpose of this circular is to provide you with further information on the abovementioned matters so that you can make an informed decision on voting in respect of the relevant resolutions at the EGM.

II. ACC TRANSACTIONS

The Company and Air China Cargo entered into the New ACC Framework Agreement on 30 October 2019.

1. Parties and the relationship between the parties

The Company is principally engaged in providing air passenger and cargo transportation services and other aviation-related services.

Air China Cargo is a 51%-owned subsidiary of CNAHC, a controlling shareholder of the Company, and is therefore a connected person of the Company under the Hong Kong Listing Rules. Air China Cargo is a limited liability company established under the laws of the PRC and is principally engaged in air cargo and mail transportation business.

2. Description of the ACC Transactions

The ACC Transactions contemplated under the New ACC Framework Agreement are as follows:

- **Bellyhold Space Business contracting operation:** The Company has contracted the operation of all Bellyhold Space Business to Air China Cargo. Air China Cargo shall undertake the overall responsibilities for transporting the cargos as the contracting carrier to the consignors with respect to the cargos which are transported through the bellyhold spaces of passenger aircraft.

- **Ground support services and other services:** The ground support services and other services provided by the Group to ACC Group include but are not limited to operation support services, IT sharing services, comprehensive support services, engine and other aircraft-related materials lease services and labour management services. The ground support services and other services provided by ACC Group to the Group include but are not limited to terminal cargo and mail services, airport apron services, container and pallet management services, engine and other aircraft-related materials lease services.

3. Pricing Policies for the ACC Transactions

The consideration of any specific ACC Transactions shall be determined after arm's length negotiations between the Group and the ACC Group and on normal commercial terms, and shall be determined in accordance with the pricing policies set forth below on a case-by-case basis.

- ***Bellyhold Space Business contracting operation:***

  (1) **Contracting Operation Income:** During the contracting period, Air China Cargo will regularly pay the Company the contracting operation income in respect of Bellyhold Space Business in each year. The parties shall determine the Benchmark Income (excluding tax) of Bellyhold Space Business contracting operation after arm's length negotiations with reference to the Company's fleet capacity, overall load factor and yield level. The specific formula is as follows:

  Benchmark Income (excluding tax) = ATK (available tonne kilometres) × OLF (overall load factor) × yield level per kilometre

  The ATK shall be determined based on the Company's fleet capacity for the current financial year and its plan of introduction and phase-out of passenger aircraft for the next year. The OLF and the yield level per kilometre shall be determined based on the historical data of the respective air routes of the Company.

  Considering possible market fluctuations, the parties agreed to jointly appoint a qualified accounting firm to conduct a special audit on the actual income (excluding tax) of Air China Cargo for the operation of Bellyhold Space Business of the previous financial year within three months after the end of each financial year. Where there is any difference between the Benchmark Income (excluding tax) and the actual income (excluding tax), the excess income or risk incurred shall be allocated between Air China Cargo and the Company at the proportion of 51% and 49%, respectively, and paid accordingly.

  Where the final settlement price will exceed the annual caps which have been set by the Company, all reasonable steps will be taken by the Company to comply with the relevant requirements under Chapter 14A of the Hong Kong Listing Rules.

  (2) **The Operation Expense of the Bellyhold Space Business:** During the contracting period, the Company shall pay the operation expenses of the Bellyhold Space Business to Air China Cargo on a regular basis per year. In accordance with the common industry practice, the operation expense shall be

determined according to the settlement price (determined according to the method as set out above in the paragraph headed "Contracting Operation Income") and the Expense Rate, and the calculation formula is as follows:

Operation Expense = Settlement Price × Expense Rate (as defined below)

The expense rate ("Expense rate") shall be determined by the parties through arm's length negotiation with reference to historical expense rates and other factors such as expense rates of companies in the relevant industry and their variation trends.

Where the Operation Expense will exceed the annual caps which have been set by the Company, all reasonable steps will be taken by the Company to comply with the relevant requirements under Chapter 14A of the Hong Kong Listing Rules.

- ***Ground support services and other services:***

The pricing policies for the ground support services and other services provided to or by the Group are set forth below:

(i) Follow the government pricing or guide price if it is available, including but not limited to the guidance from the Civil Aviation Administration of the PRC (CAAC) and the International Air Transport Association on the prices of ground support services and other terms, and the requirements on the pricing of navigation information stipulated by CAAC and Air Traffic Management Bureau (ATMB).

(ii) If no government pricing or guide price is available, the final transaction price will be determined on arm's length negotiations between parties with firstly making reference to the market prices offered by at least two independent third parties on the market for the same type of service, and after taking certain factors into account such as the service standard, service scope, business volume and specific need of parties. If any service need of the service recipient changes, appropriate adjustment will be made to the transaction price after negotiation between both parties based on the extent of variation in relevant costs, service quality or other factors.

(iii) If neither the above cases is applicable, the price will be determined on the basis of cost plus reasonable profit. The costs are mainly based on the costs and expenses of the service provider, including costs of human resources and costs of facility, equipment and materials. Reasonable profit margin will be determined with mainly making reference to the historical average prices on similar products or services (where possible) published in relevant industry, and/or the profit margin of the comparable products and services disclosed by other listed companies. The profit margin of ACC Group shall not exceed 10%. The final transaction prices shall be determined on terms that to the Group are no less favourable to those provided by independent third parties to the Group or those provided by ACC Group to independent third parties (with regards to the receiving of services by the Group), or no more favourable than those provided by the Group to the independent third parties (with regards to the rendering of services by the Group).

4. The Term of the New ACC Framework Agreement

The initial term of the New ACC Framework Agreement is three years commencing from 1 January 2020 and ending on 31 December 2022, which is automatically renewable for successive terms of three years after the expiry of its initial term subject to the fulfilment of requirements under the Hong Kong Listing Rules/Shanghai Listing Rules and obtaining the required approval. Before expiry of the New ACC Framework Agreement, the Board will re-assess the terms and conditions of the New ACC Framework Agreement, and the Company will re-comply with the relevant rules governing connected transactions under the Hong Kong Listing Rules/Shanghai Listing Rules. During the term of the New ACC Framework Agreement, the agreement can be terminated on any 31 December by either party thereto by serving the other party a written notice of termination of not less than three months.

5. Reasons for and Benefits of the ACC Transactions

The Directors believe that it is in the best interest of the Group to continue the ACC Transactions with the ACC Group having taken into account the following factors:

- In respect of the Bellyhold Space Business contracting operation, contracting the bellyhold space operation to Air China Cargo is an important step for the Company to focus on air passenger transportation business, which is also in line with the general trend among major domestic airlines. By virtue of which, the Company will focus its resources on the operation of air passenger transportation business, enhance the utilization efficiency of important resources and enhance the operational and management capacity in core business of air passenger transportation; make the most of economies of scale of the Company and Air China Cargo at their respective business, generate stable bellyhold space contracting revenue to the Company; consolidate mechanism of the operation responsibility and risk sharing, reduce the possible adverse impact brought by the fluctuation of freight market, so as to further promote the brand image and competitiveness of the Company in the air passenger transportation sector, thereby creating more investment return for the shareholders.

- In respect of ground support services and other services, the long established successful cooperative relationship between the Company and Air China Cargo is able to provide streamlined and efficient cooperation and transaction between the Group and the ACC Group.

6. Historical Amounts and Historical Annual Caps

The table below sets out (i) the annual caps of amounts payable by the ACC Group or the Group for each of the three years ended/ending 31 December 2017, 2018 and 2019, respectively; and (ii) the actual amounts paid by the ACC Group or the Group for each of the two years ended 31 December 2017 and 2018 and for January to August 2019, and the estimated amounts payable for the year ending 31 December 2019.

	Historical Amounts				Historical Annual Caps		
	for the year ended 31 December		Actual amount for the period from January to August	Estimated annual amount for	for the year ended/ ending 31 December		
Transactions	**2017**	**2018**	**2019**	**2019**	**2017**	**2018**	**2019**
				(in millions of RMB)			
Amounts paid/payable by the ACC Group to the Group	**5,636**	**6,043**	**3,653**	**7,045**	**5,854**	**7,160**	**8,777**
In terms of bellyhold space	5,104	5,543	3,190	6,374	5,182	6,429	7,977
In terms of ground support services	62	54	80	120	143	169	200
In terms of other services	470	446	383	551	529	562	600
Amounts paid/payable by the Group to the ACC Group	**993**	**1,017**	**637**	**1,340**	**1,625**	**1,944**	**2,326**
In terms of selling services of bellyhold space	385	418	242	481	519	643	798
In terms of ground support services	576	586	385	826	932	1,088	1,269
In terms of other services	32	13	10	33	174	213	259

7. Proposed Annual Caps and Basis of Determination

The table below sets out the proposed annual caps of amounts payable by the ACC Group or the Group for each of the three years ending 31 December 2020, 2021 and 2022, respectively:

Transactions	Proposed Annual Caps for the year ending 31 December 2020	2021	2022
	(in millions of RMB)		
Amounts payable by the ACC Group to the Group	**8,800**	**10,600**	**12,700**
In terms of contracting operation income of Bellyhold Space Business	8,000	9,600	11,600
In terms of ground support services and other services	800	1,000	1,100
Amounts payable by the Group to the ACC Group	**1,800**	**2,160**	**2,560**
In terms of operation expenses of bellyhold space	800	960	1,160
In terms of ground support services and other services	1,000	1,200	1,400

Amounts Payable by the ACC Group to the Group

In arriving at the estimated amounts of contracting operation income of Bellyhold Space Business payable by the ACC Group to the Company for each of the three years ending 31 December 2022, the Company has considered, among other things, the historical transaction amounts and the estimation of annual growth rate of the contracting operation income of Bellyhold Space Business for the next three years based on following consideration:

- The bellyhold space provided to the ACC Group will increase along with the expansion of the fleet capacity of passenger aircraft of the Company. As of 31 December 2018, the Company had 409 aircraft. The Company expects to introduce 33, 55 and 36 aircraft and phase out 5, 1 and 0 aircraft in each year of 2019 to 2021, respectively. The average compound annual growth rate of Company's fleet capacity estimated accordingly for the years from 2019 to 2021 is about 10%. It is also assumed that the growth rate of fleet expansion in 2022 will not exceed 10%;

- For the growth rate of yield level per kilometre, considering Air China Cargo's capacity growth from 2020 to 2022 and with reference to the average compound annual growth of yield level per kilometre of the Group of 9.8% for the years from 2016 to 2018, it is assumed that yield level per kilometre will maintained similar growth rate from 2020 to 2022.

In arriving at the estimated aggregate amounts payable by the ACC Group to the Group in connection with the ground support services and other services provided by the Group for each of the three years ending 31 December 2022, respectively, the Company has considered, among other things, the historical transaction amounts and the following factors:

- Increasing need for relevant services: Capacity (AFTK) of Air China Cargo has expanded at a compound growth rate of 5.74% from 2016 to 2018; in view of the capacity growth of bellyhold space of the Company as well as the fact that Air China Cargo's future business will take its freighters, bellyhold space, cargo terminals (airport apron) and lorry business as core assets, its cross border air transport capacity, cargo terminals operation capacity (airport apron operation capacity) at home and abroad, ground distribution capacity at home and abroad and ability to design and implement F2B/C logistics solution as its fundamental ability, and "e-commerce plus logistics" integrated service provider as its business positioning, and it will strive to building a full business chain that covers whole cross-border market of in the PRC and serves manufacturers to end-user customers, it is expected that the capacity (AFTK) of Air China Cargo will expand at a compound growth rate of approximately 8% from 2020 to 2022, and the need of Air China Cargo for relevant services will increase in line with the expansion of capacity;

- Increase in unit price: It is expected that the unit price of relevant services will increase at an annual rate of approximately 7% from 2020 to 2022 by taking into account the historical increase of the Group's labour costs and equipment costs, as well as the growth rate of inflation; and

- Certain buffer has been included by rounding to the nearest integer to cater for the ACC Group's operating needs from time to time.

Amounts Payable by the Group to the ACC Group

In arriving at the estimated aggregate amounts payable by the Group to the ACC Group in connection with operation expense of Bellyhold Space Business for each of the three years ending 31 December 2022, the Company has made reference to the estimated amounts of contracting operation income of Bellyhold Space Business payable by the ACC Group for each of the three years ending 31 December 2022, as well as the estimation on the expense rates to be adopted on the basis of historical expenses rates in the next three years. For each of the three years ending 31 December 2022, annual caps of contracting operation income for the Bellyhold Space Business payable by ACC Group to the Company are estimated to be RMB8 billion, RMB9.6 billion and RMB11.6 billion (as stated above). As the expense rate adopted shall not exceed 10%, the annual caps of operation expenses of bellyhold space for each of the three years ending 31 December 2022 are estimated to be RMB0.8 billion, RMB0.96 billion and RMB1.16 billion.

The Company focuses more on operating management improvement under the previous bellyhold space operation model while more on operating result under contracting operation model. Since the Company has disposed the equity shareholdings of Air China Cargo held by it and turned to focus its resources on the operation of air passenger transportation business, contracting operation model is more aligned with the overall development strategies of the Company. For each of the five years ended 31 December 2018, the service charge for passenger aircraft bellyhold space paid by the Company to the ACC Group accounted for 8.08%, 8.97%, 10.59%, 7.54% and 7.55% of bellyhold revenue, respectively. Though the percentages basically remain at the level of 7.55% in the recent years, as the relevant percentage once exceeded 10% in the first three years, the Company adopted 10% as expense rate to estimate annual caps for the coming three years.

In arriving at the estimated aggregate amounts payable by the Group to the ACC Group in connection with the ground support services and other services provided by the ACC Group for each of the three years ending 31 December 2022, respectively, the Company has considered, among other things, the historical transaction amounts and the following factors:

- Increasing need for relevant services: Given that the fleet capacity of the Group is expected to expand at an annual rate of approximately 9% from 2020 to 2022, it is expected that the need of the Group for relevant services will increase in line with the expansion of fleet capacity;

- Increase in unit price: Taking into account the historical increase of the Group's labour costs and equipment costs, as well as the growth rate of inflation, assuming the growth rate of unit prices for services provided by the ACC Group is in line with that of the Group, it is expected that the unit price of relevant services provided by the ACC Group will increase at an annual rate of approximately 7% from 2020 to 2022; and

- Certain buffer has been included by rounding to the nearest integer to cater for the ACC Group's operating needs from time to time.

8. Internal Control Procedures

The Group has adopted the following internal control procedures to ensure that the ACC Transactions will be conducted on normal commercial terms, and in accordance with the New ACC Framework Agreement and the pricing policies of the Group:

- Before entering into individual ACC Transactions, the Finance Department, the Legal Department, the Asset Management Department (which has a dedicated sub-division responsible for the management of connected transactions) and if applicable, certain other relevant departments of the Company will review the proposed terms for the individual ACC Transactions and discuss with the relevant departments of the Group to ensure that such transactions are conducted on normal commercial terms and in compliance with the pricing policies of the Group before these relevant departments approve the finalized transaction agreements according to their authority within the Group.

- The Asset Management Department of the Company is responsible for overseeing the connected transactions of the Company. The Asset Management Department will monitor and collect detailed information on the ACC Transactions on a regular basis, including but not limited to the implementation of pricing policies, payment arrangements and actual transaction amount to ensure that the transactions are conducted in accordance with the framework agreement. In addition, the Asset Management Department is responsible for monitoring and reviewing the balance amount of the annual cap for the ACC Transactions on a monthly basis and if the annual cap for the ACC Transactions is expected to be exceeded for a particular year, it will report to the management and take appropriate measures in accordance with the relevant requirements of the Hong Kong Listing Rules and/or Shanghai Listing Rules.

- The Company's Internal Audit Department is responsible for performing annual assessment on the internal control procedures of the Group, including but not limited to the relevant information on the management of continuing connected transactions. In addition, the Internal Audit Department is responsible for compiling the annual internal control assessment report and submitting the report to the Board for examination and approval.

- The senior management of the Company is responsible for supervising and monitoring the adoption of internal control procedures by the above-mentioned business departments, so as to ensure the implementation of pricing policies is in compliance with relevant framework agreements and the actual transaction amounts are controlled within annual caps. The senior management of the Company also reviews the implementation of pricing policies and the monitoring of annual caps annually.

- The independent auditor of the Company and the independent non-executive Directors will conduct an annual review on the continuing connected transactions of the Group.

The Company considers that the above internal control procedures could function as effective measures to regulate continuing connected transactions. The Company also provides accurate materials in relation to continuing connected transactions as always to facilitate the annual review conducted by the independent non-executive Directors and the independent auditor. Therefore, the Directors consider that the above internal control procedures could ensure the continuing connected transactions will be conducted on normal commercial terms and not prejudicial to the interests of the Company and its minority shareholders.

9. Hong Kong Listing Rules Implications

As a non-wholly owned subsidiary of CNAHC, the Company's controlling shareholder, Air China Cargo is a connected person of the Company as defined under the Hong Kong Listing Rules, and accordingly the ACC Transactions constitute continuing connected transactions of the Company under Chapter 14A of the Hong Kong Listing Rules. As the highest applicable percentage ratio in respect of the proposed annual caps applicable to contracting operation income of Bellyhold Space Business payable by ACC Group under the ACC Transactions is, on an annual basis, higher than 5%, such transactions are therefore subject to the announcement, annual review, circular (including advice of independent financial adviser) and Independent Shareholders' approval requirements under Chapter 14A of the Hong Kong Listing Rules.

In respect of ground support services and other services provided by the Group, as the highest applicable percentage ratio in respect of the proposed annual caps of amounts payable by the ACC Group is, on an annual basis, higher than 0.1% but less than 5%, these transactions are therefore subject to the announcement and annual review requirements under Chapter 14A of the Hong Kong Listing Rules but are exempt from the Independent Shareholders' approval requirement.

In respect of the operation expenses of Bellyhold Space Business payable by the Company to the Air China Cargo, as the highest applicable percentage ratio in respect of the proposed annual caps is, on an annual basis, higher than 0.1% but less than 5%, these transactions are therefore subject to the announcement and annual review requirements under Chapter 14A of the Hong Kong Listing Rules but are exempt from the Independent Shareholders' approval requirement.

In respect of ground support services and other services provided by the ACC Group, as the highest applicable percentage ratio in respect of the proposed annual caps of amounts payable by the Group is, on an annual basis, higher than 0.1% but less than 5%, these transactions are therefore subject to the announcement and annual review requirements under Chapter 14A of the Hong Kong Listing Rules but are exempt from the Independent Shareholders' approval requirement.

10. Shanghai Listing Rules Implications

As Air China Cargo is controlled by CNAHC, the controlling shareholder of the Company, Air China Cargo is considered as a related party of the Company according to Shanghai Listing Rules. As a result, the transactions between the Group and the ACC Group constitute related party transactions under Shanghai Listing Rules. According to Shanghai Listing Rules, the transaction amounts of the proposed annual caps exceed 5% of the latest audited net assets of the Company, and therefore shall be disclosed in a timely manner and be submitted to the general meeting of the Company for consideration and approval by unrelated shareholders of the Company (i.e. the Independent Shareholders).

Therefore, although the ground support and other services provided by the Group, the operation expenses of Bellyhold Space Business payable by the Company to Air China Cargo, and the ground support services and other services provided by the ACC Group are exempted from Independent Shareholders' approval under Hong Kong Listing Rules, they are required to be approved by the Independent Shareholders under the Shanghai Listing Rules.

III. CNACG TRANSACTIONS

The New CNACG Framework Agreement was entered into between the Company and CNACG on 30 October 2019.

1. Parties and Connections of the Parties

The Company's principal business activity is air passenger, air cargo and airline-related services.

CNACG is both a substantial shareholder of the Company and a wholly-owned subsidiary of CNAHC, the Company's controlling shareholder, and is therefore a connected person of the Company as defined under the Hong Kong Listing Rules. CNACG is an investment holding company established in Hong Kong whose principal businesses include passenger terminal operation, cargo terminal operation, airport ground handling services, airline catering services, finance/operating lease, aircraft maintenance, property investment, logistics and other businesses conducted through its subsidiaries.

2. Description of the CNACG Transactions

The New CNACG Framework Agreement provides a framework for the CNACG Transactions contemplated thereunder between any member of the Group on the one hand and any member of CNACG Group on the other hand. According to the New CNACG Framework Agreement:

- **Finance and operating lease services:** CNACG Group will provide finance and operating lease services in respect of, among other things, aircraft, engines, simulators, equipment and vehicles to the Group; the Group will provide finance and operating lease services in respect of, among other things, equipment and vehicles to CNACG Group.

- **Ground support services and other services:** including but not limited to the following transactions conducted between any member of the Group on the one hand and any member of CNACG Group on the other hand: ground support services, aircraft maintenance services, aircraft repair services, property investment and management services, ticket and tourism services, logistics services, administrative management services, cleaning and washing services, resident security services, lounge supplies procurement services and aircraft material procurement services.

3. Pricing Policies for the CNACG Transactions

The consideration of any specific CNACG Transactions shall be agreed on arm's length negotiations between the Group and the CNACG Group and on normal commercial terms, which shall be determined in accordance with the pricing policies set forth below on a case-by-case basis.

- **Finance and operating lease services:** The final transaction price will be determined on arm's length negotiations between both parties with reference to the prices for the same type of lease services offered by independent third parties and after taking into account certain factors. Such factors include purchasing price of the leasing subject, interest rate and arrangement fees (if any) (for finance lease), rental fee (for operating lease), the lease terms, the feature of the leasing subject and the comparable market rental prices. The final transaction price should not be higher than the transaction prices offered by at least two independent third parties on the same conditions.

- **Ground support services and other services:**

  The pricing policies for ground support services and other services provided to or by the Group are set forth below:

  (i) Follow the government pricing or guide price if it is available, including but not limited to the guidance from the Civil Aviation Administration of the PRC (CAAC) and the International Air Transport Association on the prices of ground support services and other terms, and the requirements on the pricing of navigation information stipulated by CAAC and Air Traffic Management Bureau (ATMB).

  (ii) If no government pricing or guide price is available, the final transaction price will be determined on arm's length negotiations between the parties, with firstly making reference to the market prices offered by at least two independent third parties on the market for the same type of service, and after taking certain factors into account such as service standard, service scope, business volume and specific need of parties. If any service need of the service recipient changes, appropriate adjustment will be made to the transaction price after negotiation between both parties based on the extent of variation in relevant costs, service quality or other factors.

  (iii) If neither the above cases is applicable, the price will be determined on the basis of cost plus reasonable profit. The costs are mainly based on the costs and expenses of the service provider, including costs of human resources and costs of facility, equipment and materials. Reasonable profit margin will be determined mainly making reference to the historical average prices on similar products or services (where possible) published in relevant industry, and/or the profit margin of the comparable products and services disclosed by other listed companies. The profit margin of CNACG Group shall not exceed 10%. The final transaction prices shall be determined on terms that to the Group are no less favourable to those provided by independent third parties to the Group or those provided by CNACG Group to independent third parties (with regards to the receiving of services by the Group), or no more favourable than those provided by the Group to the independent third parties (with regards to the rendering of services by the Group).

4. Term of the New CNACG Framework Agreement

The initial term of the New CNACG Framework Agreement is three years commencing from 1 January 2020 and ending on 31 December 2022, which is automatically renewable for successive terms of three years after the expiry of its initial term, subject to the fulfilment of requirements under the Hong Kong Listing Rules/Shanghai Listing Rules and obtaining the required approval. Before expiry of the New CNACG Framework Agreement, the Board will re-assess the terms and conditions of the New CNACG Framework Agreement, and the Company will re-comply with the relevant rules governing connected transactions under the Hong Kong Listing Rules/Shanghai Listing Rules. During the term of the New CNACG Framework Agreement, the agreement can be terminated on any 31 December by either party thereto by serving the other party a written notice of termination of not less than three months.

Consistent with the common practice in the aviation industry, it is expected that the finance lease terms and the operating lease terms under the New CNACG Framework Agreement will exceed three years in most cases, but will be capped within the useful life of the leasing subject of finance or operating lease by respective finance and operating lease agreement. The useful life of the aircraft and engines is usually over 10 years and the useful life of simulators, ground support equipment and special vehicles is usually 3 to 20 years. Somerley has analysed the above lease terms. For details, please refer to the letter from the Independent Financial Adviser as set out on page 28 to page 64 of this circular.

5. Reasons for and Benefits of the CNACG Transactions

In respect of the leasing business, entering into lease transactions with CNACG Group helps to streamline the process for the Group to secure relevant equipment that meets the specific needs of the Group with a lower cost of financing, higher flexibility and less impact on the Group's cash flow as compared to direct purchasing. In addition, the subsidiary of CNACG, to be acting as the lessors, is registered in the free trade zones in the PRC and are entitled to certain favourable tax treatments which will further lower the transaction costs of the Group. In terms of the aircraft finance lease, the Company expects that through adopting aircraft finance lease under the New CNACG Framework Agreement with CNACG Group, the estimated total saveable financing costs for the Group as compared to adopting secured loans arrangements with equivalent interest rates provided by the market over the same period will be approximately US$47.62 million, US$52.13 million and US$54.67 million, respectively from 2020 to 2022.

In respect of ground support services and other services, the Group has entered into a series of continuing connected transactions with CNACG Group in its ordinary and usual course of business. CNACG Group possesses ample management experience and financial resources on airport ground support services and logistics business, and it is able to provide high-quality services to the Group.

6. Historical Amounts and Historical Annual Caps

The table below sets out (i) the annual caps of the Group for the three years ended/ending 31 December 2017, 2018 and 2019; and (ii) the actual aggregate amounts paid by the Group for each of the two years ended 31 December 2017 and 2018 and for January to August 2019, and the estimated aggregate amounts payable for the year ending 31 December 2019.

	Historical Amounts				Historical Annual Caps		
	for the year ended 31 December		Actual amount for the period from January to August	Estimated annual amount for	for the year ended/ ending 31 December		
Transactions	**2017**	**2018**	**2019**	**2019**	**2017**	**2018** *Note 1*	**2019**
Maximum transaction amount for aircraft finance lease service *(US$ Million)*	N/A	957	550	1,490	N/A	1,046.59	1,492.03
Finance lease of engines and simulators, operating lease of back-up aircraft engines and back-up ground support equipment, ground support services and other services *(RMB Million)*	378	416	351	503	2,450	2,450	2,450

Notes:

1. In terms of maximum transaction amount for aircraft finance lease service, it covers the period from 1 June 2018 to 31 December 2018.

2. For the three years ended/ending 31 December 2017, 2018 and 2019, both the estimated aggregate amounts payable to, and the actual amounts paid to the Group by CNACG Group are below the de minimis threshold as stipulated under Rule 14A.76(1)(a) of the Hong Kong Listing Rules.

3. For the three years ended/ending 31 December 2017, 2018 and 2019, utilisation rate of the annual caps for finance lease of engines and simulators, operating lease of back-up aircraft engines and back-up ground support equipment, ground support services and other services was low. The main reason leads to such low utilisation rate is that the operating lease projects relating to aircraft, engine, simulator and ground support equipment of the subsidiary under CNACG that engages in leasing services were still at start-up stage, thus number of projects under progress is limited.

7. Proposed Annual Caps and Basis of Determination

The table below sets out the proposed annual caps for the total amount payable to CNACG Group by the Group for each of the three years ending 31 December 2020, 2021 and 2022, respectively:

Transactions	Proposed Annual Caps for the year ending 31 December 2020	2021	2022
		(in millions of RMB)	
Total value of right-of-use assets relating to the finance and operating leases entered into by the Group as lessee	14,500	16,000	16,500
Ground support services and other services	600	696	807

In arriving at the total use-right assets in relation to finance and operating leases of each year above, the Company has considered the following factors:

- Of the estimated total value of right-of-use assets in connection with finance and operating leases entered into by the Group as lessee, about 95% is the value of right-of-use assets in relation to finance lease of aircraft and other assets. When estimating the total value of right-of-use assets in connection with aircraft finance lease in the following three years, the Company has considered the followings: (i) historical transaction amounts; (ii) the aircraft introduction plan of the Group in the following three years (based on the Company's 2019 Interim Report, the Group expects to introduce 55, 93, and 42 aircraft to its fleet for years 2019 to 2021 respectively, and the average compound annual growth rate of the Group's fleet capacity for years 2019 to 2021 is 8.85%. It is also assumed that the growth rate of fleet expansion of the Group in 2022 will not exceed such rate), and the aggregate principal amount of the aircraft finance lease with CNACG Group is estimated based on the assumption that half of the aggregate consideration amounts of the aircraft scheduled to be introduced during the period from 2020 to 2022 according to confirmed orders will be introduced by way of finance lease with CNACG Group; (iii) adopting the prevailing benchmark interest rate i.e. 4.9%, for RMB loans for over 5 years promulgated by the PBOC ("Five Years Lending Rate") as the interest rate of aircraft finance leases considering that the lease term of each leasing aircraft is expected to be 10 to 12 years, and calculating the interest accordingly; (iv) calculating the arrangement fees at 0.5% of the principal amount of aircraft under finance lease with reference to prevailing market conditions. When estimating financing lease in connection with assets such as engines in the following three years, the Company had considered related finance leasing needs and adopted the same interest rate and arrangement fee rate as the above aircraft finance lease for estimation. Based on the above, the Company expected that the total rental fee (including the principal and interest payable throughout the lease term) and total arrangement fee of the finance leases for newly added assets such as aircraft in the three years ending 31 December 2022 will be US$2,518 million, US$2,747 million and US$2,848 million, respectively. By adopting the incremental borrowing rate of the Company as the discount rate (4.9% for leases with terms over 5 years) to discount such future estimated total rental fee and arrangement fee, the total value of right-of-use assets in relation to finance lease of aircraft and other assets for the three years ending 31 December 2022 will be approximately RMB13,821 million, RMB15,131 million and RMB15,861 million, respectively.

- The remaining about 5% of estimated total value of right-of-use assets in connection with finance and operating leases entered into by the Group as lessee is the value of right-of-use assets in relation to operating lease. When estimating the total value of right-of-use assets in relation to above-said lease in the following three years, the Company has considered the followings: (i) historical transaction amounts; (ii) the operation condition of the Group's engines, simulators, and equipment and the Group's commercial demand for operating lease in the following three years (based on information currently available to the Company, the Company plans to lease 3 to 4 used engines, 4 back-up engines and 8 equipment from CNACG Group in each of the three years from 2020 to 2022, respectively); and (iii) the operating lease price and terms of the same or similar assets in domestic market (taking a certain kind of heavy aircraft tractor, its annual rental fee for operating lease in domestic market usually ranges from RMB600,000 to RMB900,000 and its lease term ranges from 3 years to 12 years). Based on the above, the Company expected that for the three years ending 31 December 2022, the annual rental fee of operating leases for newly added engines, simulators and equipment will be RMB77 million, RMB88 million and RMB89 million, respectively, while total rental fee of operating leases for newly added engines, simulators and equipment will be RMB640 million, RMB690 million and RMB690 million, respectively. By adopting the incremental borrowing rate of the Company as the discount rate (4.9% for leases with terms over 5 years and 4.75% for leases with terms ranging from 1 to 5 years) to discount such estimated future total rental fee, the total value of right-of-use assets in relation to operating lease of the three years ending 31 December 2022 will be approximately RMB610 million, RMB660 million and RMB660 million, respectively.

- Certain buffer has been included by rounding to the nearest integer to cater for the Group's operating needs from time to time.

In arriving at the estimated aggregate amounts payable to the CNACG Group in connection with the ground support services and other services provided by the CNACG Group for the three years ending 31 December 2022, respectively, the Company has considered, among other things, the historical transaction amounts and the following factors:

- Increasing need for relevant services: Given that the fleet capacity of the Group is expected to expand at an annual rate of approximately 9% from 2020 to 2022, it is expected that the need of the Group for relevant services will increase in line with the expansion of fleet capacity;

- Increase in unit price: Taking into account the historical increase of the Group's labour costs and equipment costs, as well as the growth rate of inflation, assuming the growth rate of unit prices for services provided by CNACG Group is generally in line with that of the Group, it is expected that the unit price of relevant services provided by the CNACG Group will increase at an annual rate of approximately 7% from 2020 to 2022; and

- Certain buffer has been included by rounding to the nearest integer to cater for the Group's operating needs from time to time.

8. Internal Control Procedures

The Group has adopted the following internal control procedures to ensure that the CNACG Transactions will be conducted on normal commercial terms, and in accordance with the New CNACG Framework Agreement and the pricing policies of the Group:

- Before entering into individual CNACG Transactions, the Finance Department, the Legal Department, the Asset Management Department (which has a dedicated sub-division responsible for the management of connected transactions) and if applicable, certain other relevant departments of the Company will review the proposed terms for the individual CNACG Transactions and discuss with the relevant business department of the Group to ensure that such transactions are conducted on normal commercial terms and in compliance with the pricing policies of the Group before these relevant departments approve the finalized transaction agreements according to their authority within the Group.

- The Asset Management Department of the Company is responsible for overseeing the connected transactions of the Company. The Asset Management Department will monitor and collect detailed information on the CNACG Transactions on a regular basis, including but not limited to the implementation of pricing policies, payment arrangements and actual transaction amount of each finance lease transaction, operating lease transaction and ground support services and other services to ensure that the transactions are conducted in accordance with the framework agreement. In addition, the Asset Management Department is responsible for monitoring and reviewing the balance amount of the annual cap for the CNACG Transactions on a monthly basis and if the annual cap for the CNACG Transactions is expected to be exceeded for a particular year, it will report to the management and take appropriate measures in accordance with the relevant requirements of the Hong Kong Listing Rules and/or Shanghai Listing Rules.

- The Company's Internal Audit Department is responsible for performing annual assessment on the internal control procedures of the Group, including but not limited to the relevant information on the management of continuing connected transactions. In addition, the Internal Audit Department is responsible for compiling the annual internal control assessment report and submitting the report to the Board for examination and approval.

- The senior management of the Company is responsible for supervising and monitoring the adoption of internal control procedures by the above-mentioned business departments, so as to ensure the implementation of pricing policies is in compliance with relevant framework agreements and the actual transaction amounts are controlled within annual caps. The senior management of the Company also reviews the implementation of pricing policies and the monitoring of annual caps annually.

- The independent auditor of the Company and the independent non-executive Directors will conduct an annual review on the continuing connected transactions of the Group.

The Company considers that the above internal control procedures could function as effective measures to regulate continuing connected transactions. The Company also provides accurate materials in relation to continuing connected transactions to facilitate the annual review conducted by the independent non-executive Directors and the independent auditor. Therefore, the Directors consider that the above internal control procedures could ensure the continuing connected transactions will be conducted on normal commercial terms and not prejudicial to the interests of the Company and its minority shareholders.

9. Hong Kong Listing Rules Implications

CNACG is a connected person of the Company as defined under the Hong Kong Listing Rules, and accordingly the CNACG Transactions constitute continuing connected transactions of the Company under Chapter 14A of the Hong Kong Listing Rules. As the highest applicable percentage ratio in respect of the proposed annual caps applicable to finance and operating lease services provided by CNACG Group under the CNACG Transactions is, on an annual basis, higher than 5% but less than 25%, these transactions are therefore subject to the announcement, annual review, circular (including advice of independent financial adviser) and Independent Shareholders' approval requirements under Chapter 14A of the Hong Kong Listing Rules, and the requirements under Chapter 14 of the Hong Kong Listing Rules applicable to discloseable transactions.

In respect of ground support services and other services provided by CNACG Group, as the highest applicable percentage ratio in respect of the proposed annual caps of amounts payable by the Group is, on an annual basis, higher than 0.1% but less than 5%, these transactions are subject to the announcement and annual review requirements under Chapter 14A of the Hong Kong Listing Rules but are exempt from the Independent Shareholders' approval requirement.

In respect of finance and operating lease services provided by the Group to CNACG Group, for each of the three years ending 31 December 2020, 2021 and 2022, the aggregate amounts payable to the Group is expected to fall below the de minimis threshold as stipulated under Rule 14A.76(1)(a) of the Hong Kong Listing Rules, therefore, such transaction will be exempt from the announcement, annual review and Independent Shareholders' approval requirements under Chapter 14A of the Hong Kong Listing Rules.

In respect of ground support services and other services provided by the Group to CNACG Group, for each of the three years ending 31 December 2020, 2021 and 2022, the aggregate amounts payable to the Group is expected to fall below the de minimis threshold as stipulated under Rule

14A.76(1)(a) of the Hong Kong Listing Rules, therefore, such transactions will be exempt from the announcement, annual review and Independent Shareholders' approval requirements under Chapter 14A of the Hong Kong Listing Rules.

10. Shanghai Listing Rules Implications

As CNACG is controlled by CNAHC, the controlling shareholder of the Company, CNACG is considered as a related party of the Company according to Shanghai Listing Rules. As a result, the transactions between the Group and CNACG Group constitute related party transactions under Shanghai Listing Rules. According to Shanghai Listing Rules, the transaction amounts of the proposed annual caps exceed 5% of the latest audited net assets of the Company, and therefore shall be disclosed in a timely manner and be submitted to the general meeting of the Company for consideration and approval by unrelated shareholders of the Company (i.e. the Independent Shareholders).

Therefore, although the ground support and other services provided by CNACG Group are exempted from Independent Shareholders' approval under Hong Kong Listing Rules, they are required to be approved by the Independent Shareholders under the Shanghai Listing Rules.

IV. EGM

The Company will convene the EGM at 9:00 a.m. on Thursday, 19 December 2019 at The Conference Room C713, No. 30, Tianzhu Road, Airport Industrial Zone, Shunyi District, Beijing, the PRC. Votes on the resolutions to be considered at the EGM shall be taken by way of poll. A form of proxy and a notice of attendance are also enclosed herein and published on the websites of the Hong Kong Stock Exchange (www.hkexnews.hk) and the Company (http://www.airchina.com.cn). The notice of EGM is reproduced in page 69 to 70 of this circular.

In respect of the ACC Transactions, pursuant to Rule 14A.36 of the Hong Kong Listing Rules, any Shareholder with a material interest in the ACC Transactions is required to abstain from voting on the relevant resolution at the EGM. As at the Latest Practicable Date, CNAHC, the controlling shareholder of the Company, held 51% equity interest in Air China Cargo. CNACG, a substantial shareholder of the Company, is a wholly-owned subsidiary of CNAHC. In addition, Cathay Pacific is a substantial shareholder of the Company and Air China Cargo. Therefore, CNAHC, CNACG, Cathay Pacific and their respective associates are required to abstain from voting on the resolution in respect of the ACC Transactions. As at the Latest Practicable Date, CNAHC and CNACG held an aggregate of 7,508,571,617 shares of the Company (representing approximately 51.70% of the issued share capital of the Company), and controlled or were entitled to control over the voting right in respect of their shares in the Company. Cathay Pacific and its associates held an aggregate of 2,633,725,455 shares of the Company (representing approximately 18.13% of the issued share capital of the Company), and controlled or were entitled to control over the voting right in respect of their shares in the Company.

In respect of the CNACG Transactions, pursuant to Rule 14A.36 of the Hong Kong Listing Rules, any Shareholder with a material interest in the CNACG Transactions is required to abstain from voting on the relevant resolution at the EGM. As at the Latest Practicable Date, CNACG is a substantial shareholder of the Company and a wholly-owned subsidiary of CNAHC. Therefore, CNAHC and CNACG and their respective associates are required to abstain from voting on the resolution in respect of the CNACG Transactions. As at the Latest Practicable Date, CNAHC and CNACG held an aggregate of 7,508,571,617 shares of the Company (representing approximately 51.70% of the issued share capital of the Company), and controlled or were entitled to control over the voting right in respect of their shares in the Company.

To the best knowledge, information and belief of the Directors, having made all reasonable enquiries, save as disclosed above, no Shareholder has a material interest in the above resolutions or should be required to abstain from voting on the relevant resolutions at the EGM.

The Company will close its register of members and suspend the registration of transfer of H Shares from Tuesday, 19 November 2019 to Thursday, 19 December 2019 (both days inclusive) in order to determine the list of holders of H Shares of the Company who will be entitled to attend and vote at the EGM. Shareholders of the Company whose names appear on the H Share register of members of the Company on Tuesday, 19 November 2019 may attend the EGM after completing the registration procedures. In order to qualify for attendance at the EGM, instruments of transfer accompanied by share certificates and other appropriate documents must be lodged with the Company's H Share registrar, Computershare Hong Kong Investor Services Limited, by 4:30 p. m. on Monday, 18 November 2019.

Whether or not you intend to attend the EGM, you are requested to complete and return the form of proxy in accordance with the instruction printed thereon as soon as possible but in any event not less than 24 hours before the time appointed for convening the EGM or any adjournment thereof. If you intend to attend the EGM, you are required to complete and return the notice of attendance to the Company's H Share registrar, Computershare Hong Kong Investor Services Limited, on or before Friday, 29 November 2019. Completion and return of the form of proxy will not preclude you from attending and voting in person at the EGM or at any adjourned meeting thereof should you so wish and completion and return of the notice of attendance do not affect the right of Shareholder to attend the meeting.

V. RECOMMENDATION

The Board (including the independent non-executive Directors) considers that the ACC Transactions and CNACG Transactions are on normal commercial terms or better, and are entered into in the ordinary and usual course of business of the Group, and the terms and conditions contained therein and the respective proposed annual caps are fair and reasonable and in the interests of the Company and the Shareholders as a whole. The Board recommends the Independent Shareholders to vote in favour of the New ACC Framework Agreement, the ACC Transactions and the proposed annual caps thereunder, and to vote in favour of the New CNACG Framework Agreement, the CNACG Transactions and the proposed annual caps thereunder.

Mr. Cai Jianjiang, Mr. Song Zhiyong, Mr. Cao Jianxiong, Mr. Xue Yasong and Mr. John Robert Slosar were considered to have material interest in the ACC Transactions and have abstained from voting on the relevant board resolutions. Mr. Cai Jianjiang, Mr. Song Zhiyong, Mr. Cao Jianxiong and Mr. Xue Yasong were considered to have material interest in the CNACG Transactions and have abstained from voting on the relevant board resolutions. Save the above mentioned Directors, no other Director is required to abstain from voting on the relevant board resolutions.

VI. ADDITIONAL INFORMATION

Your attention is drawn to the letter from the Independent Board Committee as set out on pages 26 to 27 of this circular which contains its recommendation to the Independent Shareholders as to the voting at the EGM in relation to (i) the transactions contemplated under the New ACC Framework Agreement and the proposed annual caps thereunder; and (ii) the transactions contemplated under the New CNACG Framework Agreement and the proposed annual caps thereunder.

Your attention is also drawn to the letter from the Independent Financial Adviser as set out on pages 28 to 64 of this circular, which contains, among other things, its advice to the Independent Board Committee and the Independent Shareholders in relation to (i) the transactions contemplated under the New ACC Framework Agreement and the proposed annual caps thereunder; and (ii) the transactions contemplated under the New CNACG Framework Agreement and the proposed annual caps thereunder as well as the principal factors and reasons considered by it in concluding its advice.

Your attention is also drawn to the additional information set out in Appendix I of this circular.

By Order of the Board
Air China Limited
Cai Jianjiang
Chairman

Beijing, the PRC

中國國際航空股份有限公司
AIR CHINA LIMITED

(a joint stock limited company incorporated in the People's Republic of China with limited liability)
(Stock Code: 00753)

Independent Board Committee:
Mr. Wang Xiaokang
Mr. Liu Deheng
Mr. Stanley Hui Hon-chung
Mr. Li Dajin

4 November 2019

To the Independent Shareholders of the Company:

CONTINUING CONNECTED TRANSACTIONS AND DISCLOSEABLE TRANSACTION

We refer to the circular dated 4 November 2019 issued by the Company to its Shareholders (the "**Circular**") of which this letter forms part. Terms defined in the Circular shall have the same meanings in this letter unless the context otherwise requires.

On 30 October 2019, the Board approved the entering into of the New ACC Framework Agreement in respect of the ACC Transactions as set out in the Circular, and approved the entering into of the New CNACG Framework Agreement in respect of the CNACG Transactions as set out in the Circular, for both initial terms of three years commencing from 1 January 2020 and ending on 31 December 2022. The transactions contemplated under the New ACC Framework Agreement and their proposed annual caps as well as the transactions contemplated under the New CNACG Framework Agreement and their proposed annual caps are subject to the announcement, annual review, circular (including advice of independent financial adviser) and Independent Shareholders' approval requirements under Chapter 14A of the Hong Kong Listing Rules.

The terms and the reasons for the entry of the New ACC Framework Agreement and the New CNACG Framework Agreement are summarised in the Letter from the Board set out on pages 4 to 25 of the Circular.

The Independent Board Committee was formed to make a recommendation to the Independent Shareholders as to whether the transactions contemplated under the New ACC Framework Agreement and their proposed annual caps, as well as the transactions contemplated under the New CNACG Framework

Agreement and their proposed annual caps are fair and reasonable and whether such transactions are in the interest of the Company and the Shareholders as a whole. Somerley has been appointed as the independent financial adviser to advise the Independent Board Committee and the Independent Shareholders in this regard.

As your Independent Board Committee, we have discussed with the management of the Company the reasons for the entering into of the transactions contemplated under the New ACC Framework Agreement and their proposed annual caps, as well as the transactions contemplated under the New CNACG Framework Agreement and their proposed annual caps, their terms and the basis upon which the terms have been determined. We have also considered the key factors taken into account by Somerley in arriving at its opinion regarding the above mentioned transactions and their proposed annual caps as set out in the Letter from the Independent Financial Adviser on pages 28 to 64 of the Circular, which we urge you to read carefully.

The Independent Board Committee, after taking into account, among other things, the advice of Somerley, considers that the transactions contemplated under the New ACC Framework Agreement and their proposed annual caps, as well as the transactions contemplated under the New CNACG Framework Agreement and their proposed annual caps are conducted on normal commercial terms or on terms no less favourable than those available to independent third parties and are entered into in the ordinary and usual course of business of the Group, are fair and reasonable and in the interest of the Company and the Shareholders as a whole, and that the proposed annual caps under those transactions are also fair and reasonable. Accordingly, the Independent Board Committee recommends the Independent Shareholders to vote in favor of the relevant ordinary resolutions as set out in the notice of the EGM.

Yours faithfully,
Independent Board Committee

Mr. Wang Xiaokang	**Mr. Liu Deheng**	**Mr. Stanley Hui Hon-chung**	**Mr. Li Dajin**
Independent non-executive Director	*Independent non-executive Director*	*Independent non-executive Director*	*Independent non-executive Director*

The following is the text of a letter of advice from Somerley Capital Limited prepared for the purpose of inclusion in this circular, setting out its advice to the Independent Board Committee and the Independent Shareholders in respect of the New ACC Framework Agreement and the New CNACG Framework Agreement.

SOMERLEY CAPITAL LIMITED
20th Floor
China Building
29 Queen's Road Central
Hong Kong

4 November 2019

To: The Independent Board Committee and the Independent Shareholders

Dear Sirs,

CONTINUING CONNECTED TRANSACTIONS AND DISCLOSEABLE TRANSACTION

INTRODUCTION

We refer to our appointment to advise the Independent Board Committee and the Independent Shareholders in connection with the New ACC Framework Agreement and the New CNACG Framework Agreement and the transactions contemplated thereunder (together, the "**Transactions**"). Details of the aforesaid transactions are set out in the letter from the Board contained in the circular of the Company (the "**Circular**") to its shareholders dated 4 November 2019, of which this letter forms part. Unless otherwise defined, terms used in this letter shall have the same meanings as those defined in the Circular.

On 30 October 2019 (after trading hours), the Company entered into the New ACC Framework Agreement and the New CNACG Framework Agreement in relation to the ACC Transactions and the CNACG Transactions with ACC Group and CNACG Group, respectively.

As at the Latest Practicable Date, Air China Cargo is a 51.00% owned subsidiary of CNAHC which is a controlling shareholder holding approximately 51.70% of the issued share capital of the Company. Cathay Pacific is also a substantial shareholder of Air China Cargo and a substantial Shareholder of the Company, together with its associates, holding approximately 18.13% of the issued share capital of the Company. Therefore, Air China Cargo is a connected person of the Company as defined under the Hong Kong Listing Rules. Accordingly, the New ACC Framework Agreement and the transactions contemplated thereunder constitute continuing connected transactions of the Company under Chapter 14A of the Hong Kong Listing Rules.

As at the Latest Practicable Date, CNACG is a substantial Shareholder of the Company and a wholly owned subsidiary of CNAHC. Therefore, CNACG is also a connected person of the Company defined under the Hong Kong Listing Rules and accordingly, and the New CNACG Framework Agreement and the transactions contemplated thereunder constitute continuing connected transactions of the Company under Chapter 14A of the Hong Kong Listing Rules.

As the highest applicable percentage ratio in respect of the proposed annual caps applicable to contracting operation income of Bellyhold Space Business payable by ACC Group under the ACC Transactions is, on an annual basis, higher than 5%, the proposed annual caps relating to such transactions are therefore subject to the announcement, annual review, circular (including advice of independent financial adviser) and Independent Shareholders' approval requirements under Chapter 14A of the Hong Kong Listing Rules.

In respect of ground support services and other services provided by the Group, as the highest applicable percentage ratio in respect of the proposed annual caps of amounts payable by ACC Group is, on an annual basis, higher than 0.1% but less than 5%, these transactions are therefore subject to the announcement and annual review requirements under Chapter 14A of the Hong Kong Listing Rules but are exempt from the Independent Shareholders' approval requirement.

In respect of the operation expenses of Bellyhold Space Business payable by the Company to Air China Group, as the highest applicable percentage ratio in respect of the proposed annual caps is, on an annual basis, higher than 0.1% but less than 5%, these transactions are therefore subject to the announcement and annual review requirements under Chapter 14A of the Hong Kong Listing Rules but are exempt from the Independent Shareholders' approval requirement.

In respect of ground support services and other services provided by ACC Group, as the highest applicable percentage ratio in respect of the transactions of amounts payable by the Group is, on an annual basis, higher than 0.1% but less than 5%, these proposed annual caps are therefore subject to the announcement and annual review requirements under Chapter 14A of the Hong Kong Listing Rules but are exempt from the Independent Shareholders' approval requirement.

As the highest applicable percentage ratio in respect of the proposed annual caps applicable to finance lease and operating lease service provided by CNACG Group under the CNACG Transactions is, on an annual basis, higher than 5%, these transactions are therefore subject to the announcement, annual review, circular (including advice of independent financial adviser) and Independent Shareholders' approval requirements under Chapter 14A of the Hong Kong Listing Rules, and the requirements under Chapter 14 of the Hong Kong Listing Rules applicable to discloseable transactions.

In respect of ground support services and other services provided by CNACG Group, as the highest applicable percentage ratio in respect of the proposed annual caps of amount payable by the Group is, on an annual basis, higher than 0.1% but less than 5%, these transactions are therefore subject to the announcement and annual review requirements under Chapter 14A of the Hong Kong Listing Rules but are exempt from the Independent Shareholders' approval requirement.

In respect of finance and operating lease service provided by the Group to CNACG Group, for each of the three years ending 31 December 2020, 2021 and 2022, the aggregate amounts payable to the Group is expected to fall below the de minimis threshold as stipulated under Rule 14A.76(1)(a) of the Hong Kong Listing Rules, therefore, such transaction will be exempt from the announcement, annual review and Independent Shareholders' approval requirements under Chapter 14A of the Hong Kong Listing Rules.

In respect of ground support services and other services provided by the Group to CNACG Group, for each of the three years ending 31 December 2020, 2021 and 2022, the aggregate amounts payable to the Group is expected to fall below the de minimis threshold as stipulated under Rule 14A.76(1)(a) of the Hong Kong Listing Rules, therefore, such transaction will be exempt from the announcement, annual review and Independent Shareholders' approval requirements under Chapter 14A of the Hong Kong Listing Rules.

The Independent Board Committee comprising all the independent non-executive Directors, namely Mr. Wang Xiaokang, Mr. Liu Deheng, Mr. Stanley Hui Hon-chung and Mr. Li Dajin has been established to make a recommendation to the Independent Shareholders as to whether the terms of the Transactions are on normal commercial terms, in the ordinary and usual course of business of the Company and are fair and reasonable and in the interests of the Company and its shareholders as a whole. Somerley Capital Limited has been appointed as the independent financial adviser to advise the Independent Board Committee and the Independent Shareholders in the same regard.

We are not associated or connected with the Company, Air China Cargo, CNAHC, CNACG, Cathay Pacific or their respective core connected persons or associates and, accordingly, are considered eligible to give independent advice on the Transactions. Apart from normal professional fees payable to us in connection with this appointment, no arrangement exists whereby we will receive any fees or benefits from the Company, Air China Cargo, CNAHC, CNACG, Cathay Pacific or their respective core connected persons or associates.

In formulating our advice and recommendation, we have relied on the information and facts supplied, and the opinions expressed, by the Directors and management of the Company (collectively, the "**Management**"), which we have assumed to be true, accurate and complete. We have reviewed information on the Company, including but not limited to, the New ACC Framework Agreement and the New CNACG Framework Agreement, annual reports of the Company for each of the years ended 31 December 2016 ("**2016 Annual Report**"), 31 December 2017 ("**FY2017**") (the "**2017 Annual Report**") and 31 December 2018 ("**FY2018**") (the "**2018 Annual Report**"), interim report of the Company for the period ended 30 June 2019 (the "**2019 Interim Report**") and other information contained in the Circular.

In addition, we have relied on the information and facts supplied, and the opinions expressed by the Group and have assumed in relation to the facts to be true, accurate and complete in all material aspects and in relation to any opinions to be honestly held at the time they were made and will remain, in relation to the facts to be true, accurate and complete in all material aspects and in relation to any opinions to be honestly held, up to the date of the EGM. We have also sought and received confirmation from the Group that no material facts have been omitted from the information supplied by them and that their opinions expressed to us are not misleading in any material respect. We consider that the information we have received is sufficient for us to formulate our opinion and recommendation as set out in this letter and have no reason to believe that any material information has been omitted or withheld, nor to doubt the truth or accuracy of the information provided to us. We have, however, not conducted any independent investigation into the businesses and affairs of the Group, Air China Cargo, CNAHC, CNACG, Cathay Pacific, nor have we carried out any independent verification of the information supplied.

PRINCIPAL FACTORS AND REASONS CONSIDERED

In formulating our opinion and recommendation with regard to the Transactions, we have considered the following principal factors and reasons:

1. Information on the parties

The Group

The Company is incorporated in the People's Republic of China with limited liability, the Shares of which have been listed on the Main Board of the Hong Kong Stock Exchange since 15 December 2004. The Group is principally engaged in the provision of air passenger transportation, freight transportation, postal transportation and maintenance services in Mainland China, Hong Kong, Macau and other international regions.

According to the 2018 Annual Report, the Group reported a revenue of approximately RMB136.8 billion, representing a year-on-year increase of approximately 12.70%. The Group's total operating expenses also showed a corresponding rise of approximately 12.71%. Also, as disclosed in 2017 Annual Report and 2018 Annual Report, profit attributable to equity shareholders of the Company grew by approximately 6.39% and approximately 1.47% respectively for FY2017 and FY2018.

As disclosed in the 2018 Annual Report, the Group recorded a total of around 2,245.2 thousand flight hours, with a year-on-year increase of 6.14%. In addition, the volume of cargo and mail carried amounted to around 1,908.37 thousand tonnes, which represented a year-on-year increase of around 3.62%. Based on the 2018 Annual Report, the Group introduced 50 aircrafts during 2018, among which 5 were bought using internal funds, 34 were acquired under finance leases and 11 were acquired under operating leases. As at 30 June 2019, the Group operated a fleet of 676 aircraft in total, with an average age of 6.81 years, of which the Company operated a fleet of 415 aircraft with an average age of 7.02 years.

As at 30 June 2019, the Company and other airlines in which the Company holds direct or indirect interests, including Shenzhen Airlines Company Limited (including Kunming Airlines Company Limited), Air Macau Company Limited, Beijing Airlines Company Limited, Dalian Airlines Company Limited and Air China Inner Mongolia Co., Ltd., newly launched or adjusted 28 domestic and international routes, and operated a total of 766 passenger routes including 132 international routes, 29 regional routes and 605 domestic routes. The Company's passenger routes reached 41 countries and regions and 190 cities, including 120 domestic cities, 67 international cities and 3 regions. The Company proactively carried out international cooperation and offered 15,436 code sharing flights per week through collaboration with 36 global partners. As at 30 June 2019, the Company has expanded its service coverage to 1,317 destinations in 193 countries through its cooperation with the Star Alliance global partners.

Air China Cargo

Air China Cargo was established in 2003. Headquartered in Beijing, Air China Cargo takes Shanghai as its main long haul air freighter operation base and is primarily engaged in air cargo and mail transportation. Following completion of the disposal of 51% interests in Air China Cargo by the Company on 28 December 2018, Air China Cargo is held as to 51% by Capital Holding. Capital Holding is a wholly-owned subsidiary of CNAHC which is a state-owned company incorporated in the People's Republic of China and the controlling shareholder of the Company.

As at 31 December 2018, ACC operated a fleet of 15 aircrafts with an average age of 11.54 years. During FY2018, ACC recorded consolidated revenue of approximately RMB12,410 million, representing a year-on-year increase of around 10.18%, of which cargo and mail transportation revenue amounted to approximately RMB11,018 million, representing a year-on-year increase of around 11.26%. The Company has developed its cooperation relationship with ACC in relation air cargo business respectively since 2003.

CNACG

CNACG is an investment holding company whose principal business include ground support services, airline catering services, aircraft maintenance and repair services, property investment, ticket and tourism services, logistics and finance and operating lease services conducted through its subsidiaries. CNACG is a substantial Shareholder of the Company and a wholly owned subsidiary of CNAHC.

The CNACG Group has been providing a wide range of aircraft related services to the Group since 2008, including but not limited to, passenger terminal operation, cargo terminal operation, airport ground handling services, airline catering services, finance and/or operating leases, aircraft maintenance, property investment, logistics and other businesses.

2. ACC Transactions

2.1 Background of and reasons for the ACC Transactions

As disclosed in the Circular, the Directors believe that it is in the best interest of the Group to continue the ACC Transactions with the ACC Group having considered the following factors:

(i) In respect of the Bellyhold Space Business contracting operation, contracting the passenger aircraft bellyhold space freight contract operations ("**Bellyhold Services**") to Air China Cargo is an important step for the Company to focus on air passenger transportation business, which is also in line with the general trend among major domestic airlines. By virtue of which, the Company will focus its resources on the operation of air passenger transportation business to enhance the utilisation efficiency of important resources and the operational and management capacity in core business of air passenger transportation; make the most of economies of scales of the Company and Air China Cargo at their respective business, generate stable bellyhold space contracting revenue to the Company; consolidate mechanism of the operation responsibility and risk sharing, reduce the possible adverse impact brought by the fluctuation of the freight market, so as to further promote the brand image and competitiveness of the Company in the air passenger transportation sector, thereby creating more investment return for the shareholders; and

(ii) In respect of ground support services and other services, the long established successful cooperative relationship between the Company and Air China Cargo is able to provide streamlined and efficient cooperation and transaction between the Group and the ACC Group.

As discussed in the 2018 Annual Report, Air China Cargo has been engaged in the air freighter operation business since 2003. Based on our understanding from the Management, ACC has been handling the Bellyhold Services operations of the Company in the PRC for almost 16 years and based on prior experience, is considered to be equipped with the level of understanding and experience required.

In light of the long-established existing cooperation relationship between the Group and the ACC Group, we agree with the Directors and would consider continuing such relationship would allow the Company to continue to focus on devoting its resources to expanding its air passenger transportation business while being able to engage the support of a seasoned industry expert to facilitate its business growth.

We also note that the New ACC Framework Agreement also covers ground support services and other services to be provided to and/or sourced from the ACC Group ("**ACC Ground Services**"). To assess the fairness and reasonableness of such inclusion, we have discussed and understand from the Management that the ACC Group will provide to the Group services including terminal cargo and mail services, airport apron services, container and pallet management services, engine and other aircraft related materials lease services, and the Group will provide to the ACC Group with operational support services, IT sharing services, comprehensive support services, engine and other aircraft related materials lease services and labour management services. We were given to understand that the services provided to and by the Group are necessary for both the Group and ACC Group to carry out its ordinary and usual course of business and are provided within the respective party's expertise and speciality.

2.2 *Terms of the New ACC Framework Agreement*

The key terms of the New ACC Framework Agreement are as follows:

Services: Bellyhold Services

The Company has contracted the operation of all Bellyhold Space Business to Air China Cargo. Air China Cargo shall undertake the overall responsibilities for transporting the cargos as the contracting carrier to the consignors with respect to the cargos which are transported through the bellyhold spaces of passenger aircraft.

ACC Ground Services

The ground support services and other services provided by the Group to ACC Group include but are not limited to operational support services, IT sharing services, comprehensive support services, engine and other aircraft-related materials lease services and labour management services.

The ground support services and other services provided by ACC Group to the Group include but are not limited to terminal cargo and mail services, airport apron services, container and pallet management services, engine and other aircraft-related materials lease services.

Pricing terms: Bellyhold Services

(1) Contracting operation income: During the contracting period, Air China Cargo will regularly pay the Company the contracting operation income in respect of the Bellyhold Space Business in each year. The parties shall determine the Benchmark Income (excluding tax) of Bellyhold Space Business contracting operation after arm's length negotiations with reference to the Company's fleet capacity, overall load factor and yield level. The specific formula is as follows:

Benchmark Income (excluding tax) = ATK (available tonne kilometres) × OLF (overall load factor) × yield level per kilometre

The ATK shall be determined based on the Company's fleet capacity for the current financial year and its plan of introduction and phase-out of passenger aircraft for the next year. The OLF and the yield level per kilometre shall be determined based on the historical data of the respective air routes of the Company.

Considering possible market fluctuations, the parties agreed to jointly appoint a qualified accounting firm to conduct a special audit to the actual income (excluding tax) of Air China Cargo for the operation of Bellyhold Space Business of the previous financial year within three months after the end of each financial year. Where there is any difference between the Benchmark Income (excluding tax) and the actual income (excluding tax), the excess income or risk incurred shall be allocated between Air China Cargo and the Company at the proportion of 51% and 49%, respectively, and paid accordingly.

Where the final settlement price will exceed the annual caps which have been set by the Company, all reasonable steps will be taken by the Company to comply with the relevant requirements under Chapter 14A of the Hong Kong Listing Rules.

(2) The Operation Expense of the Bellyhold Space Business: During the contracting period, the Company shall pay the operation expenses of the Bellyhold Space Business to Air China Cargo on a regular basis per year. In accordance with the common industry practice, the operation expenses shall be determined according to the settlement price (determined according to the method as set out above in the paragraph headed "Contracting Operation Income") and the Expense Rate, and the calculation formula is as follows:

Operation Expenses = Settlement Price × Expense Rate (as defined below)

The expense rate (the "**Expense Rate**") shall be determined through arm's length negotiation with reference to historical expense rates and other factors such as expense rates of companies in the relevant industry and their variation trends.

Where the operation expenses will exceed the annual caps which have been set by the Company, all reasonable steps will be taken by the Company to comply with the relevant requirements under Chapter 14A of the Hong Kong Listing Rules.

ACC Ground Services

The pricing policies for ground support services and other services provided to or by the ACC Group are set forth below:

(i) Follow the government pricing or guide price if it is available, including but not limited to the guidance from the Civil Aviation Administration of the PRC (CAAC) and the International Air Transport Association on the prices of ground support services and other terms, and the requirements on the pricing of navigation information stipulated by CAAC and Air Traffic Management Bureau (ATMB);

(ii) If no government pricing or guide price is available, the final transaction price will be determined on arm's length negotiations between the parties with firstly making reference to the market prices offered by at least two independent third parties on the market for the same type of service, and after taking certain factors into account such as service standard, service scope, business volume and specific need of parties. If any service need of the service recipient changes, appropriate adjustment will be made to the transaction price after negotiation between both parties based on the extent of variation in relevant costs, service quality or other factors; and

(iii) If neither the above cases are applicable, the price will be determined on the basis of costs plus reasonable profit. The costs are mainly based on the costs and expenses of the service provider, including, costs of human resources, facility, equipment and materials. Reasonable profit margin will be determined with mainly making reference to, the historical average prices on similar products or services (where possible) published in relevant industry, and/or the profit margin of the comparable products and services disclosed by other listed companies. The profit margin of ACC Group shall not exceed 10%. The final transaction prices shall be determined on terms that are no less favourable to the Group than those provided by independent third parties to the Group or those provided by ACC Group to independent third parties (with regards to the receiving of services by the Group), or no more favourable to ACC Group than those provided by the Group to the independent third parties (with regards to the rendering of services by the Group).

Term and termination:	The initial term of the New ACC Framework Agreement is three years commencing from 1 January 2020 and ending on 31 December 2022, which is automatically renewable for successive terms of three years after the expiry of its initial term subject to the fulfilment of requirements under the Hong Kong Listing Rules/ Shanghai Listing Rules and obtaining the required approval. Before expiry of the New ACC Framework Agreement, the Board will re-assess the terms and conditions of the New ACC Framework Agreement, and the Company will re-comply with the relevant rules governing connected transactions under the Hong Kong Listing Rules. During the term of the New ACC Framework Agreement, the agreement can be terminated on any 31 December by either party thereto by serving the other party a written notice of termination of not less than three months.

Bellyhold Services

We note that the terms of the Bellyhold Services contractual operation agreement ("**Bellyhold Services Contractual Operation Agreement**") prescribes that the benchmark income (excluding tax) (the "**Benchmark Income**") is the amount payable by Air China Cargo to the Company as the designated contractor for the services provided for the financial year. Under the terms to the Bellyhold Services Contractual Operation Agreement, the Benchmark Income is equal to the available tonne-kilometre ("**ATK**") times by the overall load factor ("**OLF**") and the yield level per kilometre ("**Yield per Kilometre**").

Based on our discussion with the Management, ATK is based on the Company's fleet capacity for the current financial year and its plan of introduction and phase out of passenger aircraft of the Company for the next year, whereas OLF and Yield per Kilometre will be determined based on the historical data of the respective air routes of the Company.

We have further discussed and understand from the Management that save for the cooperation with Air China Cargo, neither the Company or Air China Cargo has entered into similar Bellyhold Services Contractual Operation Agreement with any other party. As such, in considering whether the pricing formula is fair and reasonable, we have, on a best-effort basis, through public domain, researched and noted a comparable company being listed for more than 10 years in Hong Kong with a long established history, namely China Eastern Airlines Corporation Limited (Stock Code: 670) ("**China Eastern**"), which is engaged in a similar line of business and with similar geographical coverage as compared with the Company and has executed a bellyhold contractual operation agreement with its connected person, China Cargo Airlines Co., Limited ("**China Cargo Airlines**"). Based on China Eastern's circular dated 30 September 2019, we noted that a similar formula was used to calculate the value of its benchmark income (the "**China Eastern Formula**"). Under the China Eastern Formula, the available tonne-kilometre is also based on the plan of introduction of passenger aircraft fleet for the following year and the overall load factor and the revenue level per kilometre is also determined based on the historical data of the respective air route of the company. The only observable difference between the China Eastern Formula and the formula used by the

Company to determine the Benchmark Income is the party responsible for the computation of benchmark income; China Eastern engages a separate asset evaluation agency to evaluate the benchmark income whereas the Company will do the evaluation by itself. Having considered the fact that there are no material differences between the formula used by the Company to determine the Benchmark Income and the China Eastern Formula and as confirmed by the Company, there is no regulatory or other requirements for engaging an independent party for evaluating the Benchmark Income, we would consider the use of the formula, being equal to Benchmark Income = ATK x OLF x Yield per Kilometre has been previously applied by industry/market competitor (i.e. China Eastern) for similar transactions.

To cater for possible market fluctuations that may lead to possible deviations between the actual income received for the Bellyhold Services and the Benchmark Income estimated, the Company and Air China Cargo has agreed to jointly appoint a qualified accounting firm to conduct a special audit to determine the actual income (excluding tax) of Air China Cargo for operating the bellyhold space business for the previous financial year within three months after the end of each financial year. Where there is any difference between the Benchmark Income (excluding tax) and the actual income (excluding tax), the Benchmark Income should be adjusted by the adjustment amount (the "**Adjustment Amount**") which equals to the result of the audited actual income (excluding tax) minus the Benchmark Income (excluding tax), in order to derive the final settlement amount for the Bellyhold Services and this amount is referred to as the settlement price (the "**Settlement Price**"). Under the adjustment mechanism, if the Adjustment Amount is positive, 49% of the Adjustment Amount (excluding tax) shall be paid by Air China Cargo to the Company; if the Adjustment Amount is negative, Air China Cargo will bear 51% of total Adjustment Amount (the "**Adjustment Mechanism**").

We note that there was a similar adjustment mechanism for the China Eastern Formula. However, the percentage rate applicable to the adjustment amount in the China Eastern case is on a 50-50 sharing basis (i.e. if the adjustment amount is positive/negative, China Eastern will enjoy/bear 50% of the adjustment amount and China Cargo Airlines will receive/pay for the remaining portion) whereas in the Company's case, the Adjustment Amount to be shared between Air China Cargo and the Company is on a 51% and 49% basis ("**Adjustment Percentage**"). We have discussed and understood from the Company that the Adjustment Percentage was determined based on arm's length negotiations. We were further informed that by providing Air China Cargo with a moderately bigger share of the reward/shortfall under the Adjustment Percentage, the Management is of the view that it effectively encourages Air China Cargo to improve its performance. Similarly, Air China Cargo would also be effectively penalised at a greater rate should it underperform to the Benchmark Income as it will bear 51% of the shortfall. In this respect and considering the above justifications and factor provided by the Management, we are of the view that the Adjustment Mechanism as a whole is generally in line with the market practice and is fair and reasonable.

Operation expenses of the Bellyhold Services

During the term of the Bellyhold Services Contractual Operation Agreement, the Company shall pay the operation expenses of the Bellyhold Services to Air China Cargo on a regular basis. In accordance with common industry practice, the operation expenses (“**Operation Expenses**”) to be paid is equal to the product of the Settlement Price and the Expense Rate (the “**Operation Expenses Formula**”). As disclosed in the Circular, the Expense Rate shall be determined by the parties through arm’s length negotiation with reference to historical expense rates and other factors such as expense rates of companies in the relevant industry and their variation trends. We further understand from the Management that the Company would normally refer to the average Expense Rate of the last three years as a reference although depending on market fluctuations, the Company may also consider a longer referencing period e.g. five years.

We note the Operation Expenses Formula is similar to the formula used by China Eastern in determining the Operation Expenses payable to China Cargo Airlines. However, we noted that China Eastern will engage an accounting firm to separately negotiate the pricing process and the expense rate used will be adjusted yearly depending on the outcome of the negotiations whereas in the Company’s case, the Company will conduct its own Expense Rate negotiation process though still with reference to the market and industry conditions. With reference to the Company’s internal control procedures as described in the section headed *“4. Internal control procedures”* below and our further discussions with the Management, we note that prior approvals from finance, legal and asset management departments and all relevant departments must be obtained and checks to verify whether the ACC Transactions, which include the payment of Operation Expenses are on normal commercial terms prior to any formal implementation of agreements. Based on our understanding from the Management, such checks would include the aforementioned comparison between Expense Rate offered by Air China Cargo and expense rates used by relevant industry participants, such as China Eastern. We consider the Company has sufficient procedures in place to ensure that the negotiations with Air China Cargo will be arm’s length and with reference to normal commercial terms and therefore the Operation Expenses Formula is fair and reasonable.

ACC Ground Services

The pricing policies for ACC Ground Services provided to or by the Group are set forth below:

(i) Follow the government pricing or guide price if it is available, including but not limited to the guidance from the Civil Aviation Administration of the PRC (CAAC) and the International Air Transport Association on the prices of ground support services and other terms, and the requirements on the pricing of navigation information stipulated by CAAC and Air Traffic Management Bureau (ATMB) (the “**Guidance**”);

(ii) If no government pricing or guide price is available, the final transaction price will be determined on arm's length negotiations between the parties with firstly making reference to the market prices offered by at least two independent third parties on the market for the same type of service and after taking certain factors into account such as service standard, service scope, business volume and specific need of parties. If any service need of the service recipient changes, appropriate adjustment will be made to the transaction price after negotiation between both parties based on the extent of variation in relevant costs, service quality or other factors; and

(iii) If neither the above cases is applicable, the price will be determined on the basis of cost plus reasonable profit. The costs are mainly based on the costs and expenses of the service provider, including, costs of human resources and costs of facility, equipment and materials. Reasonable profit margin will be determined with mainly making reference to the historical average prices on similar products or services (where possible) published in relevant industry, and/or the profit margin of the comparable products and services disclosed by other listed companies. The profit margin of ACC Group shall not exceed 10%. The final transaction prices shall be determined on terms that are no less favourable to the Group than those provided by independent third parties to the Group or those provided by ACC Group to independent third parties (with regards to the receiving of services by the Group), or no more favourable to ACC Group than those provided by the Group to the independent third parties (with regards to the rendering of services by the Group).

We have discussed and understand from the Management the ground support services provided by the Group to the ACC Group and vice versa, provided by the ACC Group to the Group are generally negotiated and agreed by both parties.

Based on our discussion, we understand the price determination process would involve the consideration of various factors, including, the Guidance, cost of providing such services and availabilities of resources. In determining the fairness and reasonableness of the pricing policies mentioned above, we have reviewed the relevant Guidance, 3 sample ground services agreements entered into between the Company and independent third parties ("**ACC Sample Ground Services Transactions**") and the existing service agreement of ground support services between the Company and ACC Group (the "**Existing ACC Ground Services Agreement**") and discussed the various price determination process with the Management.

(i) ACC Ground Services provided by the Group

We understand that prior to the provision of any quotations to the ACC Group for ACC Ground Services sought, the Group would make references to the Guidance, in particular, the guidance issued by the Civil Aviation Administration of China (CAAC), as well as costs, such as labour and other technical charges. We understand that charges may differ and would depend on primary factors including location geographical region and the plane's model. Relevant departments of the Group would also refer to quotations provided to independent third parties for similar services so as to ensure that the prices offered by the Group to the ACC Group would be no more favourable to ACC Group than the prices offered to independent third parties. We have reviewed the Existing ACC Ground Services Agreement covering services provided by the Group and compared it with the ACC Sample Ground Services Transactions and understand that the terms offered are similar. We further understand that as according to the internal policy procedures as described in the section headed *"4. Internal Control Procedures"* below, the Existing ACC Ground Services Agreement was jointly reviewed and approved by at least three different departments of the Company, including the asset management department.

(ii) ACC Ground Services provided to the Group

We understand that prior to entering into any agreements with the ACC Group for the ACC Ground Services, the Group would first of all make references to the Guidance and also consider cost of similar services provided by independent third parties. If and when required, we understand from the Management that the Group would require the ACC Group to provide supporting document to substantiate that the quote provided and the profit margin applied to the Group are no different to those provided or applied to independent third parties.

We have reviewed the Existing ACC Ground Services Agreement covering services provided by the ACC Group to the Group and compared it with the ACC Sample Ground Services Transactions, and noted that the terms offered are similar. In determining the fairness and reasonable of the use of "cost plus no more than 10% profit margin" element of the pricing policy (the "**ACC Margin Cap**"), we have, on a best-effort basis through public domain, identified that an industry player engaged in a similar line of business with similar geographical coverage and has been listed in Hong Kong for more than 10 years, namely China Southern Airlines Company Limited (Stock Code:1055) ("**China Southern**") has, in its respective announcements dated 16 December 2016 and 27 December 2018 disclosed that the pricing policy for ground services provided by its connected person is also on a cost plus a profit margin of 10% basis. In this respect, we would consider the use of cost plus no more than 10% profit margin concept under the ACC Ground Services transactions as not uncommon in the market. We further noted that as according to the internal policy procedures as described in the section headed *"4. Internal Control Procedures"* below, the Existing ACC Ground Services Agreement was jointly reviewed and approved by at least three different departments of the Company, including the asset management department.

In light of the aforementioned and in particular, noting that the ACC Margin Cap is only applicable to ACC Ground Services provided by the ACC Group to the Group (i.e. there is no profit margin cap applied to ACC Ground Services transactions provided by the Group to the ACC Group), we consider the pricing basis for ACC Ground Services to be fair and reasonable.

2.3 *Historical amounts and historical caps and the proposed annual caps*

The table below sets out (i) the annual caps of amounts payable by the ACC Group or the Group for each of the three years ended/ending 31 December 2017, 2018 and 2019, respectively; and (ii) the actual amounts paid by the ACC Group or the Group for each of the two years ended 31 December 2017 and 2018 and from January to August 2019, and the estimated amounts payable for the year ending 31 December 2019.

	Historical Amounts				Historical Caps		
	For the year ended 31 December		Actual amount for the period from January to August 2019	Estimated annual amount for 2019	For the year ended/ending 31 December		
Transactions	**2017**	**2018**	**August 2019**	**2019**	**2017**	**2018**	**2019**
				(in millions of RMB)			
Amounts paid/payable by the ACC Group to the Group	**5,636**	**6,043**	**3,653**	**7,045**	**5,854**	**7,160**	**8,777**
In terms of bellyhold space	5,104	5,543	3,190	6,374	5,182	6,429	7,977
In terms of ground support services	62	54	80	120	143	169	200
In terms of other services	470	446	383	551	529	562	600
Amounts paid/payable by the Group to the ACC Group	**993**	**1,017**	**637**	**1,340**	**1,625**	**1,944**	**2,326**
In terms of bellyhold space	385	418	242	481	519	643	798
In terms of ground support services	576	586	385	826	932	1,088	1,269
In terms of other services	32	13	10	33	174	213	259

We have discussed the basis for its estimated transaction amount for 2019 with the Management and understand it has considered, among others, the actual amount paid/received under the existing ACC Transactions from January to August 2019 (which has been shown in the table above), the remaining value/outstanding contract value under the existing ACC Transactions as well as seasonal factors. We have reviewed the historical transaction amounts and distribution patterns for 2017 and 2018 and noted that the historical transaction amounts for the first half of 2017 and 2018 respectively have represented a smaller portion of the total year actual transacted value. In light of the aforementioned, we consider the bases used to estimate the total transaction value for 2019 to be fair and reasonable.

The table below sets out the proposed annual caps of amounts payable by the ACC Group or the Group for each of the three years ending 31 December 2020, 2021 and 2022, respectively:

Transactions	Proposed Annual Caps for the year ending 31 December 2020	2021	2022
	(in millions of RMB)		
Amounts payable by the ACC Group to the Group	**8,800**	**10,600**	**12,700**
In terms of income from the Bellyhold Services	8,000	9,600	11,600
In terms of ground support services and other services	800	1,000	1,100
Amounts payable by the Group to the ACC Group	**1,800**	**2,160**	**2,560**
In terms of operation expenses of Bellyhold Services	800	960	1,160
In terms of ground support services and other services	1,000	1,200	1,400

Amounts payable by the ACC Group to the Group

Bellyhold Services

As shown in the table above, it is noted that the annual caps for 2020, 2021 and 2022 embedded an estimated annual growth of around 25.5%, 20.0% and 20.8% as compared to the estimated annual transaction amount for 2019 and the annual caps for 2020 and 2021 respectively, representing a compound annual growth rate of around 20.42% from 2020 to 2022.

As disclosed in the letter from the Board of the Circular, in arriving at the estimated aggregate amounts payable by the ACC Group to the Group for the Benchmark Income for each of the three years ending 31 December 2022, the Company has considered, among other things, the historical transaction amounts and the following primary factors:

- Expected fleet capacity – The bellyhold space provided to the ACC Group will increase along with the expansion of the fleet capacity of passenger aircraft of the Company. As of 31 December 2018, the Company had 409 aircraft. The Company expects to introduce 33, 55, and 36 aircraft and phase out 5, 1 and 0 aircraft in each year of 2019 to 2021, respectively. The average compound annual growth rate of the Company's fleet capacity estimated accordingly for the years from 2019 to 2021 is about 10%. It is also assumed that the growth rate of fleet expansion in 2022 will not exceed 10%; and

- Yield per Kilometre – Considering Air China Cargo's capacity growth from 2020 to 2022 and with reference to the average compound annual growth of yield level per kilometre of the Group of 9.8% for the years from 2016 to 2018, it is assumed that yield level per kilometre will be maintained at a similar growth rate from 2020 to 2022.

We are of the view with the Directors that the respective annual caps are reasonable and in the interest of the Company after taking into account that:

(i) Expansion of fleet capacity

Based on our discussion with the Management, the increase in the Group's aircraft fleet is directly linked to the growth in ATK as ATK measures an airline's total available capacity. We further understand from the Management that growth rate for the aircraft fleet operated by the Company and the fleet operated by the Group are usually very similar. We have discussed and reviewed the internal aircraft introduction plan of the Company with the Management and noted an expected average compound annual growth rate of approximately 9.8% for the coming three years from 2020-2022. To ascertain the fairness and reasonableness of such a growth rate and given the said relationship between the aircraft introduction plan for the Group and the Company respectively, we have reviewed the projected number of aircraft to be added to the Group's aircraft fleet based on the Company's 2019 Interim Report. Based on the disclosures made, the Group expects to introduce 55, 93, and 42 aircrafts to its fleet for years 2019 to 2021 respectively. Based on the published number of aircraft operated by the Group as disclosed in the Company's 2018 Annual Report and our discussion with the Management, it is therefore estimated that the Group's aircraft fleet for 2019 to 2021 would be estimated at approximately 709, 799, and 840 respectively, representing an average compound annual growth rate of approximately 8.85%. Based on our understanding from the Management, the fleet capacity growth rate is expected to continue into 2022.

We have also reviewed the Company's historical ATK growth data based on the disclosures made in its 2016, 2017 and 2018 Annual Reports. Based on the disclosures made, we noted that ATK for each of the three years quoted were 33,776.53 million, 35,672.57 million and 38,920.17 million which corresponds to an approximate 7.347% compounded average growth.

In light of the relationship between ATK and expansion plan, the relationship between the expansion plan of the Group and the Company, the historical growth of ATK and the fleet expansion plan, we are of the view with the Management's expected fleet capacity growth estimation of 10% is fair and reasonable.

(ii) Yield per Kilometre

We have reviewed the Company's annual reports for the three years ended 31 December 2018, and based on the disclosures, we noted that the Group's Yield per Kilometre for each of the three years ended 31 December 2018 was RMB1.1873, RMB1.3578 and RMB1.4312 respectively, which represents a compound annual growth rate of approximately 9.79%. As such, we are of the view with the use of this growth rate in the estimation of the annual caps for Bellyhold Services.

Ground Services

As shown in the table above, it is noted that the annual caps for 2020, 2021 and 2022 embedded an estimated annual growth of around 19.2%, 25.0% and 10.0% as compared to the estimated annual transaction amount for 2019 and the annual caps for 2020 and 2021 respectively, representing a compound annual growth rate of around 17.26% for the three years.

As also disclosed in the letter from the Board of the Circular, in arriving at the estimated aggregate amounts payable by the ACC Group to the Group in connection with the ACC Ground Services for each of the three years ending 31 December 2022, respectively, the Company has considered, among other things, the historical transaction amounts and the following factors:

- Increase in the need for relevant services: Capacity (AFTK) of Air China Cargo has expanded at a compound growth rate of 5.74% from 2016 to 2018; in view of the capacity growth of bellyhold space of the Company as well as the fact that Air China Cargo's future business will take its freighters, bellyhold space, cargo terminals (airport apron) and lorry business as core assets, its cross border air transport capacity, cargo terminals operation capacity (airport apron operation capacity) at home and abroad, ground distribution capacity at home and abroad and ability to design and implement F2B/C logistics solution as its fundamental ability, and "e-commerce plus logistics" integrated service provider as its business positioning, and it will strive to building a full business chain that covers whole cross-border market of in the PRC and serves manufacturers to end-user customers, it is expected that the capacity (AFTK) of Air China Cargo will expand at an annual compound rate of approximately 8% from 2020 to 2022, and the need of Air China Cargo for relevant services will increase in line with the expansion of capacity;

- Increase in unit price: The unit price of relevant services is expected to increase at an annual rate of approximately 7% from 2020 to 2022 by taking into account the historical increase of the Group's labour costs and equipment costs, as well as the growth rate of inflation; and

- Certain buffer has been included by rounding to the nearest integer to cater for the Group's operating needs from time to time.

We are of the view with the Directors that the respective annual caps are reasonable and in the interest of the Company after taking into account that:

(i) Increase in fleet capacity of ACC Group

We have discussed and understand from the Company that the fleet capacity of ACC Group is directly reflected by the available freight tonne kilometer ("**AFTK**") statistics of the Company. Though we note that the average annual growth rate for the Group's AFTK over the last three financial years ended 31 December 2018 was approximately 5.9%, we also note that the Group's AFTK, based on its annual reports for the four financial years ended 31 December 2018, has reported an average annual growth rate of approximately 9.0%. We have discussed the historical data and the projected AFTK for the next three financial years ending 31 December 2022 and understands that the Group expects the AFTK to improve over the next three years. As such, we are of the view with the use of 8% growth rate in the estimation of the annual caps for ACC Ground Services as compared with the historical average growth rate, it is considered to be reasonable.

(ii) Increase in unit price

We have discussed and understood from the Management the key factors for increase in unit price for ground support and other services would be the growth in the cost of providing such a service, and such growth is directly linked to the GDP. With reference to the statistics published by the National Bureau of Statistics of China, the indices of gross domestic product increased by approximately 6.6% between 2017 and 2018 and by approximately 6.8% between 2016 and 2017. As such, an increase in unit price of 7% is considered to be in line.

Amounts payable by the Group to the ACC Group

Bellyhold Services

In arriving at the estimated aggregate amounts payable by the Group to ACC Group in connection with operation expenses of Bellyhold Space Business for each of the three years ending 31 December 2022, the Company has made reference to the estimated amounts of contracting operation income of Bellyhold Space Business payable by the ACC Group for each of the three years ending 31 December 2022, as well as the estimation on the expense rates to be adopted on the basis of historical expenses rates in the next three years. For each of the three years ending 31 December 2022, annual caps of contracting operation income for the Bellyhold Space Business payable by ACC Group to the Company are estimated to be RMB8 billion, RMB9.6 billion and RMB11.6 billion (as stated above). As the expense rate adopted shall not exceed 10%, the annual caps of operation expenses of bellyhold space for each of the three years ending 31 December 2022 are estimated to be RMB0.8 billion, RMB0.96 billion and RMB1.16 billion.

As stated in the letter from the Board of the Circular, the Company focuses more on operating management improvement under the previous bellyhold space operation model while more on operating result under contracting operation model. Since the Company has disposed the equity shareholdings of Air China Cargo held by it and turned to focus its resources on the operation of air passenger transportation business, contracting operation model is more aligned with the overall development strategies of the Company. For each of the five years ended 31 December 2018, the service charge for passenger aircraft bellyhold space paid by the Company to ACC Group accounted for 8.08%, 8.97%, 10.59%, 7.54% and 7.55% of bellyhold revenue, respectively. Though the percentages basically remained at the level of 7.55% in the recent years, as the relevant percentage once exceeded 10% in the last five years. We have discussed and understand from the Company that given 10% has previously occurred, the adoption of a 10% Expense Rate to estimate annual caps for the coming three years is able to cater for possible growth in fees which would not be unusual. In addition, the Company has also incorporated certain buffer by rounding to the nearest integer to cater for the change of operating needs of ACC Group from time to time.

With reference to the actual amounts of fees previously incurred by the Group for ACC Group's Bellyhold Services provided, being RMB385 million, RMB418 million and RMB481 million respectively for each of the three years ending 31 December 2019, we can observe that the amount of fees paid/payable consistently equals to approximately 7.54% of amount received as Benchmark Income/Settlement Price from the ACC Group. We have further discussed and reviewed the calculation of annual caps for 2020, 2021, 2022 and understand from the Management that in determining the annual caps for 2020, 2021 and 2022, it has not only referred to the historical Expense Rate from the last three financial years ended 31 December 2018, it has taken into account of possible market fluctuations and changes in business needs and applied a 10% Expense Rate in its calculations. We were further given to understand that the actual Expense Rate would highly depend on the Benchmark Income and Settlement Price relevant to the Bellyhold Services provided by Air China Cargo. As evident from the Operation Expenses Formula, the amount for Operation Expenses corresponds directly and is usually quoted as a percentage of the Benchmark Income/Settlement Price.

In light of the historical trend and the relationship between Operation Expenses and Benchmark Income/Settlement Price, we consider the Company's estimation of annual cap for Operation Expenses based on the Expense Rate of 10% to be fair and reasonable.

Ground Services

It is noted that the annual caps for 2020, 2021 and 2022 embedded an estimated annual growth of around 16.41%, 20.00% and 16.67% as compared to the estimated annual transaction amount for 2019 and the annual caps for 2020 and 2021 respectively, representing a compound annual growth rate of around 18.32%.

In arriving at the estimated aggregate amounts payable by the Group to the ACC Group in connection with the ACC Ground Services provided by the ACC Group for each of the three years ending 31 December 2022, respectively, the Company has considered, among other things, the historical transaction amounts and the following factors:

- Increasing need for relevant services: Given that the fleet capacity of the Group is expected to expand at an annual rate of approximately 9% from 2020 to 2022, it is expected that the need of the Group for relevant services will increase in line with the expansion of fleet capacity;
- Increase in unit price: Taking into account the historical increase of the Group's labour costs and equipment costs, as well as growth rate of inflation, assuming the growth rate of unit prices for services provided by the ACC Group is generally in line with that of the Group, it is expected that the unit price of relevant services provided by the ACC Group will increase at an annual rate of approximately 7% from 2020 to 2022; and
- Certain buffer has been included by rounding to the nearest integer to cater for the ACC Group's operating needs from time to time.

We are of the view with the Directors that the respective annual caps are reasonable and in the interest of the Company after taking into account that:

(i) Expansion of fleet capacity

As mentioned above, we have reviewed the projected number of aircraft to be added to the Group's aircraft fleet to determine the fairness and reasonableness of the use of 9% as the growth rate of the Group's aircraft fleet. Based on the published number of aircraft operated by the Group as disclosed in the Company's 2018 Annual Report and our discussion with the Management, it is therefore estimated that the Group's aircraft fleet for 2019 to 2021 would be estimated at approximately 709, 799, and 840 respectively, representing an average growth rate of approximately 8.91%. Based on our understanding from the Management, this growth rate is expected to continue into 2022.

(ii) Increase in unit price

We have discussed and understood from the Management that similar to the ground support services and other services expected to be provided by the Group to the ACC Group, the key factors for increase in unit price for ground support and other services expected to be received from ACC Group (hence amounts payable) would be the expected growth in the cost of providing such a service and such growth is directly linked to the GDP. With reference to the statistics published by the National Bureau of Statistics of China, the indices of gross domestic product increased by approximately 6.6% between 2017 and 2018 and by approximately 6.8% between 2016 and 2017.

Furthermore, we have reviewed the Company's annual reports for each of the three years ended 31 December 2018 and noted that total operating expenses has increased by approximately 3.29%, 15.02% and 12.71% respectively, which corresponds to an average annual growth rate of approximately 10.34%.

In light of the above, we would consider the Company's use of the above growth rate for changes in unit price of 7% to be prudent and fair and reasonable.

3. CNACG Transactions

3.1 Background of and reasons for the CNACG Transactions

As disclosed in the letter from the Board of the Circular, the Management considers that the entering into of lease transactions with CNACG Group helps to streamline the process for the Group to secure relevant equipment that meets the specific needs of the Group with a lower cost of financing, higher flexibility and less impact on the Group's cash flow as compared to direct purchasing. In addition, the subsidiary of CNACG, to be acting as the lessors, is registered in the free trade zones in the PRC and are entitled to certain favourable tax treatments which will further lower the transaction costs of the Group. In terms of the aircraft finance lease, the Company expects that the total estimated financing costs of approximately US$47.62 million, US$52.13 million and US$54.67 million, will be saved by the Group from 2020 to 2022 respectively through the aircraft finance lease under New CNACG Framework Agreement with CNACG Group, as compared with adopting secured loan arrangements with equivalent interest rates provided by the market during the same period.

We noted from the annual reports for FY2017 and FY2018 and the 2019 Interim Report that around 57.86%, 58.04% and 58.14% of the aircraft fleet of the Group were held under either finance lease or operating lease as at 31 December 2017, 31 December 2018 and 30 June 2019 respectively. As such, the entering into of the New CNACG Framework Agreement is considered in line with the Group's financing strategy for its business operation. In addition, not only that the entering into of the New CNACG Framework Agreement will allow financing costs saving and financing flexibility for the Group as discussed in the paragraphs above, most importantly it will not make the Group becoming obliged to enter into any transactions with CNACG, but will only allow CNACG to be one of the available choices for the Group's selection for its finance/operating lease arrangements.

Based on the above, we are of the view that the entering into of the New CNACG Framework Agreement is in the ordinary and usual course of business of the Group and is in the interests of the Company and the Shareholders.

As disclosed in the Circular, in respect of ground support services and other services, the Group has entered into a series of continuing connected transactions with CNACG Group in its ordinary and usual course of business ("**CNACG Ground Services**"). CNACG Group possesses ample management experience and financial resources on ground support services and logistics business, and is able to provide high-quality services to the Group.

To assess the fairness and reasonableness of the CNACG Ground Services, we have discussed and understand from the Management that the Group has engaged CNACG to provide the Group with ground support services, aircraft maintenance services, aircraft repair services, property investment and management services, ticket and tourism services, logistics services, administrative management services, cleaning and washing services, resident security services, lounge supplies procurement services and aircraft material procurement services. We were given to understand that such services provided by the CNACG Group are necessary for the Group to carry out its ordinary and usual course of business. In this respect, in light of the ongoing business relationship between the Company and CNACG Group of 11 years, we would be of the view with the Company that this provision of services to be engaged by the Group under the CNACG Transactions is fair and reasonable.

3.2 Terms of the New CNACG Framework Agreement

The key terms of the New CNACG Framework Agreement are as follows:

Services:	Finance lease and operating lease services: CNACG Group will provide finance lease and operating lease services in respect of, among other things, aircraft, engines, simulators, equipment and vehicles to the Group; the Group will provide finance lease and operating lease services in respect of, among other things, equipment and vehicles to CNACG Group. CNACG Ground Services Transactions conducted between any member of the Group on the one hand and any member of CNACG Group on the other hand include but not limited to : ground support services, aircraft maintenance services, aircraft repair services, property investment and management services, ticket and tourism services, logistics services, administrative management services, cleaning and washing services, resident security services, lounge supplies procurement services and aircraft material procurement services.

Pricing terms: Finance lease and operating lease services:

The final transaction price will be determined on arm's length negotiations between both parties after taking certain factors into account and with reference to the prices for the same type of lease services offered by independent third parties. Such certain factors considered above include purchasing price of the leasing subject, interest rate and arrangement fees (if any) (for finance lease), rental fee (for operating lease), the lease terms, the feature of the leasing subject and the comparable market rental prices. The final transaction price should not be higher than the transaction prices offered by the at least two independent third parties on the same conditions.

CNACG Ground Services

The pricing policies for ground support services and other services provided to or by the Group are set forth below:

(i) Follow the government pricing or guide price (if any), including but not limited to the guidance from the Civil Aviation Administration of the PRC (CAAC) and the International Air Transport Association on the prices of ground support services and other terms, and the requirements on the pricing of navigation information stipulated by CAAC and Air Traffic Management Bureau (ATMB);

(ii) If no government pricing or guide price is available, the final transaction price will be determined on arm's length negotiations between the parties, with firstly making reference to the market prices offered by at least two independent third parties for the same type of service, and after taking certain factors into account such as service standard, service scope, business volume and specific need of parties. If any service need of the service recipient changes, appropriate adjustment will be made to the transaction price after negotiation between both parties based on the extent of variation in relevant costs, service quality or other factors; and

(iii) If neither the above cases is applicable, the price will be determined on a basis of cost plus reasonable profit. The costs are mainly based on the costs and expenses of the service provider, including costs of human resources, facility, equipment and materials. Reasonable profit margin will be determined mainly making reference to, among others, the historical average prices on similar products or services (where possible) published in relevant industry, and/or the profit margin of the comparable products and services disclosed by other listed companies. The profit margin of CNACG Group shall not exceed 10%. The final transaction prices shall be determined on terms that to the Group are no less favourable to those provided by independent third parties to the Group or those provided by CNACG Group to independent third parties (with regards to the receiving of services by the Group), or no more favourable to CNACG Group than those provided by the Group to the independent third parties (with regards to the rendering of services by the Group).

Term and termination: The initial term of the New CNACG Framework Agreement is three years commencing from 1 January 2020 and ending on 31 December 2022, which is automatically renewable for successive terms of three years after the expiry of its initial term subject to the fulfilment of requirements under Hong Kong Listing Rules/ Shanghai Listing Rules and obtaining the required approval. Before expiry of the New CNACG Framework Agreement, the Board will re-assess the terms and conditions of the New CNACG Framework Agreement, and the Company will re-comply with the relevant rules governing connected transactions under the Hong Kong Listing Rules. During the term of the New CNACG Framework Agreement, the agreement can be terminated on any 31 December by either party thereto by serving the other party a written notice of termination of not less than three months.

Finance lease and operating leases

To assess the fairness and reasonableness of the terms of the finance lease and operating lease transactions under the CNACG Transactions, we have obtained and reviewed the New CNACG Framework Agreement. Based on our discussion with the Management, we understand that before entering into any lease agreements, the Group will obtain and review at least two lease proposals from independent third parties through requests for proposals or other public procurement processes, and evaluate whether the comprehensive costs (including principle or rental fee and arrangement fees, if any) provided by the CNACG Group are fair and reasonable and no less favourable to the Group than those offered by independent third parties.

Based on our understanding from the Management, interest rates used for finance leases for, among others, aircrafts, is usually with reference to official lending rate promulgated by the People's Bank of China ("**PBOC**"). We have also understood from the Management that as at the Latest Practicable Date, the period of finance leases for aircrafts would not be less than

5 years. We note the PBOC official lending rate for period greater than 5 years is 4.9% as of the Latest Practicable Date. We further understand from the Management that the length of the implementation agreements for each finance lease as well as operating lease item would be with reference to useful life of the relevant aviation asset which is usually over 10 years for aircraft and 3-20 years for aviation equipment.

We understand from the Management that the Group has entered into similar leasing arrangements with CNACG Group and/or independent third parties from time to time in the past. In this regard, we have requested the Company to provide us with, among other things, samples of proposals/quotations submitted by CNACG Group and independent third parties respectively in 2018 as regards aircraft finance lease ("**Sample Aircraft Finance Leases**") for the same type of the leasing subject. Also, we understand the Company has previously entered into aviation equipment operating lease with CNACG Group. We have separately requested for and were provided with two previous operating leases relating to aviation equipment entered into with an independent third party and CNACG Group respectively ("**Sample Other Leases**") as an example to illustrate the common terms of an aviation equipment under operating lease.

From the Sample Aircraft Finance Leases provided, we noted that the interest rates used for Sample Aircraft Finance Leases were determined with reference to official lending rate promulgated by the PBOC and the terms for such Sample Aircraft Finance Leases ranged between 10-12 years in duration. We also noted from the Sample Aircraft Finance Leases and from our discussion with the Management that the Company would consider, among others factors, whether the total cost of borrowing (i.e. the rate offered) by the lender is considered favourable among the quotes received and whether the amount of financing available to be provided by the lender is sufficient to satisfy the Company's requirements, before entering into any formal lease agreements. Based on the supporting documents relevant to the approval of the Sample Aircraft Finance Leases, we noted that the Sample Aircraft Finance Leases were jointly reviewed and approved by at least three different departments of the Company.

On the Sample Other Leases provided, we have discussed with the Management and noted that the duration of the agreements are of a term of 5 years or above. Based on the discussion with the Management, we understand that the total rental for the period is determined with reference to the cost of the aviation equipment. Separately, we understand from the Management that in comparing different quotes for the same equipment, the Company would also calculate the embedded interest offered. The reference rate used is also the PBOC official rate. In addition to the above, and similar to that of aircraft finance leases, we understand the Company selects the lender based on, among others, whether the required amount of financing for the subject aviation equipment is available as well as the rental per period payable. Again, prior to entering into of any operating leases for aviation equipment, we understand that the agreements are jointly reviewed and approved by at least three different departments of the Company.

Based on the above, we consider the terms of the finance lease and operating lease services under the CNACG Transactions are generally in line with the market. Furthermore, we would consider the New CNACG Framework Agreement as regards the finance lease and operating lease as simply a mean to provide the Company with an additional flexibility in selecting financing provider but not an obligation for the Company to enter into agreements with CNACG, which is in the interest of the Company.

CNACG Ground Services

The pricing policies for CNACG Ground Services are set forth below:

(i) Follow the government pricing or guide price if it is available, including but not limited to the guidance from the Civil Aviation Administration of the PRC (CAAC) and the International Air Transport Association on the prices of ground support services and other terms, and the requirements on the pricing of navigation information stipulated by CAAC and Air Traffic Management Bureau (ATMB);

(ii) If no government pricing or guide price is available, the final transaction price will be determined on arm's length negotiations between the parties, with firstly making reference to the market prices offered by at least two independent third parties on the market for the same type of service and after taking certain factors into account such as service standard, service scope, business volume and specific need of parties. If any service need of the service recipient changes, appropriate adjustment will be made to the transaction price after negotiation between both parties based on the extent of variation in relevant costs, service quality or other factors; and

(iii) If neither the above cases is applicable, the price will be determined on the basis of cost plus reasonable profit. The costs are mainly based on the costs and expenses of the service provider, including costs of human resources and costs of facility, equipment and materials. Reasonable profit margin will be determined mainly making reference to the historical average prices on similar products or services (where possible) published in relevant industry, and/or the profit margin of the comparable products and services disclosed by other listed companies. The profit margin of CNACG Group shall not exceed 10%. The final transaction prices shall be determined on terms that to the Group are no less favourable to those provided by independent third parties to the Group or those provided by CNACG Group to independent third parties (with regards to the receiving of services by the Group), or no more favourable to CNACG Group than those provided by the Group to the independent third parties (with regards to the rendering of services by the Group).

Similar to that of ACC Ground Services in relation to services provided by ACC Group to the Group, we understand that prior to entering into any agreements with the CNACG Group for the CNACG Ground Services sought, the Group would first of all make references to the Guidance and also consider cost of similar services provided by independent third parties. If and when required, we understand from the Management that the Group would also require the CNACG Group to provide supporting document to substantiate that the quote and/ or profit margin provided to the Group is no different to quotes provided to independent third parties.

We further understand that the Group's relevant department would be responsible for the verifications of such comparisons made and to confirm that the margins quoted by the Group for similar services provided to its customers and therefore the margins quoted by CNACG Group would be considered as reasonable. Similar to our independent work done for the ACC Ground Services, to determine the fairness and reasonable of the use of "cost plus no more than 10% profit margin" element of the pricing policy, we have, on a best-effort basis, through public domain, noted that an industry player that has been listed on the Exchange for more than 10 years and is engaged in a similar line business and with similar geographical coverage, namely China Southern (Stock Code:1055) has, in its respective announcements dated 16 December 2016 and 27 December 2018 disclosed that its pricing policy for ground services provided by its connected person is also on a cost plus a profit margin of 10% basis. In this respect, we would consider the use of cost plus no more than 10% profit margin concept is not uncommon in the market. We have also reviewed the existing CNACG ground services agreement (the "**Existing CNACG Ground Services Agreement**") and compared it with one sample ground services transaction entered into with independent third parties in relation to services similar to that of the CNACG Ground Services transactions and noted that the terms offered are similar. We further noted that according to the internal policy procedures as described in the section headed *"4. Internal control procedures"* below, the Existing CNACG Ground Services Agreement were jointly reviewed and approved by at least three different departments of the Company including the asset management department.

In light of the aforementioned, we consider the pricing basis for CNACG Ground Services to be fair and reasonable.

3.3 Historical amounts and historical caps and the proposed annual caps

The table below sets out (i) the annual caps of the Group for the three years ended/ending 31 December 2017, 2018 and 2019; and (ii) the actual aggregate amounts paid by the Group for each of the two years ended 31 December 2017 and 2018 and from January to August 2019, and the estimated aggregate amounts payable for the year ending 31 December 2019.

Transactions	Historical Amounts: for the year ended 31 December 2017	Historical Amounts: for the year ended 31 December 2018	Historical Amounts: Actual amount for the period from January to August 2019	Estimated annual amount for 2019	Historical Caps: for the year ended/ending 31 December 2017	Historical Caps: 2018 (Note 1)	Historical Caps: 2019
Transaction amount for aircraft finance lease service *(US$ Million)*	N/A	957	550	1,490	N/A	1,046.59	1,492.03
Finance lease for engines and simulators, operating lease for back-up aircraft engines, and back-up ground support equipment, ground support services and other services *(RMB Million)*	378	416	351	503	2,450	2,450	2,450

Notes:

1. In terms of maximum transaction amount for aircraft finance lease service, it covers the period from 1 June 2018 to 31 December 2018.

2. For the three years ended/ending 31 December 2017, 2018 and 2019, both the estimated aggregate amounts payable to, and the actual amounts paid to the Group by the CNACG Group are below the de minimis threshold as stipulated under Rule 14A.76(1)(a) of the Hong Kong Listing Rules.

3. For the three years ended/ending 31 December 2017, 2018 and 2019, utilisation rate of the annual caps for finance lease of engines and simulators, operating lease of back-up aircraft engines and back-up ground support equipment, ground support services and other services was low. The main reason leads to such low utilisation rate is that the operating lease projects relating to engine, simulator and ground support equipment of the subsidiary under CNACG that engages in leasing services were still at start-up stage, thus number of projects under progress is limited.

We have discussed the basis for its estimated transaction amount for 2019 with the Management and understand that it has considered, among others, the actual value of the finance lease services entered with CNACG Group and expected finance leases to be entered with CNACG Group in 2019. Having considered the aforementioned, we consider the bases used to estimate the total transaction value for 2019 to be fair and reasonable.

The table below sets out the proposed annual caps for the total amount payable to CNACG Group by the Group for each of the three years ending 31 December 2020, 2021 and 2022, respectively:

	Proposed Annual Caps for the year ending 31 December		
Transactions	**2020**	**2021**	**2022**
	(in millions of RMB)		
Total value of right-of-use assets in relation to finance lease and operating lease entered into by the Group as lessee	14,500	16,000	16,500
Ground support services and other services	600	690	807

Finance lease and operating lease

As disclosed in the letter from the Board of the Circular, the annual caps relating to the finance lease and operating lease to be entered into between the Group and the CNACG Group are:

- For the finance lease for aircraft were determined with reference to: (i) the aircraft introduction plan for each of the three years (based on the Company's 2019 Interim Report, the Group expects to introduce 55, 93, and 42 aircrafts to its fleet for years 2019 to 2021 respectively, and the average compound annual growth rate of the Group's fleet capacity for years 2019 to 2021 is 8.85%. It is also assumed that the growth rate of fleet expansion of the Group in 2022 will not exceed such rate), and the aggregate principal amount of the aircraft finance lease with CNACG Group is estimated based on the assumption that half of the aggregate consideration amounts of the aircraft scheduled to be introduced during the period from 2020 and 2022 according to confirmed orders will be introduced by way of finance lease with CNACG Group; (ii) the average lease term of aircraft being 10 to 12 years; (iii) the benchmark lending rate for RMB loans above 5 years promulgated PBOC of 4.9%; and (iv) an arrangement fee of 0.5% based on prevailing market conditions. When estimating financing lease in connection with assets such as engines in the following three years which, according to the Company, accounts for a minimal portion of the respective annual caps, the Company had considered related financial leasing needs and adopted rate of interest fee and arrangement fee of same aircraft financing lease for estimation; and

- For operating leases involving engines, simulators and equipment (together "**Aviation Equipment**") for each of 2020, 2021, 2022 are estimated with reference to: (i) the historical transaction amounts; (ii) the operation condition of the Aviation Equipment and the Group's commercial demand for operating lease in the following three years; (iii) the operating lease price and terms of the same or similar assets in the domestic market; and (iv) a reasonable cushion to cater for the Group's operating need from time to time.

We have discussed and understand from the Management that approximately 95% of the total annual cap for finance lease and operating lease to be entered into by the Group as lessee is attributable to the anticipated total value of right-of-use assets relating to finance lease of aircraft ("**Aircraft Finance Leases PV**"). Based on the disclosures made in the letter from the Board of the Circular, the planned Aircraft Finance Leases PV is RMB13.8 billion, RMB15.1 billion and RMB15.9 billion for 2020, 2021 and 2022 respectively.

We further noted from the Management that the maximum aggregate principal amount of the aircraft finance lease with CNACG Group for any particular year shall not exceed half of the aggregate consideration amounts for the total aircraft projected to be added by using finance leases during the said year. As such, the computation process the Company has adopted only accounted for half of the total expected purchase price of the total aircrafts scheduled to be introduced using finance lease as the relevant principal amount. We note that the Company's peers, China Southern and China Eastern in their respective continuing connected transaction circulars dated 26 October 2017 and 30 September 2019, adopts a similar computation process of accounting for only half of the total expected purchase price of total aircrafts scheduled to be introduced as the relevant principal amount.

As advised by the Management, pursuant to IFRS 16, the finance lease entered into by the Company as the lessee will be recognised as right-of-use assets and discounted using the Company's incremental borrowing rate, and the result of such calculation is used to determine the total annual cap for the finance lease and operating leases for the specific year. Accordingly, the amounts of the Aircraft Finance Leases PV for each of the years 2020, 2021 and 2022, being the total value of right-of-use assets relating to the aircraft finance leases expected to be entered into between the Company and CNACG Group during 2020, 2021, and 2022 respectively, constitute the annual cap for the respective years. We have noted that China Eastern has adopted a similar approach to determining its annual caps for aircraft finance leases in its circular dated 30 September 2019. We have reviewed the computation of the respective values for the right-of-use assets relating to the planned aircraft finance leases and noted that it is calculated by discounting the estimated total financing amount required for 50% of the total new aircrafts (including interest and arrangement fees) to be introduced for the particular year by a discount rate of 4.9% (for leases with terms over 5 years) which is equivalent to the Company's prescribed internal incremental borrowing rates for loans/leases over five years. We have reviewed the Group's 2019 Interim Report and noted that the interest rate for the Group's interest-bearing bank and other loans repayable ranged from 1.95% to 5.02% (median interest rate being 3.49%) and range of interest rates for corporate bonds repayable is from 2.84% to 5.30% (median interest rate being 4.07%) as at 30 June 2019. Given the range and the median of interest rates applicable to the Group's interest-bearing bank loans and other borrowings, and the fact that the use of the internal rate, being 4.9%, is towards the higher end of the aforementioned quoted ranges, we would consider the Company's use of discount rate of 4.9% to be prudent.

In addition to the above, we have also carried out the following independent work and considered the following factors:

(1) we understand from the Management that the finance lease contracts for aircraft is usually between 10 years and 12 years in duration. As mentioned under the paragraph headed "*3.2 Terms of the New CNACG Framework Agreement*" above, we have obtained and reviewed 6 Sample Aircraft Finance Leases submitted by independent

third parties and noted that the duration for the leases were all between 10 and 12 years. In this respect, we would consider the expected lease period of between 10 years and 12 years to be normal business practice for the aviation industry in China;

(2) we understand from the Management that the interest rate for the finance leases are normally set with reference to the PBOC rate for the corresponding length of the lease. In light of the fact that the aircraft finance leases are usually between 10 and 12 years in length, we have reviewed the PBOC website and have confirmed that, as at the Latest Practicable Date, the corresponding reference interest rate for loans for period longer than 5 years in the PRC is 4.9%. Based on the Sample Aircraft Finance Leases, we also noted that the leases entered into between the Group and independent third parties were all with reference to the PBOC official rate. We are therefore of the view that it is common reference interest rate for aircraft finance leases to be determined with reference to the PBOC official rate;

(3) based on the Sample Aircraft Finance Leases obtained we understand the one-off arrangement fees quoted by independent third-party lessors were based on a percentage ranging from nil to 0.5%. As such we are of the view it is not uncommon for arrangement fees to be included in aircraft finance lease agreements and it is reasonable for the Company to include the arrangement fee of 0.5% in its computation process for Aircraft Finance Leases PV; and

(4) we have reviewed the projected number of aircraft to be added to the Group's aircraft fleet. We have reviewed the Company's 2016 Annual Report, 2017 Annual Report and 2018 Annual Report and noted that the Group introduced 54, 56 and 50 aircrafts respectively for 2016, 2017 and 2018. Of the number of new aircrafts introduced, 9, 23, 34 were acquired under finance leases for 2016, 2017 and 2018 respectively. Based on the Company's 2019 Interim Report, the Group expects to introduce 55, 93, and 42 aircrafts to its fleet for years 2019 to 2021 respectively and with reference to the published number of aircraft operated by the Group as disclosed in the Company's 2018 Annual Report and our discussion with the Management, the Group's total aircraft fleet for 2019 to 2021 would be estimated to reach approximately 709, 799, and 840 aircrafts respectively, representing an average compound annual growth rate of approximately 8.85%. We understand from the Management that the growth rate of aircrafts acquired under finance leases are expected to continue into 2022. Based on such projection and our review, we consider this assumption to also be prudent.

We also understand that the Management has also included a buffer in its estimated amounts for Aircraft Finance Leases PV to account for possible fluctuations in foreign exchange rate and possible changes in business needs. Based on our understanding, as the leases are normally denominated in the USD, we consider the buffer which provides flexibility for accommodating, among others, any possible fluctuations in foreign exchange rate, to be prudent.

In this respect, and considering the above, we are of the view that such estimates for calculating the Aircraft Finance Leases PV for 2020, 2021 and 2022, which accounts for approximately 95% of the respective total annual cap for the finance lease and operating lease, is fair and reasonable.

We have discussed and understand from the Management that anticipated financing required for Aviation Equipment using operating leases for 2020 to 2022 were mainly estimated by reference to the expected purchase schedules of engines and related aviation equipment and their respective market prices. We understand the market prices referred to is based on the Company's previous purchases of similar engines and aviation equipment and with independent third parties, and the length of similar operating leases entered into by the Group.

In assessing the fairness and reasonableness of the above, we have obtained and reviewed the Company's expected acquisition of Aviation Equipment by way of operating lease arrangements with the CNACG Group for the three years ending 31 December 2022 and the historical operating lease record involving Aviation Equipment between 2017-2019. Based on our review, we note the Group expects to finance, on average, with acquisition of 16 engines and other related aviation equipment on an annual basis between 2020 and 2022 and we note such an anticipated plan represents only approximately 19.5% of the average total acquisition of Aviation Equipment by way of operating lease between 2017 and 2019. As such, we would consider the bases used for the aforesaid purchase plan for the three years ended 2022 to be prudent and in addition, we consider the possibility of entering into of Aviation Equipment operating leases under the New CNACG Framework Agreement between the Company and CNACG Group simply represents an additional financing option for the Group to acquiring Aviation Equipment. From the information provided, the finance lease and operating lease period for engines ranges between 5 to 12 years and for other aviation equipment, the average lease period is around 6 years.

Similar to that of Aircraft Finance Leases PV, we were advised by the Management that pursuant to IFRS 16, Aviation Equipment will be recognised as right-of-use assets and such right-of-use asset value (the "**Aviation Equipment Leases PV**"), being the estimated total rental fee for the Aviation Equipment to be purchased from CNACG Group after discounted by the Company's internal incremental borrowing rate, is used to determine the total annual cap for the operating leases of Aviation Equipment to be entered with CNACG Group. We noted that China Eastern has also adopted a similar approach to determining its annual cap for operating leases in its circular dated 30 September 2019. As advised by the Management, the prescribed internal incremental borrowing rate referred to for leases with a term longer than five years is 4.9%, and 4.75% for leases with a term of 5 years or below. Similar to the aforementioned with Aircraft Finance Lease PV, we have reviewed the Group's 2019 Interim Report and noted that the interest rate for the Group's interest-bearing bank and other loans repayable ranged from 1.95% to 5.02% (median interest rate being 3.49%) and range of interest rates for corporate bonds repayable is from 2.84% to 5.30% (median interest rate being 4.07%). Given the range and the median of interest rates applicable to the Group's interest-bearing bank loans and other borrowings, and the fact that the use of the internal rate, being 4.9% for leases with a term of more than five years and 4.75% for leases with a term of five years or below, is towards the higher end of the aforementioned quoted ranges, we would consider the Company's use of internal rate of 4.9% and 4.75% to be prudent.

Based on the discussion above, we consider the estimation for the Aviation Equipment Leases PV for years 2020, 2021 and 2022, which accounts for approximately 5% of the respective total annual cap for the finance lease and operating lease, is fair and reasonable as far as the Company and Independent Shareholders are concerned.

CNACG Ground Services

As disclosed in the letter from the Board of the Circular, the annual caps relating to the CNACG Ground Services for the three years ending 31 December 2022 are: (i) increase in the need for relevant services by an expected annual rate of 9% throughout 2020 and 2022; (ii) increase in unit price for relevant services provided by CNACG Group by an annual rate of approximately 7% between 2020 and 2022; and (iii) a reasonable cushion to cater for the Group's operating need from time to time.

The 2020 annual cap of RMB600 million for CNACG Ground Services payable by the Group to CNACG Group was mainly estimated by reference to historical increases in ground support and other services provided by CNACG Group.

In assessing the fairness and reasonableness of the annual caps, we have carried out the following independent work and considered the following factors:

(1) Based on our discussion with the Management, we understand the demand for ground support and other services is directly linked with the size of the Group's aircraft fleet. With reference to the 2018 Annual Report and our discussion with the Management, given the published number of total aircraft operated by the Group as for year ended 2018, the total aircraft fleet to be operated by the Group, based on its estimations disclosed in the 2019 Interim Report would be approximately 709, 799, and 840 respectively for 2019 to 2021, representing an average compound annual growth rate of approximately 8.85%. Based on our understanding from the Management, this growth rate is expected to continue into 2022; and

(2) We have discussed and understood from the Management the key factors for increase in unit price for ground support and other services would be the growth in the cost of providing such a service. With reference to the statistics published by the National Bureau of Statistics of China, the indices of gross domestic product increased by approximately 6.6% between 2017 and 2018 and by approximately 6.8% between 2016 and 2017. As such, an increase in unit price of 7% is considered to be in line.

In light of the above, we would be of the view with the Company that the estimation of the respective annual caps for CNACG Ground Services is fair and reasonable.

4. Internal control procedures

As disclosed in the letter from the Board of the Circular, the Company has adopted a set of effective internal control measures to supervise the continuing connected transactions of the Group:

- Before entering into individual ACC Transactions and CNACG Transactions, the finance department, the legal department, the asset management department (which has a dedicated sub-division responsible for management of connected transactions) and if applicable, certain other relevant departments of the Company review the proposed terms for the individual ACC Transactions and CNACG Transactions and discuss with the relevant business department of the Group to ensure that such transactions are conducted on normal commercial terms and in compliance with the pricing policy of the Group before these relevant departments approve the finalised transaction agreements according to their authority within the Group;

- The asset management department of the Company is responsible for overseeing the connected transactions of the Company. The asset management department will monitor and collect detailed information on the ACC Transactions and CNACG Transactions on a regular basis, including but not limited to the implementation of pricing policies, payment arrangements and actual transaction amount of each finance lease transaction, operating lease transaction and ground support services and other services to ensure that the transactions are conducted in accordance with the New ACC Framework Agreement and New CNACG Framework Agreement. In addition, the asset management department will be responsible for monitoring and reviewing the balance amount of the annual cap for the ACC Transactions and CNACG Transactions on a monthly basis and if the annual cap for the ACC Transactions and/or the CNACG Transactions is expected to be exceeded for a particular year, it will report to the management and take appropriate measures in accordance with the relevant requirements in Hong Kong Listing Rules and/or Shanghai Listing Rules;

- The Company's internal audit department is responsible for performing the annual assessment on the internal control procedures of the Group, including but not limited to the relevant information on the management of the continuing connected transactions. In addition, the internal audit department is responsible for compiling the annual internal control assessment report and submitting the report to the Board for examination and approval;

- The senior management of the Company is responsible for supervising and monitoring the adoption of internal control procedures by the above-mentioned business departments, so as to ensure the implementation pricing policies is in compliance with relevant framework agreement and actual transaction amounts are controlled within annual caps. The senior management of the Company also reviews the implementation of pricing policies and the monitoring of annual caps annually; and

- The independent auditor of the Company and the independent non-executive Directors will conduct an annual review on the continuing connected transactions of the Group.

We consider the requirement to obtain of at least two independent quotes (where applicable) is reasonable for the Company to assess the then prevailing market terms of finance and operating leases and/or ground services and/or other relevant services offered by independent third parties. As such, we are of the view with the Directors that the internal control procedures and policies relating to the ACC Transactions and CNACG Transactions have demonstrated the Group's practices of getting access to market information and having regular assessment on the terms of the ACC Transactions and CNACG Transactions so as to make sure that its terms will be no less favourable (so far as the Group is concerned) than those prevailing in the market for similar transactions.

5. Hong Kong Listing Rules Requirements

Pursuant to Rule 14A.55 of the Hong Kong Listing Rules, the independent non-executive Directors will confirm in the annual report of the Company that the Group's continuing connected transactions have been entered into (1) in the ordinary and usual course of business of the Company; (2) on normal commercial terms or on terms no less favourable to the Group than terms available from independent third parties; (3) in accordance with the relevant agreement; and (4) on terms that are fair and reasonable and in the interests of the Shareholders as a whole.

The auditors of the Company will also perform a review of the Group's continuing connected transactions and will confirm in the annual report of the Company that such continuing connected transactions were conducted in the manner stated in Rule 14A.56 of the Hong Kong Listing Rules.

For each financial year of the Company during the terms of the New ACC Framework Agreement and New CNACG Framework Agreement, the subject implementation transactions under the New ACC Framework Agreement and the New CNACG Framework Agreement will be subject to review by the independent non-executive Directors and the Company's auditors as required by the provisions of the Rules 14A.55 and 14A.56 of the Hong Kong Listing Rules respectively. The independent non-executive Directors must confirm in the annual report of the Company for the years 2020-2022 such transactions have been entered into:

(1) in the ordinary and usual course of business of the Company;

(2) either on normal commercial terms or, if there are not sufficient comparable transactions to judge whether they are on normal commercial terms, on terms no less favourable to the Company than terms available to or from (as appropriate) independent third parties; and

(3) in accordance with the relevant agreements governing them on terms that are fair and reasonable and in the interests of the Company and the Shareholders.

Furthermore, the Hong Kong Listing Rules require that the Company's auditors must provide a letter to the Board (with a copy provided to the Hong Kong Stock Exchange at least ten business days prior to the bulk printing of the annual report of the Company), confirming that the Transactions:

(1) have received the approval of the Board;

(2) are in accordance with the pricing policies of the Company if the transactions involve provision of goods or services by the Company have been entered into in accordance with the relevant agreement governing the transactions; and

(3) have not exceeded the cap disclosed in its previous announcement.

Given the above, we believe there will be sufficient procedures and arrangements in place to ensure that the Transactions will be conducted on terms that are fair and reasonable and on normal commercial terms as far as the Independent Shareholders are concerned.

OPINION AND RECOMMENDATION

Having considered the principal factors and reasons set out above, we are of the view that that the terms of the New ACC Framework Agreement and the New CNACG Framework Agreement (including the respective annual caps) are on normal commercial terms and in the ordinary and usual course of business of the Group and are fair and reasonable so far as the Company and the Independent Shareholders are concerned. We also consider that the entering into of New ACC Framework Agreement and the New CNACG Framework Agreement is in the interests of the Company and the Shareholders as a whole. Accordingly, we advise the Independent Shareholders, and the Independent Board Committee to recommend the Independent Shareholders, to vote in favour of the ordinary resolutions to be proposed at the EGM to approve the New ACC Framework Agreement and the New CNACG Framework Agreement, and the adoption of the respective annual caps.

Yours faithfully,
for and on behalf of
SOMERLEY CAPITAL LIMITED
Lyan Tam
Director

Ms. Lyan Tam is a licensed person registered with the Securities and Futures Commission and as a responsible officer of Somerley to carry out Type 6 (advising on corporate finance) regulated activities under the SFO and has over 17 years of experience in corporate finance industry.

1. RESPONSIBILITY STATEMENT

This circular, for which the Directors collectively and individually accept full responsibility, includes particulars given in compliance with the Hong Kong Listing Rules for the purpose of giving information with regard to the Group. The Directors, having made all reasonable enquiries, confirm that to the best of their knowledge and belief the information contained in this circular is accurate and complete in all material respects and not misleading or deceptive, and there are no other matters the omission of which would make any statement herein or this circular misleading.

2. DISCLOSURE OF INTERESTS OF DIRECTORS AND SUPERVISORS

As at the Latest Practicable Date, none of the Directors, Supervisors or chief executive of the Company had interests or short positions in the shares, underlying shares and/or debentures (as the case may be) of the Company or its associated corporations (within the meaning of Part XV of the SFO) which were notifiable to the Company and the Hong Kong Stock Exchange pursuant to the SFO, or were recorded in the register maintained by the Company pursuant to section 352 of the SFO, or which were notifiable to the Company and the Hong Kong Stock Exchange pursuant to the Model Code for Securities Transactions by Directors of Listed Companies.

As at the Latest Practicable Date, none of the Directors or Supervisors has any direct or indirect interest in any assets which have been, since 31 December 2018 (the date to which the latest published audited financial statements of the Group were made up), acquired or disposed of by or leased to any member of the Group or are proposed to be acquired or disposed of by or leased to any member of the Group.

None of the Directors or Supervisors of the Company is materially interested in any contract or arrangement subsisting at the Latest Practicable Date and which is significant in relation to the business of the Group.

Mr. John Robert Slosar is a non-executive Director of the Company and is concurrently the chairman and an executive director of Cathay Pacific. Cathay Pacific is a substantial shareholder of the Company, holding 2,633,725,455 H shares in the Company as at the Latest Practicable Date, and it wholly owns Cathay Dragon. Mr. Cai Jianjiang, who is the chairman and a non-executive Director of the Company, and Mr. Song Zhiyong, who is an executive Director of the Company, are concurrently non-executive directors of Cathay Pacific. Cathay Pacific and Cathay Dragon compete or are likely to compete either directly or indirectly with the Company in some aspects of the business of the Company as they operate airline services to certain destinations, which are also served by the Company.

Save as mentioned above, as at the Latest Practicable Date, none of the Directors or Supervisors and their respective close associates (as defined in the Hong Kong Listing Rules) has any competing interests which would be required to be disclosed under Rule 8.10 of the Hong Kong Listing Rules as if each of them was a controlling shareholder of the Company.

3. SERVICE CONTRACTS

As at the Latest Practicable Date, none of the Directors or Supervisors has any existing or proposed service contract with any member of the Group which is not expiring or terminable by the Group within one year without payment of compensation (other than statutory compensation).

4. DIRECTORS' AND SUPERVISORS' EMPLOYMENT WITH SUBSTANTIAL SHAREHOLDERS

The followings are the particulars of Directors' and Supervisors' employment with substantial Shareholders as at the Latest Practicable Date:

Directors

Mr. Cai Jianjiang, a non-executive Director and the chairman of the Board of the Company, served as the chairman of the board of directors and a member and secretary of the communist party group of CNAHC. He is also a non-executive director and deputy chairman of the board of directors of Cathay Pacific.

Mr. Song Zhiyong, the executive Director, the vice chairman of the Board and the president of the Company, served as director, the general manager, and a member and the deputy secretary of the communist party group of CNAHC. He is also a non-executive director of Cathay Pacific.

Mr. Cao Jianxiong, a non-executive Director of the Company, served as a director and a member and the deputy secretary of the communist party group of CNAHC.

Mr. Xue Yasong, the employee representative Director of the Company, served as the employee representative director and the President of the Labour Union of CNAHC.

Mr. John Robert Slosar, a non-executive Director of the Company, served as an executive director and the chairman of the board of directors of Cathay Pacific.

Supervisors

Mr. He Chaofan, the supervisor of the Company, serves as the president of CNACG.

5. NO MATERIAL ADVERSE CHANGE

The Directors confirm that as at the Latest Practicable Date, there has been no material adverse change in the Group's financial or trading position since 31 December 2018, being the date to which the latest published audited financial statements of the Group have been made up.

6. EXPERT

The following is the qualifications of the expert who has given its opinions or advices, which are contained in this circular:

Name	Qualification
Somerley Capital Limited	a corporation licensed to carry out Type 1 (dealing in securities) and Type 6 (advising on corporate finance) regulated activities under the SFO

a. As at the Latest Practicable Date, Somerley did not have any direct or indirect interest in any assets which have been acquired or disposed of by or leased to any member of the Group, or are proposed to be acquired or disposed of by or leased to any member of the Group since 31 December 2018 (the date to which the latest published audited financial statements of the Group were made up);

b. As at the Latest Practicable Date, Somerley was not beneficially interested in the share capital of any member of the Group and had no right, whether legally enforceable or not, to subscribe for or to nominate persons to subscribe for securities in any member of the Group; and

c. Somerley has given and has not withdrawn its written consent to the issue of this circular with inclusion of its opinion and the reference to its name included herein in the form and context in which it appears.

7. MISCELLANEOUS

a. The joint company secretaries of the Company are Mr. Zhou Feng and Ms. Tam Shuit Mui. Ms. Tam is an associate member of the Hong Kong Institute of Certified Public Accountants (HKICPA).

b. The registered address of the Company is at Blue Sky Mansion, 28 Tianzhu Road, Airport Industrial Zone, Shunyi District, Beijing, the PRC. The head office of the Company is at No. 30, Tianzhu Road, Airport Industrial Zone, Shunyi District, Beijing, the PRC.

c. The H share registrar and transfer office of the Company is Computershare Hong Kong Investor Services Limited, Shops 1712-1716, 17th Floor, Hopewell Centre, 183 Queen's Road East, Wanchai, Hong Kong.

8. DOCUMENTS AVAILABLE FOR INSPECTION

Copies of the following documents are available for inspection at the principal place of business of the Company in Hong Kong at 5th Floor, CNAC House, 12 Tung Fai Road, Hong Kong International Airport, Hong Kong during normal business hours on any business day from the date of this circular until 18 November 2019:

a. New ACC Framework Agreement;

b. New CNACG Framework Agreement;

c. the letter from the Independent Board Committee to the Independent Shareholders, the text of which is set out on pages 26 to 27 of this circular;

d. the letter from Somerley to the Independent Board Committee and the Independent Shareholders, the text of which is set out on pages 28 to 64 of this circular;

e. the consent letter issued by the expert referred to in this circular; and

f. this circular.

中國國際航空股份有限公司
AIR CHINA LIMITED

(a joint stock limited company incorporated in the People's Republic of China with limited liability)
(Stock Code: 00753)

NOTICE OF EXTRAORDINARY GENERAL MEETING

NOTICE IS HEREBY GIVEN that an extraordinary general meeting (the "**EGM**") of Air China Limited (the "**Company**") will be held at 9:00 a.m on Thursday, 19 December 2019 at The Conference Room C713, No. 30, Tianzhu Road, Airport Industrial Zone, Shunyi District, Beijing, the PRC to consider and, if thought fit, to pass the following resolutions. Unless otherwise indicated, capitalised terms used herein shall have the same meaning as those defined in the circular of the Company dated 4 November 2019.

ORDINARY RESOLUTIONS

1. To consider and approve the framework agreement entered into between the Company and Air China Cargo on 30 October 2019, the transactions contemplated thereunder and the annual caps for the three years ending 31 December 2022.

2. To consider and approve the framework agreement entered into between the Company and CNACG on 30 October 2019, the transactions contemplated thereunder and the annual caps for the three years ending 31 December 2022.

By Orders of the Board
Air China Limited
Zhou Feng Tam Shuit Mui
Joint Company Secretaries

Beijing, the PRC, 4 November 2019

As at the date of this notice, the directors of the Company are Mr. Cai Jianjiang, Mr. Song Zhiyong, Mr. Cao Jianxiong, Mr. Xue Yasong, Mr. John Robert Slosar, Mr. Wang Xiaokang, Mr. Liu Deheng*, Mr. Stanley Hui Hon-chung* and Mr. Li Dajin*.*

* *Independent non-executive director of the Company*

Notes:

1. Closure of register of members and eligibility for attending and voting at the EGM

Holders of H Shares of the Company are advised that the register of members of the Company will be closed from Tuesday, 19 November 2019 to Thursday, 19 December 2019 (both days inclusive), in order to determine the list of holders of H shares of the Company who will be entitled to attend and vote at the EGM, during which time no transfer of H Shares of the Company will be effected and registered. In order to qualify for attendance and voting at the EGM, instruments of transfer accompanied by share certificates and other appropriate documents must be lodged with the Company's H Share registrar, Computershare Hong Kong Investor Services Limited, at Shops 1712-16, 17/F, Hopewell Centre, 183 Queen's Road East, Wanchai, Hong Kong, by 4:30 p.m. on Monday, 18 November 2019. H Share Shareholders of the Company whose names appear on the register of members of H shares of the Company on Tuesday, 19 November 2019 are entitled to attend and vote at the EGM.

2. Notice of Attendance

Holders of H Shares who intend to attend the EGM should complete and lodge the accompanying notice of attendance and return it to the Company's H Share registrar on or before Friday, 29 November 2019. The notice of attendance may be delivered by hand, by post or by fax to the Company's H Share registrar. Completion and return of the notice of attendance do not affect the right of shareholder to attend and vote at the EGM. However, the failure to return the notice of attendance may result in an adjournment of the EGM, if the number of shares carrying the right to vote represented by the shareholders proposing to attend the EGM by the notice of attendance does not reach more than half of the total number of shares of the Company carrying the right to vote at the EGM.

3. Proxy

Every shareholder who has the right to attend and vote at the EGM is entitled to appoint one or more proxies, whether or not they are members of the Company, to attend and vote on his/her behalf at the EGM.

A proxy shall be appointed by an instrument in writing. Such instrument shall be signed by the appointor or his attorney duly authorised in writing. If the appointor is a legal person, then the instrument shall be signed under a legal person's seal or signed by its director or an attorney duly authorised in writing. The instrument appointing the proxy shall be deposited at the Company's H Share registrar for holders of H Shares not less than 24 hours before the time specified for the holding of the EGM. If the instrument appointing the proxy is signed by a person authorised by the appointor, the power of attorney or other document of authority under which the instrument is signed shall be notarised. The notarised power of attorney or other document of authority shall be deposited together and at the same time with the instrument appointing the proxy at the Company's H Share registrar.

4. Other business

(i) The EGM is expected to last for no more than a half of a working day. Shareholders and their proxies attending the meeting shall be responsible for their own traveling and accommodation expenses.

(ii) The address of Computershare Hong Kong Investor Services Limited is:

17M Floor
Hopewell Centre
183 Queen's Road East
Wanchai
Hong Kong
Tel No.: (852) 2862 8628
Fax No.: (852) 2865 0990