# China Airlines, Ltd.

**Financial Statements for the**
**Years Ended December 31, 2017 and 2016 and**
**Independent Auditors' Report**

## INDEPENDENT AUDITORS' REPORT

The Board of Directors and the Shareholders
China Airlines, Ltd.

### Opinion

We have audited the accompanying financial statements of China Airlines, Ltd. (the Company), which comprise the balance sheets as of December 31, 2017 and 2016, and the statements of comprehensive income, changes in equity and cash flows for the years then ended, and the notes to the financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2017 and 2016, and its financial performance and its cash flows for the years then ended in accordance with the Regulations Governing the Preparation of Financial Reports by Securities Issuers and other regulations.

### Basis for Opinion

We conducted our audits in accordance with the Regulations Governing Auditing and Attestation of Financial Statements by Certified Public Accountants and auditing standards generally accepted in the Republic of China. Our responsibilities under those standards are further described in the Auditors' Responsibilities for the Audit of the Financial Statements section of our report. We are independent of the Company in accordance with The Norm of Professional Ethics for Certified Public Accountant of the Republic of China, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

### Key Audit Matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the financial statements for the year ended December 31, 2017. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

The key audit matters in the audit of the financial statement of the Company are stated below:

<u>Deferred Income Tax Assets</u>

Due to suffering tax losses in previous years, the Company was granted loss carryforwards which can be used against taxable income in a certain period. The Company recognized the loss carryforwards as deferred tax assets to the extent that the taxable profit in the future will be available against the loss carryforwards. As of December 31, 2017, the Company recognized tax losses as deferred tax assets, in New Taiwan dollars (NT$), in the amount of NT$779,769 thousand. Refer to Notes 4, 5 and 27 in the accompanying financial statement for the related detailed information.

The difference between the amount representative of the Company's financial position and its tax base are material to the financial statements as a whole in the aviation industry. Moreover, deferred tax assets arising from tax losses are dependent on future taxable income and the reversal of existing taxable temporary differences, which involve management's judgment when assessing the realization of tax losses. As there is a significant level of judgment involved in valuing the deferred tax assets, we have deemed this to be a key audit matter.

The following are the main audit procedures for the key audit matter mentioned above:

1. Acquiring the internal financial forecasts and the estimate of future taxable income, and reviewing the rationality of management's assumptions.

2. Acquiring information about the differences between the Company's financial position and its tax base, and assessing the rationality of reconciliations and the realization schedule of temporary differences to verify whether they are consistent with management's financial forecasts.

<u>Impairment Loss of Noncurrent Assets Held for Sale</u>

The board of directors of the Company resolved to dispose of several aircrafts. According to IFRS 5 "Non-current Assets Held for Sale and Discontinued Operations", impairment losses from the disposal of aircrafts were recognized as the differences between the expected transaction value and the carrying amount of the aircrafts, and then the aircrafts were reclassified as noncurrent assets held for sale. As of December 31, 2017, the carrying amount of the aircrafts held for sale was NT$309,330 thousand, and the Company recognized an impairment loss of NT$3,571,301 thousand. Refer to Notes 4, 5 and 12 in the accompanying financial statements for the related detailed information.

Due to the lack of an open trading market for aircrafts, the range of disposal prices for aircrafts varies significantly, and the expected transaction value of aircrafts reflecting the carrying amount of noncurrent assets held for sale was difficult to evaluate. Therefore, we identified noncurrent assets held for sale as a key audit matter.

The following were the main audit procedures for the key audit matter mentioned above:

1. Reviewing the rationality of an assessment on the transaction value by obtaining reference prices from authoritative publications recognized within the aviation industry, historical selling prices of similar types of aircrafts, and the suggested price proposed by a broker and observing the subsequent transactions.

2. Discussing the status of the transaction with the department accountable for disposing of aircrafts, and reviewing whether the correspondences and the latest quote were consistent with the market value estimated by management.

<u>Acquisition Costs of a New Fleet</u>

In accordance with IAS 16 "Property, Plant and Equipment", acquisition costs of aircrafts should be allocated into several significant components, including airframe, airframe overhaul, engine, engine overhaul, landing gear, etc., and should be depreciated over different useful lives. As of December 31, 2017, the carrying amount of flight equipment was NT$125,442,997 thousand. Refer to Notes 4, 5 and 14 in the accompanying financial statements for the related detailed information.

Since the Company introduced a brand new fleet of A350-900 this year, the adjusted allocation base should be applied. Moreover, the carrying amount of flight equipment and the amount of depreciation expense recognized would be subject to the allocation of acquisition costs and the applied useful life, which were made in accordance with management's judgment. Therefore, we identified the acquisition costs of the new fleet as a key audit matter.

The following were the main audit procedures for the key audit matter mentioned above:

1. Reviewing the certificates issued by the aircraft and engine manufacturers, the suggested operating cost of the aircraft manufacturer, and the historical experience of the maintenance department to assess the rationale used to determine the division amount by management.

2. Conducting an assessment on the rationality of useful life on the basis of fleet performance in the industry, historical experience of fleet operations, and documents that described the basis used by management to determine the useful life of its new fleet.

**Responsibilities of Management and Those Charged with Governance for the Financial Statements**

Management is responsible for the preparation and fair presentation of the financial statements in accordance with the Regulations Governing the Preparation of Financial Reports by Securities Issuers, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is responsible for assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Company or to cease operations, or has no realistic alternative but to do so.

Those charged with governance, including the audit committee and supervisors, are responsible for overseeing the Company's financial reporting process.

**Auditors' Responsibilities for the Audit of the Financial Statements**

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with the auditing standards generally accepted in the Republic of China will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with the auditing standards generally accepted in the Republic of China, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

1. Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

2. Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control.

3. Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.

4. Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditors' report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditors' report. However, future events or conditions may cause the Company to cease to continue as a going concern.

5. Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

6. Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Company to express an opinion on the financial statements. We are responsible for the direction, supervision and performance of the audit. We remain solely responsible for our audit opinion.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the financial statements for the year ended December 31, 2017 and are therefore the key audit matters. We describe these matters in our auditors' report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

The engagement partners on the audit resulting in this independent auditors' report are Chen-Hsin Yang and Li-Chi Chen.

Deloitte & Touche
Taipei, Taiwan
Republic of China

March 22, 2018

<u>*Notice to Readers*</u>

*The accompanying financial statements are intended only to present the financial position, financial performance and cash flows in accordance with accounting principles and practices generally accepted in the Republic of China and not those of any other jurisdictions. The standards, procedures and practices to audit such financial statements are those generally applied in the Republic of China.*

*For the convenience of readers, the independent auditors' report and the accompanying financial statements have been translated into English from the original Chinese version prepared and used in the Republic of China. If there is any conflict between the English version and the original Chinese version or any difference in the interpretation of the two versions, the Chinese-language independent auditors' report and financial statements shall prevail.*

## CHINA AIRLINES, LTD.

**BALANCE SHEETS**
**DECEMBER 31, 2017 AND 2016**
**(In Thousands of New Taiwan Dollars)**

| | 2017 | | 2016 | |
|---|---|---|---|---|
| **ASSETS** | **Amount** | **%** | **Amount** | **%** |
| CURRENT ASSETS | | | | |
| Cash and cash equivalents (Notes 4, 6 and 30) | $ 16,563,559 | 8 | $ 19,734,590 | 9 |
| Financial assets at fair value through profit or loss - current (Notes 4, 5, 7 and 30) | - | - | 1,200 | - |
| Derivative financial assets for hedging - current (Notes 4, 5, 8 and 30) | 293 | - | 51,403 | - |
| Receivables: | | | | |
| Notes and accounts, net (Notes 4, 5, 10 and 30) | 8,044,940 | 4 | 7,825,504 | 4 |
| Notes and accounts - related parties (Notes 30 and 31) | 510,588 | - | 439,509 | - |
| Other receivables | 532,974 | - | 833,754 | 1 |
| Current tax assets (Notes 4 and 27) | 24,096 | - | 21,652 | - |
| Inventories, net (Notes 4 and 11) | 8,610,958 | 4 | 8,338,980 | 4 |
| Noncurrent assets held for sale (Notes 4, 5 and 12) | 426,553 | - | 185,100 | - |
| Other current assets (Note 17) | 3,219,735 | 2 | 2,476,800 | 1 |
| Total current assets | 37,933,696 | 18 | 39,908,492 | 19 |
| NONCURRENT ASSETS | | | | |
| Derivative financial assets for hedging - noncurrent (Notes 4, 5, 8 and 30) | - | - | 3,268 | - |
| Financial assets carried at cost - noncurrent, net of current portion (Notes 9 and 30) | 64,177 | - | 120,200 | - |
| Investments accounted for using the equity method (Notes 4 and 13) | 11,551,369 | 5 | 10,051,325 | 5 |
| Property, plant and equipment (Notes 4, 5, 14 and 32) | 142,265,548 | 67 | 129,121,632 | 61 |
| Investment properties (Notes 4 and 15) | 2,047,448 | 1 | 2,047,448 | 1 |
| Other intangible assets (Notes 4 and 16) | 989,327 | 1 | 1,115,101 | - |
| Deferred tax assets (Notes 4, 5 and 27) | 4,974,941 | 2 | 5,749,714 | 3 |
| Other noncurrent assets (Notes 17, 20, 30, 32 and 33) | 12,091,486 | 6 | 23,422,263 | 11 |
| Total noncurrent assets | 173,984,296 | 82 | 171,630,951 | 81 |
| TOTAL | $ 211,917,992 | 100 | $ 211,539,443 | 100 |
| **LIABILITIES AND EQUITY** | | | | |
| CURRENT LIABILITIES | | | | |
| Financial liabilities at fair value through profit or loss - current (Notes 4, 5, 7 and 30) | $ 8,655 | - | $ - | - |
| Short-term bills payable (Note 18) | - | - | 900,000 | 1 |
| Derivative financial liabilities for hedging - current (Notes 4, 5, 8 and 30) | 77,639 | - | 20,854 | - |
| Notes and accounts payable (Note 30) | 297,952 | - | 638,876 | - |
| Notes and accounts payable - related parties (Notes 30 and 31) | 1,494,006 | 1 | 1,347,007 | 1 |
| Other payables (Notes 21 and 26) | 10,908,752 | 5 | 9,634,022 | 5 |
| Current tax liabilities (Notes 4 and 27) | 2 | - | 2 | - |
| Provisions - current (Notes 4, 5 and 23) | 406,457 | - | - | - |
| Deferred revenue - current (Notes 4, 5 and 22) | 14,048,025 | 7 | 13,404,227 | 6 |
| Bonds payable and put option of convertible bonds - current portion (Notes 4, 19, 25, 30 and 31) | 4,367,100 | 2 | 2,700,000 | 1 |
| Loans and debts - current (Notes 18, 30 and 32) | 18,814,633 | 9 | 31,816,140 | 15 |
| Capital lease obligations - current portion (Notes 4, 20, 30 and 32) | 1,580,000 | 1 | 1,254,000 | 1 |
| Other current liabilities (Note 30) | 2,922,143 | 1 | 2,624,677 | 1 |
| Total current liabilities | 54,925,364 | 26 | 64,339,805 | 31 |
| NONCURRENT LIABILITIES | | | | |
| Financial liabilities at fair value through profit or loss - noncurrent (Notes 4, 5, 7 and 30) | 926 | - | - | - |
| Derivative financial liabilities for hedging - noncurrent (Notes 4, 5, 8 and 30) | 6,994 | - | 2,775 | - |
| Bonds payable - noncurrent (Notes 4, 19, 25, 30 and 31) | 21,350,000 | 10 | 19,838,044 | 9 |
| Loans and debts - noncurrent (Notes 18, 30 and 32) | 61,907,978 | 29 | 52,833,478 | 25 |
| Provisions - noncurrent (Notes 4, 5 and 23) | 7,352,194 | 4 | 6,770,951 | 3 |
| Deferred tax liabilities (Notes 4 and 27) | 38,946 | - | 114,772 | - |
| Capital lease obligations - noncurrent (Notes 4, 20, 30 and 32) | 596,000 | - | 3,562,000 | 2 |
| Deferred revenue - noncurrent (Notes 4, 5 and 22) | 1,818,265 | 1 | 1,808,903 | 1 |
| Accrued pension costs (Notes 4, 5 and 24) | 6,158,744 | 3 | 6,217,346 | 3 |
| Other noncurrent liabilities (Note 30) | 739,344 | - | 267,552 | - |
| Total noncurrent liabilities | 99,969,391 | 47 | 91,415,821 | 43 |
| Total liabilities | 154,894,755 | 73 | 155,755,626 | 74 |
| EQUITY (Notes 19 and 25) | | | | |
| Share capital | 54,709,846 | 26 | 54,708,901 | 26 |
| Capital surplus | 799,999 | - | 799,932 | - |
| Retained earnings | | | | |
| Legal reserve | 206,092 | - | 287,224 | - |
| Special reserve | - | - | 76,486 | - |
| Unappropriated retained earnings (accumulated deficit) | 1,458,313 | 1 | (157,618) | - |
| Total retained earnings | 1,664,405 | 1 | 206,092 | - |
| Other equity | (107,641) | - | 112,264 | - |
| Treasury shares | (43,372) | - | (43,372) | - |
| Total equity | 57,023,237 | 27 | 55,783,817 | 26 |
| TOTAL | $ 211,917,992 | 100 | $ 211,539,443 | 100 |

The accompanying notes are an integral part of the financial statements.

# CHINA AIRLINES, LTD.

**STATEMENTS OF COMPREHENSIVE INCOME**
**FOR THE YEARS ENDED DECEMBER 31, 2017 AND 2016**
**(In Thousands of New Taiwan Dollars, Except Earnings Per Share)**

| | 2017 | | 2016 | |
|---|---|---|---|---|
| | **Amount** | **%** | **Amount** | **%** |
| REVENUE (Notes 4, 26 and 31) | $ 139,815,211 | 100 | $ 127,524,864 | 100 |
| COSTS (Notes 4, 8, 11, 24, 26 and 31) | 121,848,814 | 87 | 112,248,884 | 88 |
| GROSS PROFIT | 17,966,397 | 13 | 15,275,980 | 12 |
| OPERATING EXPENSES (Notes 4, 24, 26 and 31) | 10,608,283 | 8 | 10,800,273 | 9 |
| OPERATING PROFIT | 7,358,114 | 5 | 4,475,707 | 3 |
| NONOPERATING INCOME AND EXPENSES | | | | |
| Other income (Notes 9 and 26) | 360,980 | - | 593,451 | 1 |
| Other gains and losses (Notes 8, 9, 12, 13, 14 and 26) | (4,980,870) | (3) | (2,410,921) | (2) |
| Finance cost (Notes 8, 26 and 31) | (1,277,807) | (1) | (1,221,588) | (1) |
| Share of the profit of associates and joint ventures (Note 13) | 1,627,786 | 1 | 100,602 | - |
| Total nonoperating income and expenses | (4,269,911) | (3) | (2,938,456) | (2) |
| PROFIT BEFORE INCOME TAX | 3,088,203 | 2 | 1,537,251 | 1 |
| INCOME TAX EXPENSE (Notes 4, 5 and 27) | 880,137 | - | 965,711 | 1 |
| NET INCOME | 2,208,066 | 2 | 571,540 | - |
| OTHER COMPREHENSIVE INCOME | | | | |
| Items that will not be reclassified subsequently to profit or loss: | | | | |
| Remeasurement of defined benefit plans (Notes 4 and 24) | (645,219) | (1) | (589,382) | - |
| Share of the other comprehensive loss of associates and joint ventures accounted for using the equity method | (211,952) | - | (234,797) | - |
| Income tax relating to items that will not be reclassified subsequently to profit or loss (Note 27) | 109,687 | - | 100,195 | - |

(Continued)

## CHINA AIRLINES, LTD.

**STATEMENTS OF COMPREHENSIVE INCOME**
**FOR THE YEARS ENDED DECEMBER 31, 2017 AND 2016**
**(In Thousands of New Taiwan Dollars, Except Earnings Per Share)**

| | 2017 | | 2016 | |
|---|---|---|---|---|
| | **Amount** | **%** | **Amount** | **%** |
| Items that may be reclassified subsequently to profit or loss: | | | | |
| Exchange differences on translating foreign operations (Notes 4 and 25) | $ (134,857) | - | $ (80,104) | - |
| Cash flow hedges (Notes 4 and 25) | (116,580) | - | 300,109 | - |
| Share of the other comprehensive loss of associates and joint ventures accounted for using the equity method (Notes 4 and 25) | (11,212) | - | (4,057) | - |
| Income tax relating to items that may be reclassified subsequently to profit or loss (Notes 25 and 27) | 42,744 | - | (37,401) | - |
| Other comprehensive loss for the year, net of income tax | (967,389) | (1) | (545,437) | - |
| TOTAL COMPREHENSIVE INCOME FOR THE YEAR | $ 1,240,677 | 1 | $ 26,103 | - |
| EARNINGS PER SHARE (NEW TAIWAN DOLLARS; Note 28) | | | | |
| Basic | $ 0.40 | | $ 0.10 | |
| Diluted | $ 0.39 | | $ 0.10 | |

The accompanying notes are an integral part of the financial statements. (Concluded)

## CHINA AIRLINES, LTD.

**STATEMENTS OF CHANGES IN EQUITY**
**FOR THE YEARS ENDED DECEMBER 31, 2017 AND 2016**
**(In Thousands of New Taiwan Dollars)**

| | | | Retained Earnings | | | Other Equity | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Share Capital | Capital Surplus | Legal Reserve | Special Reserve | Unappropriated Earnings (Accumulated Deficit) | Exchange Differences on Translating Foreign Operations | Unrealized Gain (Loss) on Available-for-sale Financial Assets | Cash Flow Hedges | Treasury Shares Held by Subsidiaries | Total Equity |
| BALANCE AT JANUARY 1, 2016 | $ 54,708,901 | $ 798,415 | $ - | $ - | $ 2,872,235 | $ 157,959 | $ 1,755 | $ (225,997) | $ (43,372) | $ 58,269,896 |
| Change in capital surplus from investments in associates and joint ventures accounted for using the equity method | - | - | - | - | (1,638) | - | - | - | - | (1,638) |
| Difference between cost of the acquisition of subsidiaries and net value | - | - | - | - | (3,536) | - | - | - | - | (3,536) |
| Appropriation of 2015 earnings | | | | | | | | | | |
| Legal reserve | - | - | 287,224 | - | (287,224) | - | - | - | - | - |
| Special reserve | - | - | - | 76,486 | (76,486) | - | - | - | - | - |
| Cash dividends - $0.458522382 per share | - | - | - | - | (2,508,525) | - | - | - | - | (2,508,525) |
| Change in capital surplus from dividends distributed to subsidiaries | - | 1,517 | - | - | - | - | - | - | - | 1,517 |
| Net income for the year ended December 31, 2016 | - | - | - | - | 571,540 | - | - | - | - | 571,540 |
| Other comprehensive income (loss) for the year ended December 31, 2016, net of income tax | - | - | - | - | (723,984) | (79,395) | (41) | 257,983 | - | (545,437) |
| Total comprehensive income (loss) for the year ended December 31, 2016 | - | - | - | - | (152,444) | (79,395) | (41) | 257,983 | - | 26,103 |
| BALANCE AT DECEMBER 31, 2016 | 54,708,901 | 799,932 | 287,224 | 76,486 | (157,618) | 78,564 | 1,714 | 31,986 | (43,372) | 55,783,817 |
| Compensation of deficit - capital surplus | - | - | (81,132) | (76,486) | 157,618 | - | - | - | - | - |
| Convertible bonds converted to common shares | 945 | 131 | - | - | - | - | - | - | - | 1,076 |
| Change in capital surplus from investments in associates and joint ventures accounted for using the equity method | - | (64) | - | - | - | - | - | - | - | (64) |
| Difference between cost of the acquisition of subsidiaries and net value | - | - | - | - | (2,269) | - | - | - | - | (2,269) |
| Net income for the year ended December 31, 2017 | - | - | - | - | 2,208,066 | - | - | - | - | 2,208,066 |
| Other comprehensive income (loss) for the year ended December 31, 2017, net of income tax | - | - | - | - | (747,484) | (113,550) | 60 | (106,415) | - | (967,389) |
| Total comprehensive income (loss) for the year ended December 31, 2017 | - | - | - | - | 1,460,582 | (113,550) | 60 | (106,415) | - | 1,240,677 |
| BALANCE AT DECEMBER 31, 2017 | $ 54,709,846 | $ 799,999 | $ 206,092 | $ - | $ 1,458,313 | $ (34,986) | $ 1,774 | $ (74,429) | $ (43,372) | $ 57,023,237 |

The accompanying notes are an integral part of the financial statements.

# CHINA AIRLINES, LTD.

**STATEMENTS OF CASH FLOWS**
**FOR THE YEARS ENDED DECEMBER 31, 2017 AND 2016**
**(In Thousands of New Taiwan Dollars)**

| | 2017 | 2016 |
|---|---|---|
| CASH FLOWS FROM OPERATING ACTIVITIES | | |
| Income before income tax | $ 3,088,203 | $ 1,537,251 |
| Adjustments to reconcile pretax profit to net cash generated from (used in) operating activities: | | |
| Bad-debt expenses | 50,000 | 49,878 |
| Depreciation expenses | 17,375,194 | 16,588,758 |
| Amortization expenses | 247,725 | 138,554 |
| Net loss on fair value change of financial assets and liabilities held for trading | 33,385 | 29,909 |
| Interest income | (176,329) | (188,006) |
| Dividend income | (9,564) | (59,099) |
| Share of profit of associates and joint ventures | (1,627,786) | (100,602) |
| Loss on disposal of financial assets carried at cost | - | 346 |
| Gain on disposal of property, plant and equipment | (5,839) | (80,617) |
| Gain on disposal of investments accounted for using the equity method | (101,105) | - |
| (Gain) loss on disposal of noncurrent assets held for sale | (252,467) | 26,429 |
| Loss on inventories and property, plant and equipment | 642,423 | 207,019 |
| Impairment loss recognized on property, plant and equipment | 690,579 | 717,758 |
| Net gain on foreign currency exchange | (343,681) | (10,773) |
| Loss on repurchase of bonds payable | - | 41,943 |
| Finance costs | 1,277,807 | 1,221,588 |
| Recognition of provisions | 2,524,079 | 2,011,115 |
| Amortization of unrealized gain on sale-leasebacks | (14,512) | (14,512) |
| Impairment loss recognized on financial assets carried at cost | 56,023 | - |
| Impairment loss recognized on noncurrent assets held for sale | 3,571,301 | 347,868 |
| Changes in operating assets and liabilities | | |
| Financial assets held for trading | (32,185) | 134,448 |
| Financial liabilities held for trading | 9,580 | - |
| Derivative financial assets for hedging | - | 13,096 |
| Notes and accounts receivable | (271,309) | (785,159) |
| Accounts receivable - related parties | (71,079) | 106,633 |
| Other receivables | 266,338 | (61,401) |
| Inventories | (591,043) | (359,928) |
| Other current assets | (733,731) | (355,393) |
| Notes and accounts payable | (305,161) | (353,373) |
| Accounts payable - related parties | 146,999 | (668) |
| Other payables | 2,073,621 | (1,490,845) |
| Deferred revenue | 653,161 | 1,398,073 |
| Provisions | (1,138,140) | (366,218) |
| Other current liabilities | 157,417 | 275,042 |
| Accrued pension liabilities | (703,821) | (3,337,565) |
| Cash generated from operations | 26,486,083 | 17,281,549 |
| Interest received | 192,138 | 178,640 |
| Dividends received | 639,454 | 893,380 |

(Continued)

## CHINA AIRLINES, LTD.

**STATEMENTS OF CASH FLOWS**
**FOR THE YEARS ENDED DECEMBER 31, 2017 AND 2016**
**(In Thousands of New Taiwan Dollars)**

| | 2017 | 2016 |
|---|---|---|
| Interest paid | $ (1,245,421) | $ (1,121,355) |
| Income tax paid | (31,203) | (44,606) |
| Net cash generated from operating activities | 26,041,051 | 17,187,608 |
| CASH FLOWS FROM INVESTING ACTIVITIES | | |
| Proceeds of the sale of financial assets carried at cost | - | 5,579 |
| Acquisition of investments accounted for by the equity method | (1,240,837) | (100,000) |
| Payments for property, plant and equipment | (953,218) | (2,196,021) |
| Proceeds from disposal of property, plant and equipment | 82,534 | 514,561 |
| Proceeds from disposal of noncurrent assets held for sale | 1,128,472 | 384,285 |
| Proceeds from disposal of investments accounted for using the equity method | 380,850 | - |
| Increase in refundable deposits | (107,935) | (146,408) |
| Decrease in refundable deposits | 180,381 | 167,312 |
| Increase in prepayments for equipment | (24,215,469) | (24,724,783) |
| Refunds of prepayments for aircraft | - | 5,693,791 |
| Increase in computer software costs | (121,951) | (265,615) |
| Decrease in restricted assets | - | 206,714 |
| Net cash used in investing activities | (24,867,173) | (20,460,585) |
| CASH FLOWS FROM FINANCING ACTIVITIES | | |
| (Decrease) increase in short-term bills payable | (900,000) | 900,000 |
| Proceeds from issue of bonds payable | 5,850,000 | 10,000,000 |
| Exercise of put options of bonds payable | - | (994,705) |
| Repayments of bonds payable | (2,700,000) | (2,400,000) |
| Proceeds from long-term debts | 30,380,000 | 34,499,000 |
| Repayments of long-term debts and capital lease obligations | (36,947,007) | (35,052,725) |
| Proceeds of guarantee deposits received | 233,015 | 98,282 |
| Refunds of guarantee deposits received | (192,672) | (76,477) |
| Dividends paid to owners of the Company | - | (2,508,525) |
| Net cash (used in) generated from financing activities | (4,276,664) | 4,464,850 |
| EFFECTS OF EXCHANGE RATE CHANGES ON THE BALANCE OF CASH HELD IN FOREIGN CURRENCIES | (68,245) | 35,288 |
| NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS | (3,171,031) | 1,227,161 |
| CASH AND CASH EQUIVALENTS AT THE BEGINNING OF THE YEAR | 19,734,590 | 18,507,429 |
| CASH AND CASH EQUIVALENTS AT THE END OF THE YEAR | $ 16,563,559 | $ 19,734,590 |

The accompanying notes are an integral part of the financial statements.

(Concluded)

## 1. GENERAL INFORMATION

China Airlines, Ltd. (the "Company") was founded in 1959 and its shares have been listed on the Taiwan Stock Exchange since February 26, 1993. The Company primarily provides air transport services for passengers and cargo. Its other operations include (a) mail services; (b) ground services and routine aircraft maintenance; (c) major maintenance of flight equipment; (d) communications and data processing services to other airlines; (e) sale of aircraft parts, equipment and entire aircraft; and (f) leasing of aircrafts.

The major shareholders of the Company are the China Aviation Development Foundation (CADF) and the National Development Fund (NDF), Executive Yuan. As of both December 31, 2017 and 2016, CADF and NDF held a combined 43.63% of the Company's shares. As of December 31, 2017 and 2016, the Company had 12,654 and 12,657 employees, respectively.

## 2. APPROVAL OF FINANCIAL STATEMENTS

The financial statements were approved by the board of directors and authorized for issue on March 22, 2018.

## 3. APPLICATION OF NEW, AMENDED AND REVISED STANDARDS AND INTERPRETATIONS

a. Initial application of the amendments to the Regulations Governing the Preparation of Financial Reports by Securities Issuers (FSC) and the International Financial Reporting Standards (IFRS), International Accounting Standards (IAS), Interpretations of IFRS (IFRIC), and Interpretations of IAS (SIC) endorsed and issued into effect by the FSC

Except for the following, whenever applied, the initial application of the amendments to the Regulations Governing the Preparation of Financial Reports by Securities Issuers and the IFRSs endorsed and issued into effect by the FSC would not have any material impact on the Company's accounting policies:

Amendments to IAS 36 "Impairment of Assets"

The amendment "Disclosures for Non-financial Assets" clarifies that the recoverable amount of an asset or a cash-generating unit is disclosed only when an impairment loss on the asset has been recognized or reversed during the period. Furthermore, if the recoverable amount of an item of property, plant and equipment for which impairment loss has been recognized or reversed is the fair value less costs of disposal, the Company is required to disclose the fair value hierarchy. If the fair value measurements are categorized within Level 3, the valuation technique and key assumptions used to measure the fair value are disclosed. The discount rate used is disclosed if such fair value less costs of disposal is measured by using the present value technique. The amendment should be applied retrospectively starting from January 1, 2017. Refer to Notes 12 and 14 for the related disclosures.

Amendments to the Regulations Governing the Preparation of Financial Reports by Securities Issuers

The amendments include additions of several accounting items and requirements for disclosures of impairment of non-financial assets as a consequence of the IFRSs endorsed and issued into effect by the FSC. In addition, as a result of the post implementation review of IFRSs in Taiwan, the amendments also include an emphasis on certain recognition and measurement considerations and add requirements for disclosures of related party transactions and goodwill.

The amendments stipulate that other companies or institutions of which the chairman of the board of directors or president serves as the chairman of the board of directors or the president of the Company, or is the spouse or second immediate family of the chairman of the board of directors or president of the Company are deemed to have a substantive related party relationship, unless it can be demonstrated that no control, joint control, or significant influence exists. Furthermore, the amendments require the disclosure of the names of the related parties and the relationships with whom the Company has significant transactions. If the transactions or balance with a specific related party is 10% or more of the Company's respective total transactions or balance, such transactions should be separately disclosed by the name of each related party.

When the amendments are applied retrospectively from January 1, 2017, the disclosures of related party transactions and the impairment of goodwill are enhanced. Refer to Note 31 for related disclosures.

b. The Regulations Governing the Preparation of Financial Reports by Securities Issuers and the International Financial Reporting Standards (IFRS)

| New, Amended or Revised Standards and Interpretations (the "New IFRSs") | Effective Date Announced by IASB (Note 1) |
|---|---|
| Annual Improvements to IFRSs 2014-2016 Cycle | Note 2 |
| Amendment to IFRS 2 "Classification and Measurement of Share-based Payment Transactions" | January 1, 2018 |
| Amendments to IFRS 4 "Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts" | January 1, 2018 |
| IFRS 9 "Financial Instruments" | January 1, 2018 |
| Amendments to IFRS 9 and IFRS 7 "Mandatory Effective Date of IFRS 9 and Transition Disclosures" | January 1, 2018 |
| IFRS 15 "Revenue from Contracts with Customers" | January 1, 2018 |
| Amendments to IFRS 15 "Clarifications to IFRS 15 Revenue from Contracts with Customers" | January 1, 2018 |
| Amendment to IAS 7 "Disclosure Initiative" | January 1, 2017 |
| Amendments to IAS 12 "Recognition of Deferred Tax Assets for Unrealized Losses" | January 1, 2017 |
| Amendments to IAS 40 "Transfers of Investment Property" | January 1, 2018 |
| IFRIC 22 "Foreign Currency Transactions and Advance Consideration" | January 1, 2018 |

Note 1: Unless stated otherwise, the above New IFRSs are effective for annual periods beginning on or after their respective effective dates.

Note 2: The amendment to IFRS 12 is retrospectively applied for annual periods beginning on or after January 1, 2017; the amendment to IAS 28 is retrospectively applied for annual periods beginning on or after January 1, 2018.

1) IFRS 9 “Financial Instruments”

Classification, measurement and impairment of financial assets

With regard to financial assets, all recognized financial assets that are within the scope of IAS 39 “Financial Instruments: Recognition and Measurement” are subsequently measured at amortized cost or fair value. Under IFRS 9, the requirement for the classification of financial assets is stated below.

For the Company’s debt instruments that have contractual cash flows that are solely payments of principal and interest on the principal amount outstanding, their classification and measurement are as follows:

a) For debt instruments, if they are held within a business model whose objective is to collect contractual cash flows, the financial assets are measured at amortized cost and are assessed for impairment continuously with any impairment loss recognized in profit or loss. Interest revenue is recognized in profit or loss using the effective interest method; and

b) For debt instruments, if they are held within a business model whose objective is achieved by both the collecting of contractual cash flows and the selling of financial assets, the financial assets are measured at fair value through other comprehensive income (FVTOCI) and are assessed for impairment. Interest revenue is recognized in profit or loss using the effective interest method, and other gains or losses shall be recognized in other comprehensive income, except for impairment gains or losses and foreign exchange gains and losses. When the debt instruments are derecognized or reclassified, the cumulative gain or loss previously recognized in other comprehensive income is reclassified from equity to profit or loss.

Except for above, all other financial assets are measured at fair value through profit or loss. However, the Company may make an irrevocable election to present subsequent changes in the fair value of an equity investment (that is not held for trading) in other comprehensive income, with only dividend income generally recognized in profit or loss. No subsequent impairment assessment is required, and the cumulative gain or loss previously recognized in other comprehensive income cannot be reclassified from equity to profit or loss.

The Company analyzed the facts and circumstances of its financial assets that exist at December 31, 2017 and performed the assessment of the impact of IFRS 9 on the classification and measurement of financial assets. Under IFRS 9:

Unlisted shares measured at cost will be measured at fair value instead.

IFRS 9 requires impairment loss on financial assets to be recognized using the “Expected Credit Losses Model”. A loss allowance is required for financial assets measured at amortized cost, investments in debt instruments measured at FVTOCI, lease receivables, contract assets arising from IFRS 15 “Revenue from Contracts with Customers”, certain written loan commitments and financial guarantee contracts. A loss allowance for 12-month expected credit losses is required for a financial asset if its credit risk has not increased significantly since initial recognition. A loss allowance for full-lifetime expected credit losses is required for a financial asset if its credit risk has increased significantly since initial recognition and is not low. However, a loss allowance for full-lifetime expected credit losses is required for trade receivables that do not constitute a financing transaction.

For purchased or originated credit-impaired financial assets, the Company takes into account the expected credit losses on initial recognition in calculating the credit-adjusted effective interest rate. Subsequently, any changes in expected losses are recognized as a loss allowance with a corresponding gain or loss recognized in profit or loss.

The Company elects not to restate prior reporting periods when applying the requirements for the classification, measurement and impairment of financial assets under IFRS 9 with the cumulative effect of the initial application recognized at the date of initial application and will provide the disclosures related to the classification and the adjustment information upon initial application of IFRS 9.

The anticipated impact on assets, liabilities and equity of retrospective application of the requirements for the classification, measurement and impairment of financial assets as of January 1, 2018 is set out below:

| Impact on Assets and Equity | Carrying Amount as of December 31, 2017 | Adjustments Arising from Initial Application | Adjusted Carrying Amount as of January 1, 2018 |
|---|---|---|---|
| December 31, 2017 | | | |
| Noncurrent assets | | | |
| Financial assets at fair value through other comprehensive income | $ - | $ 107,196 | $ 107,196 |
| Financial assets carried at cost | 64,177 | (64,177) | - |
| Investments accounted for using the equity method | 11,551,369 | 4,491 | 11,555,860 |
| Total effect on assets | 211,917,992 | 47,510 | 211,965,502 |
| Equity | | | |
| Unappropriated retained earnings | 1,458,313 | 60 | 1,458,373 |
| Other equity | (107,641) | 47,450 | (60,191) |
| Total effect on equity | 57,023,237 | 47,510 | 57,070,747 |

Hedge accounting

The main changes in hedge accounting amended the application requirements for hedge accounting to better reflect the entity's risk management activities. Compared with IAS 39, the main changes include: (1) enhancing types of transactions eligible for hedge accounting, specifically broadening the risk eligible for hedge accounting of non-financial items; (2) changing the way hedging derivative instruments are accounted for to reduce profit or loss volatility; and (3) replacing retrospective effectiveness assessment with the principle of economic relationship between the hedging instrument and the hedged item.

2) IFRS 15 "Revenue from Contracts with Customers" and related amendments

IFRS 15 establishes principles for recognizing revenue that apply to all contracts with customers, and will supersede IAS 18 "Revenue", IAS 11 "Construction Contracts" and a number of revenue-related interpretations.

When applying IFRS 15, the Company recognizes revenue by applying the following steps:

- Identify the contract with the customer;
- Identify the performance obligations in the contract;
- Determine the transaction price;
- Allocate the transaction price to the performance obligations in the contract; and
- Recognize revenue when the Company satisfies a performance obligation.

In identifying performance obligations, IFRS 15 and the related amendments require that a good or service is distinct if it is capable of being distinct (for example, the Company regularly sells it separately) and the promise to transfer it is distinct within the context of the contract (i.e. the nature of the promise in the contract is to transfer each good or service individually rather than to transfer a combined output).

c. New IFRSs in issue but not yet endorsed and issued into effect by the FSC

| New IFRSs | Effective Date Announced by IASB (Note) |
|---|---|
| Annual Improvements to IFRSs 2015-2017 Cycle | January 1, 2019 |
| Amendments to IFRS 9 "Prepayment Features with Negative Compensation" | January 1, 2019 (Note 2) |
| Amendments to IFRS 10 and IAS 28 "Sale or Contribution of Assets between an Investor and its Associate or Joint Venture" | To be determined by IASB |
| IFRS 16 "Leases" | January 1, 2019 (Note 3) |
| IFRS 17 "Insurance Contracts" | January 1, 2021 |
| Amendments to IAS 28 "Long-term Interests in Associates and Joint Ventures" | January 1, 2019 |
| IFRIC 23 "Uncertainty Over Income Tax Treatments" | January 1, 2019 |

Note 1: Unless stated otherwise, the above New IFRSs are effective for annual periods beginning on or after their respective effective dates.

Note 2: The FSC permits the election for early adoption of the amendments starting from 2018.

Note 3: On December 19, 2017, the FSC announced that IFRS 16 will take effect starting from January 1, 2019.

IFRS 16 "Leases"

IFRS 16 sets out the accounting standards for leases that will supersede IAS 17 and a number of related interpretations.

Under IFRS 16, if the Company is a lessee, it shall recognize right-of-use assets and lease liabilities for all leases on the balance sheets except for low-value and short-term leases. The Company may elect to apply the accounting method similar to the accounting for operating leases under IAS 17 to the low-value and short-term leases. On the statements of comprehensive income, the Company should present the depreciation expense charged on right-of-use assets separately from the interest expense accrued on lease liabilities; interest is computed using the effective interest method. On the statements of cash flows, cash payments for the principal portion of lease liabilities are classified within financing activities; cash payments for the interest portion are classified within operating activities.

The application of IFRS 16 is not expected to have a material impact on the accounting of the Company as lessor.

When IFRS 16 becomes effective, the Company may elect to apply this standard either retrospectively to each prior reporting period presented or retrospectively with the cumulative effect of the initial application of this standard recognized at the date of initial application.

Except for the above impact, as of the date the financial statements were authorized for issue, the Company is continuously assessing the possible impact that the application of other standards and interpretations will have on the Company's financial position and financial performance, and will disclose the relevant impact when the assessment is completed.

## 4. SIGNIFICANT ACCOUNTING POLICIES

**Statement of Compliance**

The financial statements have been prepared in accordance with the Regulations Governing the Preparation of Financial Reports by Securities Issuers and IFRSs as endorsed and issued into effect by the FSC.

**Basis of Preparation**

The fair value measurements, which are grouped into Levels 1 to 3 based on the degree to which the fair value measurement inputs are observable and based on the significance of the inputs to the fair value measurement in its entirety, are described as follows:

a. Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities;

b. Level 2 inputs are inputs other than quoted prices included within Level 1 that are observable for an asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices); and

c. Level 3 inputs are unobservable inputs for an asset or liability.

When preparing these parent company only financial statements, the Company used the equity method to account for its investments in subsidiaries, associates and joint ventures. In order for the amounts of the net profit for the year, other comprehensive income for the year and total equity in the parent company only financial statements to be the same with the amounts attributable to the owners of the Company in its consolidated financial statements, adjustments arising from the differences in accounting treatments between the parent company only basis and the consolidated basis were made to investments accounted for using the equity method, the share of profit or loss of subsidiaries, associates and joint ventures, the share of other comprehensive income of subsidiaries, associates and joint ventures and the related equity items, as appropriate, in these parent company only financial statements.

**Current and Noncurrent Assets and Liabilities**

Current assets include:

a. Assets held primarily for the purpose of trading;

b. Assets expected to be realized within 12 months after the reporting period; and

c. Cash and cash equivalents unless the asset is restricted from being exchanged or used to settle a liability for at least 12 months after the reporting period.

Current liabilities include:

a. Liabilities held primarily for the purpose of trading;

b. Liabilities due to be settled within 12 months after the reporting period; and

c. Liabilities for which the Group does not have an unconditional right to defer settlement for at least 12 months after the reporting period.

Assets and liabilities that are not classified as current are classified as noncurrent.

## Foreign Currencies

In preparing the financial statements of the Company, transactions in currencies other than the Company's functional currency (i.e. foreign currencies) are recognized at the rates of exchange prevailing at the dates of the transactions. At the end of each reporting period, monetary items denominated in foreign currencies are retranslated at the rates prevailing at that date. Non-monetary items that are measured at historical cost in a foreign currency are not retranslated. Non-monetary items measured at fair value that are denominated in foreign currencies are retranslated at the rates prevailing at the date when the fair value was determined.

Exchange differences on monetary items arising from settlement or translation are recognized in profit or loss in the period in which they arise except for:

a. Exchange differences on foreign currency borrowings relating to assets under construction for future productive use, which are included in the cost of those assets when they are regarded as an adjustment to interest costs on those foreign currency borrowings;

b. Exchange differences on transactions entered into in order to hedge certain foreign currency risks.

Exchange differences arising on the retranslation of non-monetary items are included in profit or loss for the period except for exchange differences arising from the retranslation of non-monetary items in respect of which gains and losses are recognized directly in other comprehensive income, in which case, the exchange differences are also recognized directly in other comprehensive income.

For the purposes of presenting financial statements, the assets and liabilities of the Company's foreign operations are translated into New Taiwan dollars using exchange rates prevailing at the end of each reporting period. Income and expense items are translated at the average exchange rates for the period. Exchange differences arising are recognized in other comprehensive income (attributed to the owners of the Company and non-controlling interests as appropriate).

On the disposal of a foreign operation, all of the exchange differences accumulated in equity in respect of that operation attributable to the owners of the Company are reclassified to profit or loss.

## Cash Equivalents

Cash equivalents, consisting of commercial paper and time deposits, are highly liquid financial instruments with maturities of three months or less when acquired and with carrying amounts that approximate their fair values.

## Inventories

Inventories are primarily expendable and nonexpendable parts and materials, supplies used in operations and items for in-flight sale and are stated at the lower of cost or net realizable value. The costs of inventories sold or consumed are determined using the weighted-average method.

## Noncurrent Assets Held for Sale

Noncurrent assets are classified as held-for-sale if their carrying amount will be recovered principally through a sale transaction rather than through continuing use. This condition is regarded as met only when the sale is highly probable and the noncurrent asset is available for immediate sale in its present condition. To meet the criteria for the sale being highly probable, the appropriate level of management must be committed to the sale, which should be expected to qualify for recognition as a completed sale within one year from the date of classification.

Noncurrent assets classified as held-for-sale are measured at the lower of their previous carrying amount and fair value less costs to sell. Recognition of depreciation of those assets would cease.

**Investments Accounted for by the Equity Method**

Investments in subsidiaries, associates and jointly controlled entities are accounted for by the equity method.

a. Investment in subsidiaries

Subsidiaries (including special purpose entities) are the entities controlled by the Company.

Under the equity method, the investment is initially recognized at cost and the carrying amount is increased or decreased to recognize the Company's share of the profit or loss and other comprehensive income of the subsidiary after the date of acquisition. Besides, the Company also recognizes the Company's share of the change in other equity of the subsidiary.

Changes in the Company's ownership interests in subsidiaries that do not result in the Company's loss of control over the subsidiaries are accounted for as equity transactions. Any difference between the carrying amounts of the investment and the fair value of the consideration paid or received is recognized directly in equity.

When the Company's share of losses of a subsidiary equals or exceeds its interest in that subsidiary (which includes any carrying amount of the investment in subsidiary accounted for by the equity method and long-term interests that, in substance, form part of the Company's net investment in the subsidiary), the Company continues recognizing its share of further losses.

The acquisition cost in excess of the acquisition-date fair value of the identifiable net assets acquired is recognized as goodwill. Goodwill is not amortized. The acquisition-date fair value of the net identifiable assets acquired in excess of the acquisition cost is recognized immediately in profit or loss.

When the Company ceases to have control over a subsidiary, any retained investment is measured at fair value at that date and the difference between the previous carrying amount of the subsidiary attributable to the retained interest and its fair value is included in the determination of the gain or loss. Furthermore, the Company accounts for all amounts previously recognized in other comprehensive income in relation to that subsidiary on the same basis as would be required if the Company had directly disposed of the related assets or liabilities.

Profits and losses from downstream transactions with a subsidiary are eliminated in full. Profits and losses from upstream with a subsidiary and side stream transactions between subsidiaries are recognized in the Company's financial statements only to the extent of interests in the subsidiary that are not related to the Company.

b. Investments in associates and joint ventures

An associate is an entity over which the Company has significant influence and that is neither a subsidiary nor an interest in a joint venture. A joint venture is a joint arrangement whereby the Company and other parties that have joint control of the arrangement and the rights to the net assets of the arrangement.

The Company uses the equity method to account for its investments in associates and joint ventures.

Under the equity method, an investment in an associate and jointly controlled entity is initially recognized at cost and adjusted thereafter to recognize the Company's share of the profit or loss and other comprehensive income of the associate and jointly ventures. The Company also recognizes the changes in the Company's share of equity of associates and jointly ventures attributable to the Company.

When the Company subscribes for additional new shares of an associate and joint ventures at a percentage different from its existing ownership percentage, the resulting carrying amount of the investment differs from the amount of the Company's proportionate interest in the associate and joint ventures. The Company records such a difference as an adjustment to investments with the corresponding amount charged or credited to capital surplus. If the Company's ownership interest is reduced due to the subscription of additional new shares of the associate and jointly controlled entity, the proportionate amount of the gains or losses previously recognized in other comprehensive income in relation to that associate and joint ventures is reclassified to profit or loss on the same basis as would be required had the investee directly disposed of the related assets or liabilities. When the adjustment should be debited to capital surplus, but the capital surplus recognized from investments accounted for using the equity method is insufficient, the shortage is debited to retained earnings.

When the Company's share of losses of an associate and joint ventures equals or exceeds its interest in that associate and joint ventures which includes any carrying amount of the investment accounted for using the equity method and long-term interests that, in substance, form part of the Company's net investment in the associate and joint ventures entity, the Company discontinues recognizing its share of further losses. Additional losses and liabilities are recognized only to the extent that the Company has incurred legal obligations, or constructive obligations, or made payments on behalf of that associate and joint ventures.

Any excess of the cost of acquisition over the Company's share of the net fair value of the identifiable assets and liabilities of an associate and joint ventures recognized at the date of acquisition is recognized as goodwill, which is included within the carrying amount of the investment and is not amortized. Any excess of the Company's share of the net fair value of the identifiable assets and liabilities over the cost of acquisition, after reassessment, is recognized immediately in profit or loss.

The entire carrying amount of the investment (including goodwill) is tested for impairment as a single asset by comparing its recoverable amount with its carrying amount. Any impairment loss recognized forms part of the carrying amount of the investment. Any reversal of that impairment loss is recognized to the extent that the recoverable amount of the investment subsequently increases.

The Company discontinues the use of the equity method from the date on which it ceases to have significant influence and joint control. Any retained investment is measured at fair value at that date and the fair value is regarded as its fair value on initial recognition as a financial asset. The difference between the previous carrying amount of the associate and the jointly controlled entity attributable to the retained interest and its fair value is included in the determination of the gain or loss on disposal of the associate and the jointly controlled entity. The Company accounts for all amounts previously recognized in other comprehensive income in relation to that associate and the jointly controlled entity on the same basis as would be required if that associate had directly disposed of the related assets or liabilities.

When the Company transacts with its associate and joint ventures, profits and losses resulting from the transactions with the associate are recognized in the Company' financial statements only to the extent of interests in the associate and the jointly controlled entity that are not related to the Company.

**Property, Plant and Equipment**

Property, plant and equipment are tangible items that are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes and are expected to be used for more than one period. The cost of an item of property, plant and equipment shall be recognized as an asset if, and only if, it is probable that future economic benefits associated with the item will flow to the Company; and the cost of the item can be measured reliably. Property, plant and equipment are stated at cost less recognized accumulated depreciation and recognized accumulated impairment loss.

Freehold land is not depreciated.

Depreciation is recognized using the straight-line method. Each significant part is depreciated separately. The estimated useful lives, residual values and depreciation methods are reviewed at the end of each reporting period, with the effects of any changes in the estimates accounted for on a prospective basis.

Assets held under finance leases are depreciated over their expected useful lives on the same basis as owned assets. Assets are depreciated over the shorter of the lease term and their useful lives using the straight-line method.

Any gain or loss arising on the disposal or retirement of an item of property, plant and equipment is determined as the difference between the sales proceeds and the carrying amount of the asset and is recognized in profit or loss.

**Investment Properties**

Investment properties are properties held to earn rentals or for capital appreciation. Investment properties also include land held for a currently undetermined future use.

Investment properties are measured initially at cost, including transaction costs. Subsequent to initial recognition, investment properties are measured at cost less accumulated depreciation and accumulated impairment loss.

Any gain or loss arising on the derecognition of investment properties is calculated as the difference between the net disposal proceeds and the carrying amount of the asset and is included in profit or loss in the period in which the property is derecognized.

**Intangible Assets**

Intangible assets with finite useful lives that are acquired separately are initially measured at cost and subsequently measured at cost less accumulated amortization and accumulated impairment loss. Amortization is recognized on a straight-line basis. The estimated useful lifives, residual values, and amortization methods are reviewed at the end of each reporting period, with the effects of any changes in the estimates being accounted for on a prospective basis. The residual value of an intangible asset with a finite useful life shall be assumed to be zero unless the Company expects to dispose of the intangible asset before the end of its economic life.

**Impairment of Tangible and Intangible Assets Other Than Goodwill**

At the end of each reporting period, the Company reviews the carrying amounts of its tangible and intangible assets, excluding goodwill, to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss. When it is not possible to estimate the recoverable amount of an individual asset, the Company estimates the recoverable amount of the cash-generating unit to which the asset belongs. Corporate assets are allocated to the individual cash-generating units on a reasonable and consistent basis; otherwise, corporate assets are allocated to the smallest Company of cash-generating units on a reasonable and consistent allocation basis.

Intangible assets with indefinite useful lives and intangible assets not yet available for use are tested for impairment at least annually, and whenever there is an indication that the asset may be impaired.

The recoverable amount is the higher of fair value less costs to sell and value in use. In assessing value in use, the Company uses the estimated cash flows discounted by the future pre-tax discount rate, and the discount rate reflects current the market time value of money and the specific risks to the asset for estimated future cash flows not yet adjusting to the market.

If the recoverable amount of an asset or cash-generating unit is estimated to be less than its carrying amount, the carrying amount of the asset or cash-generating unit is reduced to its recoverable amount.

When an impairment loss subsequently is reversed, the carrying amount of the asset or cash-generating unit is increased to the revised estimate of its recoverable amount, but only to the extent of the carrying amount that would have been determined had no impairment loss been recognized for the asset or cash-generating unit in prior years. A reversal of an impairment loss is recognized in profit or loss.

**Financial Instruments**

Financial assets and financial liabilities are recognized when the Company becomes a party to the contractual provisions of the instruments.

Financial assets and financial liabilities are initially measured at fair value. Transaction costs that are directly attributable to the acquisition or issue of financial assets and financial liabilities (other than financial assets and financial liabilities at fair value through profit or loss) are added to or deducted from the fair value of the financial assets or financial liabilities, as appropriate, on initial recognition. Transaction costs directly attributable to the acquisition of financial assets or financial liabilities at fair value through profit or loss are recognized immediately in profit or loss.

a. Financial assets

   All regular way purchases or sales of financial assets are recognized and derecognized on a trade date basis. All regular way purchases or sales of financial assets means buy or sell financial assets in the period made by regulation or market convention.

   1) Measurement category

      Financial assets may be classified into the following specified categories: Financial assets at fair value through profit or loss, held-to maturity investments, available-for-sale financial assets and loans and receivables. The classification of financial assets depends on their nature and the purpose identified at their original recognition. The Company's financial assets consist of the following categories: Financial assets at fair value through profit or loss, available-for-sale financial assets and loans and receivables.

      a) Financial assets at fair value through profit or loss

         Financial assets are classified as at fair value through profit or loss when the financial asset is either held for trading or it is designated as at fair value through profit or loss.

         Financial assets at fair value through profit or loss are stated at fair value, with any gains or losses arising on remeasurement recognized in profit or loss. The net gain or loss recognized in profit or loss incorporates any dividend or interest earned on the financial asset. Fair value is determined in the manner described in Note 30.

      b) Loans and receivables

         Loans and receivables (including trade receivables, cash and cash equivalents, debt investments with no active market, and other receivables are measured using the effective interest method at amortized cost less any impairment, except for short-term receivables when the effect of discounting is immaterial.

2) Impairment of financial assets

Financial assets, other than those at fair value through profit or loss and available-for-sale financial assets, are assessed for indicators of impairment at the end of each reporting period. Financial assets are considered to be impaired when there is objective evidence that, as a result of one or more events that occurred after the initial recognition of the financial asset, the estimated future cash flows of the investment have been affected.

For financial assets measured at amortized cost, such as trade receivables and other receivables, assets are assessed for impairment on a collective basis even if they were assessed not to be impaired individually. Objective evidence of impairment for a portfolio of receivables could include the Group's past experience with collecting payments, an increase in the number of delayed payments in the portfolio past the average credit period of 60 days, as well as observable changes in national or local economic conditions that correlate with defaults on receivables.

For financial assets measured at amortized cost, the amount of the impairment loss recognized is the difference between such an asset's carrying amount and the present value of estimated future cash flows, discounted at the financial asset's original effective interest rate.

For financial assets measured at amortized cost, if, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized, the previously recognized impairment loss is reversed through profit or loss to the extent that the carrying amount of the investment (at the date the impairment is reversed) does not exceed what the amortized cost would have been had the impairment not been recognized.

For available-for-sale equity investments, a significant or prolonged decline in the fair value of the security below its cost is considered to be objective evidence of impairment.

For all other financial assets, objective evidence of impairment could include the following:

a) Significant financial difficulty of the issuer or counterparty;

b) Breach of contract, such as a default or delinquency in interest or principal payments;

c) It becoming probable that the borrower will enter bankruptcy or financial re-organization; or

d) The disappearance of an active market for that financial asset because of financial difficulties.

When an available-for-sale financial asset is considered to be impaired, cumulative gains or losses previously recognized in other comprehensive income are reclassified to profit or loss in the period.

In respect of available-for-sale equity securities, impairment loss previously recognized in profit or loss is not reversed through profit or loss. Any increase in fair value subsequent to an impairment loss is recognized in other comprehensive income. In respect of available-for-sale debt securities, impairment loss is subsequently reversed through profit or loss if an increase in the fair value of the investment can be objectively related to an event occurring after the recognition of the impairment loss.

For financial assets that are carried at cost, the amount of the impairment loss is measured as the difference between such an asset's carrying amount and the present value of the estimated future cash flows discounted at the current market rate of return for a similar financial asset. Such impairment loss will not be reversed in subsequent periods.

The carrying amount of a financial asset is reduced by the impairment loss directly for all financial assets with the exception of trade receivables and other receivables, where the carrying amount is reduced through the use of an allowance account. When a trade receivable and other receivables are considered uncollectable, it is written off against the allowance account. Subsequent recoveries of amounts previously written off are credited against the allowance account. Changes in the carrying amount of the allowance account are recognized in profit or loss except for uncollectable trade receivables and other receivables that are written off against the allowance account.

3) Derecognition of financial assets

The Company derecognizes a financial asset only when the contractual rights to the cash flows from the asset expire, or when it transfers the financial asset and substantially all the risks and rewards of ownership of the asset to another party.

On derecognition of a financial asset in its entirety, the difference between the asset's carrying amount and the sum of the consideration received and receivable and the cumulative gain or loss that had been recognized in other comprehensive income is recognized in profit or loss.

b. Equity instruments

Debt and equity instruments issued by the Company are classified as either financial liabilities or as equity in accordance with the substance of the contractual arrangements and the definitions of a financial liability and an equity instrument.

An equity instrument is the residual interest in any contract after all liabilities are deducted from the Company's assets. Equity instruments issued by the Company are recognized at the proceeds received, net of direct issue costs.

The repurchase of the Company's own equity instruments is recognized in and deducted directly from equity. No gain or loss is recognized in profit or loss on the purchase, sale, issuance or cancellation of the Company's own equity instruments.

c. Financial liabilities

1) Subsequent measurement

Except for derivative financial instruments, all the financial liabilities are measured at amortized cost using the effective interest method.

2) Derecognition of financial liabilities

The Company derecognizes financial liabilities only when the obligation is discharged, canceled or expired. The difference between the carrying amount of such a financial liability derecognized and the consideration paid, including any non-cash assets transferred or liabilities assumed, is recognized in profit or loss.

d. Convertible bonds

The component parts of compound instruments (i.e. convertible bonds) issued by the Company are classified separately as financial liabilities and equity in accordance with the substance of the contractual arrangements and the definitions of a financial liability and an equity instrument.

On initial recognition, the fair value of the liability component is estimated using the prevailing market interest rate for similar non-convertible instruments. This amount is recorded as a liability on an amortized cost basis using the effective interest method until extinguished upon conversion or the instrument's maturity date. Any embedded derivative liability is measured at fair value.

The conversion option classified as equity is determined by deducting the amount of the liability component from the fair value of the compound instrument as a whole. This is recognized and included in equity, net of income tax effects, and is not subsequently remeasured. In addition, the conversion option classified as equity will remain in equity until the conversion option is exercised, in which case, the balance recognized in equity will be transferred to capital surplus - share premium. When the conversion option remains unexercised at maturity, the balance recognized in equity will be transferred to capital surplus - share premiums.

Transaction costs that relate to the issue of the convertible notes are allocated to the liability and equity components in proportion to the allocation of the gross proceeds. Transaction costs relating to the equity component are recognized directly in equity. Transaction costs relating to the liability component are included in the carrying amount of the liability component.

e. Derivative financial instruments

The Company enters into a variety of derivative financial instruments to manage its exposure to interest rate, foreign exchange rate and fuel price risks, including foreign exchange forward contracts, interest rate swaps, currency options and fuel swaps.

Derivatives are initially recognized at fair value at the date the derivative contracts are entered into and are subsequently remeasured to their fair value at the end of each reporting period. The resulting gain or loss is recognized in profit or loss immediately unless the derivative is designated and effective as a hedging instrument, in which event, the timing of the recognition in profit or loss depends on the nature of the hedging relationship. When the fair value of a derivative financial instrument is positive, the derivative is recognized as a financial asset; when the fair value of a derivative financial instrument is negative, the derivative is recognized as a financial liability.

**Hedge Accounting**

The Company enters into some derivative transactions that aim to manage interest rates, foreign exchange rates, fuel prices, and other factors affecting gains or losses on assets and liabilities. The hedging transactions are defined as cash flow hedges. When entering into hedging transactions, the Company has prepared official documents that describe the hedging relationship between hedging instruments and items which have been hedged, the objective of risk management, the hedging strategy, and the way to evaluate the effectiveness of the hedging instrument.

The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges is recognized in other comprehensive income. The gain or loss relating to the ineffective portion is recognized immediately in profit or loss.

The associated gains or losses that were recognized in other comprehensive income are reclassified from equity to profit or loss as a reclassification adjustment in the line item relating to the hedged item in the same period as when the hedged item affects profit or loss. If a hedge of a forecasted transaction subsequently results in the recognition of a non-financial asset or a non-financial liability, the associated gains and losses that were recognized in other comprehensive income are removed from equity and are included in the initial cost of the non-financial asset or non-financial liability.

Hedge accounting is discontinued prospectively when the Company revokes the designated hedging relationship, or when the hedging instrument expires or is sold, terminated, or exercised, or when it no longer meets the criteria for hedge accounting. The cumulative gain or loss on the hedging instrument that has been previously recognized in other comprehensive income from the period when the hedge was effective remains separately in equity until the forecasted transaction occurs. When a forecasted transaction is no longer expected to occur, the gain or loss accumulated in equity is recognized immediately in profit or loss.

**Provisions**

The Company recognizes provisions when the Company has a present obligation (legal or constructive) arising from past events (legal or constructive obligation), payment for the obligation is probable, and the expenditure for settling the obligation can be estimated reliably.

The amount recognized as a provision is the best estimate of the expenditure required to settle the present obligation, taking into account the risks and uncertainties surrounding the obligation as of the balance sheet date. When a provision is measured using the cash flows estimated to settle the present obligation, its carrying amount is the present value of those cash flows. When the aircraft lease contracts expire and will be returned to lessor, should assess if existing obligations exist and required to recognize as provision when signing of the lease contract.

**Revenue Recognition**

a. Rendering of services

   Passenger fares and cargo revenue are recognized when transport service is provided. The value of unused passenger tickets is recognized as “advance tickets - sales”.

b. Dividend and interest income

   Dividend income from investments is recognized when a shareholder’s right to receive payment has been established provided that it is probable that the economic benefits will flow to the Company and the amount of income can be measured reliably.

   Interest income from a financial asset is recognized when it is probable that the economic benefits will flow to the Company and the amount of income can be measured reliably. Interest income is accrued on a time basis, by reference to the principal outstanding and at the effective interest rate applicable.

**Leasing**

Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee. All other leases are classified as operating leases.

a. Financial leases

   <u>The Company as lessee</u>

   Assets held under finance leases are initially recognized as assets of the Company at the lower of their fair value at the inception of the lease or the present value of the minimum lease payments. The corresponding liability to the lessee is included in the balance sheets as a finance lease obligation.

Minimum lease payments are apportioned between finance expenses and reductions of the lease obligation so as to achieve a constant rate of interest on the remaining balance of the liability. Finance expenses are recognized immediately in profit or loss, unless they are directly attributable to qualifying assets, in which case, they are capitalized in accordance with the Company's general policy on borrowing costs. Contingent rentals are recognized as expenses in the periods in which they are incurred.

b. Sales and leasebacks

For a sale and leaseback transaction, if it meets the condition whereby all the risks and rewards of ownership of the leased asset are essentially transferred to the lessee, the sale and leaseback transaction is classified as a finance lease. If part of the significant risks and rewards of ownership of the leased asset remain with the lessor (i.e. the buyer), the sale and leaseback transaction is classified as an operating lease.

1) Financial leases

This transaction does not actually dispose of the assets. The accounting treatment used treats the transaction as if it did not occur, and the assets are continuously recognized at the book value of the asset before sale.

2) Operating leases

If the selling price is equal to the fair value, the transaction gain or loss should be recognized immediately. If the selling price is above fair value, the difference between the fair value and the book value of the gain or loss should be recognized immediately; only the part of the selling price which is above fair value shall be deferred and amortized over the period of the lease.

c. Operating lease

1) The Company as lessor

Rental income from operating leases is recognized on a straight-line basis over the term of the relevant lease unless another systematic basis is representative of the time pattern of the lessee's benefit from the use of the leased asset.

2) The Company as lessee

Operating lease payments are recognized as expenses on a straight-line basis over the lease term, except where another systematic basis is more representative of the time pattern in which economic benefits from the leased asset are consumed. Contingent rentals arising under operating leases are recognized as expenses in the period in which they are incurred.

In the event that lease incentives are received when entering into operating leases, such incentives are recognized as a liability. The aggregate benefit of incentives is recognized as a reduction of rental expense on a straight-line basis, except where another systematic basis is more representative of the time pattern in which economic benefits from the leased asset are consumed.

**Employee Benefits**

a. Short-term employee benefits

Liabilities recognized in respect of short-term employee benefits are measured at the undiscounted amount of the benefits expected to be paid in exchange for the related services.

b. Retirement benefits

Payments to the defined contribution retirement benefit plan are recognized as expenses when employees have rendered services entitling them to the contributions.

Defined benefit costs (including service cost, net interest and remeasurement) under the defined contribution retirement benefit plan are determined using the projected unit credit method. Service cost (including current service cost and past service cost) and net interest on the net defined benefit liabilities (assets) are recognized as employee benefits expense in the period in which they occur. Remeasurement, comprising actuarial gains and losses and the return on plan assets (excluding interest), is recognized in other comprehensive income in the period in which it occurs. Remeasurement recognized in other comprehensive income is reflected immediately in retained earnings and will not be reclassified to profit or loss.

Net defined benefit liabilities (assets) represent the actual deficit in the Company's defined benefit plans.

**Borrowing Costs**

Borrowing costs directly attributable to the acquisition, construction or production of qualifying assets (assets which are substantially ready for their intended use or sale through a fairly long period) are added to the cost of those assets, until such time as the assets are substantially ready for their intended use or sale.

Investment income earned on the temporary investment of specific borrowings pending their expenditure on qualifying assets is deducted from the borrowing costs eligible for capitalization.

Other than that which is stated above, all other borrowing costs are recognized in profit or loss in the period in which they are incurred.

**Frequent Flyer Programs**

The Company has a "Dynasty Flyer Program" through which program members can convert accumulated mileage to a cabin upgrade, free tickets and other member reward.

A portion of passenger revenue attributable to the rewards for the frequent flyer program is deferred. The entity should recognize this deferred revenue as revenue only when the entity has fulfilled its obligations on the granting of rewards or when the period for converting the mileage to rewards has expired.

**Share-based Payment Arrangements**

Equity-settled share-based payments to employees are measured at the fair value of the equity instruments at the grant date.

The fair value determined at the grant date of the equity-settled share-based payments is expensed on a straight-line basis over the vesting period, based on the Group's estimate of equity instrument that will eventually vest, with a corresponding increase in capital surplus - employee share options. The fair value determined at the grant date of the equity-settled share-based payments is recognized as an expense in full at the grant date when the granted share options vest immediately.

**Taxation**

Income tax expense represents the sum of the current tax and deferred tax.

a. Current tax

The current tax liabilities are based on current taxable profit. Since part of the income and expenses are taxable or deductible in other periods, or in accordance with the relevant tax laws are taxable or deductible, current taxable profit differs from net profit reported in the statements of comprehensive income.

The Company’s current tax liabilities are calculated by the tax rate was legislated or substantially legislated at the balance sheet date.

According to the Income Tax Law, an additional tax at 10% of unappropriated earnings is provided for as income tax in the year the shareholders approve the retention of these earnings.

Adjustments of prior years’ tax liabilities are added to or deducted from the current year’s tax provision.

b. Deferred tax

Deferred tax is recognized on temporary differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit. Deferred tax liabilities are generally recognized for all taxable temporary differences. Deferred tax assets are generally recognized for all deductible temporary differences, unused loss carryforwards and unused tax credits for purchases of machinery, equipment and technology, research and development expenditures, and personnel training expenditures to the extent that it is probable that taxable profit will be available against which those deductible temporary differences can be utilized.

Deferred tax liabilities are recognized for taxable temporary differences associated with investments in subsidiaries and associates and interests in joint ventures, except where the Company is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future. Deferred tax assets arising from deductible temporary differences associated with such investments and interests are only recognized to the extent that it is probable that there will be sufficient taxable profit against which to utilize the benefits of the temporary differences and they are expected to reverse in the foreseeable future.

The carrying amount of deferred tax assets is reviewed at the end of each reporting period and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the assets to be recovered. A previously unrecognized deferred tax asset is also reviewed at the end of each reporting period and recognized to the extent that it has become probable that future taxable profit will allow the deferred tax asset to be recovered.

Deferred tax liabilities and assets are measured at the tax rates that are expected to apply in the period in which the liabilities are settled or the assets are realized, based on tax rates (and tax laws) that have been enacted or substantively enacted by the end of the reporting period. The measurement of deferred tax liabilities and assets reflects the tax consequences that would follow from the manner in which the Company expects, at the end of the reporting period, to recover or settle the carrying amount of its assets and liabilities.

c. Current and deferred taxes for the year

Current and deferred taxes are recognized in profit or loss, except when they relate to items that are recognized in other comprehensive income or directly in equity, in which case, the current and deferred taxes are also recognized in other comprehensive income or directly in equity, respectively.

**Maintenance and Overhaul Costs**

Routine maintenance costs are recognized in profit or loss in the period in which they are incurred.

The overhaul costs of an owned or leased aircraft that meet the criteria for fixed asset capitalization and engines as replacement parts for aircraft and engines are capitalized and amortized over the expected annual overhaul cycle using the straight-line depreciation method.

## 5. CRITICAL ACCOUNTING JUDGMENTS AND KEY SOURCES OF ESTIMATION UNCERTAINTY

In the application of the Company's accounting policies shown on Note 4, management is required to make judgments, estimates and assumptions about the carrying amounts of assets and liabilities that are not readily apparent from other sources. The estimates and associated assumptions are based on historical experience and other factors that are considered relevant. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimates are revised if the revisions affect only that period or in the period of the revisions and future periods if the revisions affect both current and future periods.

### Key Sources of Estimation Uncertainty

The key assumptions concerning the future and other key sources of estimation uncertainty at the end of the reporting period that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below.

### Income Taxes

The Company is subject to income taxes in numerous jurisdictions. Where the final tax payable differs from the amounts that were initially recognized, these differences will affect the income tax and deferred tax provisions in the period in which the differences are determined. Deferred tax assets are recognized for deductible temporary differences to the extent that it is probable that taxable profit will be available against which the deductible temporary differences can be used. When evaluating the realizability of a deferred tax asset, management uses significant accounting judgments and estimates, including expected future revenue growth and profit margins, income tax exemption periods, the use of tax credits, tax planning and certain assumptions. Changes in the industry environment and regulations will result in a material adjustment of the deferred tax asset.

### Estimated Impairment of Trade Receivables

The Company assesses the receivables portfolio monthly for impairment. Impairment evidence may include observable changes in debtors' solvency and national or local economic conditions that correlate with defaults on receivables settlement. Management's analysis of expected cash flows is based on past experience of loss on assets with similar credit risk characteristics. The Company periodically reviews the methods of determining, and assumptions on, the expected amount and timing of cash flows to reduce the difference between the estimated and the actual losses.

### Fair Value of Derivatives and Other Financial Instruments

The Company's management uses its judgment in selecting an appropriate valuation technique for financial instruments with no quoted market prices in an active market. Valuation techniques commonly used by market practitioners are applied. For derivative financial instruments, assumptions are based on quoted market rates adjusted for specific features of the instruments. Other financial instruments are valued using a discounted cash flow analysis based on assumptions supported, where possible, by observable market prices, interest rates or oil prices (if applicable). The chosen valuation techniques and assumptions used may affect the fair value of financial instruments.

### Depreciation of Property, Plant and Equipment - Flight Equipment

Flight equipment is depreciated on a straight-line basis at rates that can be used to write down their cost to their estimated residual values at the end of their useful lives. The estimates of the useful lives and residual values of the flight equipment are made by the Company on the basis of past experience and fleet operation performance in the industry. Due to changes in the fleet plan, the board of directors of the Company has decided to change the useful lives of four 747-400 (GE) from 20 to 16-17 years since January 1, 2018 in order to meet the economic benefits and number of years of consumption. It is estimated that the depreciation expense will increase by approximately NT$770 million annually.

### Defined Benefit Obligations

The present value of defined benefit obligations at the end of the reporting period are calculated using actuarial assumptions. Those assumptions, which are based on management's judgment and estimates, comprise the discount rate and expected return on plan assets. Changes in actuarial assumptions may have a material impact on the amount of defined benefit obligations.

### Maintenance Reserve for Operating Lease Aircrafts

Maintenance reserve is based on the requirement under lease contracts to reflect maintenance costs that may arise on lease expirations. Estimation of this reserve is based on the past maintenance experience with the same or similar type of aircraft; incurred overhaul costs; and historical operating performance data. Changes in judgment or estimations may have a material impact on the amount of maintenance reserve.

### Frequent Flyer Programs

As stated in Note 4, "Frequent Flyer Programs", a portion of passenger revenue attributable to the awarding of frequent flyer benefits is deferred until the awards are given out. The deferment of the revenue is estimated on the basis of historical trends of breakage and redemption, which is then used to project the expected claiming of these benefits. Changes in fair value per mileage or the redemption rate may have a material impact on deferred revenue.

### Impairment of Flight Equipment

The impairment of flight equipment was based on the recoverable amount of those assets, which is the higher of fair value less costs to sell or value-in-use of those assets. Any changes in the market price or future cash flows will affect the recoverable amount of those assets and may lead to the recognition of additional or reversal of impairment losses.

### Impairment of Noncurrent Assets Held for Sale

When the carrying amount of noncurrent assets held for sale is lower than fair value, the difference between the carrying amount and fair value is recognized as impairment loss, and the fair value was determined based on the quote of potential buyers, the market price of similar assets, etc.

## 6. CASH AND CASH EQUIVALENTS

| | December 31 2017 | December 31 2016 |
|---|---|---|
| Cash on hand and revolving funds | $ 46,287 | $ 34,129 |
| Checking accounts and demand deposits | 8,284,609 | 7,208,550 |
| Cash equivalents | | |
| Time deposits with original maturities of less than three months | 3,098,063 | 3,078,150 |
| Repurchase agreements collateralized by bonds | 5,134,600 | 9,413,761 |
| | $ 16,563,559 | $ 19,734,590 |

The market rate intervals of cash in banks and cash equivalents at the end of the reporting period were as follows:

| | December 31 2017 | December 31 2016 |
|---|---|---|
| Bank balance | 0%-2% | 0.08%-2% |
| Time deposits with original maturities of less than three months | 0.59%-4.2% | 1.3%-12.9% |
| Repurchase agreements collateralized by bonds | 0.38%-2.2% | 0.42%-1.40% |

## 7. FINANCIAL INSTRUMENTS AT FAIR VALUE THROUGH PROFIT OR LOSS (FVTPL)

| | December 31 2017 | December 31 2016 |
|---|---|---|
| Financial assets held for trading - current | | |
| Derivative financial instruments (not under hedge accounting) | | |
| Foreign exchange forward contracts | $ - | $ 1,200 |
| Financial liabilities held for trading | | |
| Derivative financial instruments (not under hedge accounting) | | |
| Current | $ 8,655 | $ - |
| Noncurrent | 926 | - |
| | $ 9,581 | $ - |

At the end of the reporting period, outstanding foreign exchange forward contracts not under hedge accounting were as follows:

| | Currency | Maturity Date | Notional Amount (In Thousands) |
|---|---|---|---|
| December 31, 2017 | | | |
| Buy forward contracts | NTD/USD | 2018.01.13-2019.01.31 | NTD194,030/USD6,500 |
| December 31, 2016 | | | |
| Buy forward contracts | NTD/USD | 2017.01.26 | NTD32,258/USD1,000 |

## 8. DERIVATIVE FINANCIAL INSTRUMENTS FOR HEDGING

| | December 31 | |
|---|---|---|
| | 2017 | 2016 |
| Derivative financial assets under hedge accounting | | |
| Cash flow hedges | | |
| Foreign exchange forward contracts | $ 293 | $ 54,671 |
| Current | $ 293 | $ 51,403 |
| Noncurrent | - | 3,268 |
| | $ 293 | $ 54,671 |
| Derivative financial liabilities under hedge accounting | | |
| Cash flow hedges | | |
| Interest rate swaps | $ - | $ 3,855 |
| Foreign exchange forward contracts | 84,633 | 19,774 |
| | $ 84,633 | $ 23,629 |
| Current | $ 77,639 | $ 20,854 |
| Noncurrent | 6,994 | 2,775 |
| | $ 84,633 | $ 23,629 |

The fair value of each derivative contract is determined using quotes from financial institutions.

a. Interest rate swaps

The Company entered into interest rate swap contracts to mitigate the risk of changes in interest rates on the cash flow exposure related to the outstanding floating rate debt. All swapped fixed interest rate swap out the floating rate interest rate swap contracts are designated as cash flow hedges.

The outstanding interest rate swap contracts at the end of the reporting period were as follows:

| Notional Amount (In Thousands) | Maturity Date | Range of Interest Rates Paid | Range of Interest Rates Received |
|---|---|---|---|
| December 31, 2016 | | | |
| NT$ 2,500,000 | 2017.03.09-2017.06.22 | 1.01%-1.14% | TAIBOR rate |

The interest rate swaps settle on a quarterly basis. The Company will settle the difference between the fixed and floating interest rates on a net basis.

b. Foreign exchange forward contracts

The Company entered into foreign exchange forward contracts to minimize the risk of changes in foreign currency rates on the cash flow exposure related to fuel payments and aircraft payments, which will be paid in U.S. dollars.

The outstanding foreign exchange forward contracts at the end of the reporting period were as follows:

| | Currency | Maturity Date | Notional Amount (In Thousands) |
|---|---|---|---|
| December 31, 2017 | | | |
| Buy forward contracts | NTD/USD | 2018.01.16-2019.06.21 | NTD6,649,254/USD222,750 |
| December 31, 2016 | | | |
| Buy forward contracts | NTD/USD | 2017.01.13-2018.10.25 | NTD5,019,355/USD155,600 |

Gains and losses on hedging instruments reclassified from equity to profit or loss were included in the following line items in the statements of comprehensive income:

| | For the Year Ended December 31 | |
|---|---|---|
| | 2017 | 2016 |
| Increase in operating costs | $ (52,034) | $ (345,675) |
| Increase in finance costs | (2,814) | (10,390) |
| Other foreign exchange losses | (11,654) | (71,630) |
| | $ (66,502) | $ (427,695) |

The amount of gains and losses on hedging instruments for the year ended 2017 and 2016 reclassified from profit or loss to prepayments for equipment was $100,367 thousand and $154,970 thousand, respectively.

## 9. FINANCIAL ASSETS CARRIED AT COST

| | December 31 | | | |
|---|---|---|---|---|
| | 2017 | | 2016 | |
| | Carrying Amount | % of Ownership | Carrying Amount | % of Ownership |
| Unlisted common shares | | | | |
| Everest Investment Holdings Ltd. (AH) | $ 52,704 | 14 | $ 52,704 | 14 |
| Jardine Air Terminal Services | - | 15 | 56,023 | 15 |
| Chung Hwa Express Co. | 11,000 | 11 | 11,000 | 11 |
| | 63,704 | | 119,727 | |
| Unlisted preference shares | | | | |
| Everest Investment Holdings Ltd. (AH) | 473 | - | 473 | - |
| | $ 64,177 | | $ 120,200 | |
| Classified according to financial asset measurement categories | | | | |
| Available-for-sale financial assets | $ 64,177 | | $ 120,200 | |

On the reporting date, the above unlisted share investments held by the Company were measured at cost after deducting impairment losses because their ranges of reasonable fair value estimates were significant and unable to be reasonably evaluated. Thus, the management considered their fair values unable to be measured.

## 10. NOTES RECEIVABLE AND ACCOUNTS RECEIVABLE

| | December 31 | |
|---|---|---|
| | **2017** | **2016** |
| Notes receivable | $ 361,910 | $ 522,523 |
| Accounts receivable | | |
| Accounts receivable | 7,825,667 | 7,450,185 |
| Less: Allowance for impairment loss | (142,637) | (147,204) |
| | 7,683,030 | 7,302,981 |
| | $ 8,044,940 | $ 7,825,504 |

The average credit period was 7 to 45 days. In determining the recoverability of an account receivable, the Company considered any change in the credit quality of the account receivable since the date credit was initially granted to the end of the reporting period, and the allowance for impairment loss was based on the estimated irrecoverable amounts determined by reference to the Company's past default experience with the respective counterparties and analyses of their current financial positions.

Movements in the allowance for impairment loss recognized on notes receivable and accounts receivable were as follow:

| | For the Year Ended December 31 | |
|---|---|---|
| | **2017** | **2016** |
| Beginning balance | $ 147,204 | $ 99,788 |
| Impairment loss recognized on receivables | 50,000 | 49,878 |
| Amounts written off during current period | (54,567) | (2,462) |
| Ending Balance | $ 142,637 | $ 147,204 |

## 11. INVENTORIES

| | December 31 | |
|---|---|---|
| | **2017** | **2016** |
| Aircraft spare parts | $ 7,970,618 | $ 7,625,731 |
| Items for in-flight sale | 569,294 | 546,565 |
| Work in process - maintenance services | 71,046 | 166,684 |
| | $ 8,610,958 | $ 8,338,980 |

The operating costs for the years ended December 31, 2017 and 2016 included losses from inventory write-downs of $324,447 thousand and $196,000 thousand, respectively.

## 12. NONCURRENT ASSETS HELD FOR SALE

| | December 31 | |
|---|---|---|
| | 2017 | 2016 |
| Aircrafts held for sale | $ 309,330 | $ 185,100 |
| Long-term equity investments held for sale - Asian Compressor technology services | 117,223 | - |
| | $ 426,553 | $ 185,100 |

To enhance its competitiveness, the Company plans to introduce new aircrafts and retire old aircrafts according to a planned schedule. Such aircrafts, classified as noncurrent assets held for sale, had an original book value which was higher than the expected sale price and which was recognized as an impairment loss. However, the actual loss shall be identified by the actual sale price.

In 2017 and 2016, the Company recognized impairment losses of $3,571,301 thousand and $347,868 thousand, respectively. In 2017 and 2016, the Company recognized disposal gains and losses of $252,467 thousand and $(26,429) thousand, respectively. The fair value was determined by transactions of the related market, and the proposed sale price was based on the current status of the aircrafts. The fair value is classified as level 3.

Long-term equity investments in Asian Compressor Technology Services were reclassified to noncurrent assets held for sale. For related information, refer to Note 13,b.

## 13. INVESTMENTS ACCOUNTED FOR USING THE EQUITY METHOD

| | December 31 | |
|---|---|---|
| | 2017 | 2016 |
| Investments in subsidiaries | $ 9,827,299 | $ 7,925,771 |
| Investments in associates | 793,477 | 1,319,526 |
| Investments in jointly controlled entities | 930,593 | 806,028 |
| | $ 11,551,369 | $ 10,051,325 |

a. Investment in subsidiaries

| | December 31 | |
|---|---|---|
| | 2017 | 2016 |
| Unlisted companies | | |
| Cal Park | $ 1,522,696 | $ 1,529,375 |
| Mandarin Airlines | 1,211,739 | 1,125,057 |
| Cal-Dynasty International | 1,185,323 | 1,244,328 |
| Taiwan Air Cargo Terminal | 1,339,450 | 1,261,894 |
| Tigerair Taiwan Co., Ltd. | 915,135 | 362,861 |
| Taoyuan International Airport Services | 654,104 | 649,189 |
| Cal-Asia Investment | 478,933 | 450,305 |
| Sabre Travel Network (Taiwan) | 450,600 | 438,502 |
| Cal Hotel | 435,965 | 387,375 |
| Taiwan Airport Services | 259,459 | 231,316 |
| Hwa Hsia | 83,014 | 71,534 |

(Continued)

| | December 31 | |
|---|---|---|
| | 2017 | 2016 |
| Taiwan Aircraft Maintenance And Engineering Co., Ltd. | $ 1,231,548 | $ 110,128 |
| Yestrip | 25,904 | 25,464 |
| Dynasty Holidays | 25,992 | 30,961 |
| Global Sky Express | 7,437 | 7,418 |
| Freighter Princess Ltd. | - | 32 |
| Freighter Prince Ltd. | - | 32 |
| | $ 9,827,299 | $ 7,925,771 |

(Continued)

At the end of the reporting period, the proportion of ownership and voting rights in subsidiaries held by the Company were as follows:

| | December 31 | |
|---|---|---|
| | 2017 | 2016 |
| Tigerair Taiwan Co., Ltd. | 90% | 80% |
| Taiwan Air Cargo Terminal | 54% | 54% |
| Cal Park | 100% | 100% |
| Mandarin Airlines | 94% | 94% |
| Cal-Dynasty International | 100% | 100% |
| Taoyuan International Airport Services | 49% | 49% |
| Cal-Asia Investment | 100% | 100% |
| Sabre Travel Network (Taiwan) | 94% | 94% |
| Taiwan Airport Services | 47% | 47% |
| Cal Hotel | 100% | 100% |
| Hwa Hsia | 100% | 100% |
| Taiwan Aircraft Maintenance And Engineering Co., Ltd. | 100% | 100% |
| Dynasty Holidays | 51% | 51% |
| Yestrip | 100% | 100% |
| Global Sky Express | 25% | 25% |
| Freighter Princess Ltd. | - | 100% |
| Freighter Prince Ltd. | - | 100% |

Each of the Company's holdings of the issued share capital of Taoyuan International Airport Service, Taiwan Airport Service and Global Sky Express did not exceed 50%, but since the Company had control over these investees, they were listed as subsidiaries.

The Company liquidated Freighter Princess Ltd. and Freighter Prince Ltd., because the lease contracts related to these subsidiaries expired. A disposal loss of $61 thousand was recognized.

The Company increased its investment in Taiwan Aircraft Maintenance and Engineering Co., Ltd., with payments of $490,000 thousand, $700,000 thousand and $100,000 thousand in April and November 2017 and October 2016, respectively, for the purpose of building hangars.

The board of directors reached an agreement to purchase 10% of the shares of Tigerair Taiwan Co., Ltd., which was held by Roar Aviation III Pte. Ltd., in December 2016. The transaction was completed in January 2017.

The share of profit or loss of subsidiaries recognized under the equity method was as follows:

| | 2017 | 2016 |
|---|---|---|
| The share of profit or loss | $ 1,146,623 | $ (391,718) |

b. Investments in associates

| | December 31 | |
|---|---|---|
| | 2017 | 2016 |
| Unlisted companies | | |
| China Aircraft Services | $ 493,077 | $ 515,051 |
| Kaohsiung Catering Services | 300,400 | 267,371 |
| Asian Compressor Technology Services | - | 279,176 |
| Science Park Logistics | - | 257,928 |
| | $ 793,477 | $ 1,319,526 |

As the end of the reporting period, the proportion of ownership and voting rights in associates held by the Company were as follows:

| | December 31 | |
|---|---|---|
| | 2017 | 2016 |
| China Aircraft Services | 20% | 20% |
| Kaohsiung Catering Services | 36% | 36% |
| Asian Compressor Technology Services | - | 25% |
| Science Park Logistics | - | 26% |

The recognized investment income of associates accounted for using the equity method were as follows:

| | 2017 | 2016 |
|---|---|---|
| China Aircraft Services | $ 24,470 | $ 51,028 |
| Kaohsiung Catering Services | 86,757 | 75,674 |
| Asian Compressor Technology Services | 88,943 | 109,815 |
| Science Park Logistics | 21,819 | 26,136 |
| | $ 221,989 | $ 262,653 |

In August 2017, the Company sold all of its holdings of Science Park Logistics to a non-related party, HCT Logistics Co., Ltd. The agreed upon price was $380,850 thousand, and a disposal gain of $101,166 thousand was recognized.

In October 2017, the Company signed a contract with a non-related party, MB Aerospace, to sell all of its holdings of Asian Compressor Technology Services, and the Company reclassified its holdings of Asian Compressor Technology Services as noncurrent assets held for sale at book value. The transaction was completed and all payments were settled in January 2018.

c. Investments in jointly controlled entities

The investments in jointly controlled entities were as follows:

| | December 31 | |
|---|---|---|
| | **2017** | **2016** |
| China Pacific Catering Services | $ 756,965 | $ 638,980 |
| China Pacific Laundry Services | 171,229 | 167,048 |
| Nordam Asia | 2,399 | - |
| | $ 930,593 | $ 806,028 |

At the end of the reporting period, the percentages of ownership and voting rights in jointly controlled entities held by the Company were as follows:

| | December 31 | |
|---|---|---|
| | **2017** | **2016** |
| China Pacific Catering Services | 51% | 51% |
| China Pacific Laundry Services | 55% | 55% |
| Nordam Asia | 49% | - |

The Company signed a joint venture agreement with the Taikoo Company to invest in China Pacific Catering Services and China Pacific Laundry Services. According to the agreement, both parties have the majority power in the board of directors to pose a motion for veto, and therefore the Company does not have control.

To enhance the Company's maintenance capabilities, the Company established a joint venture with the US Nordam Aerospace Company in December 2017 to provide thrust reversers and composite repair services in Asia under the Nordam brand.

Details of the investment income attributable to investments in jointly controlled entities were as follows:

| | December 31 | |
|---|---|---|
| | **2017** | **2016** |
| China Pacific Catering Services | $ 235,871 | $ 208,039 |
| China Pacific Laundry Services | 23,354 | 21,628 |
| Nordam Asia | (51) | - |
| | $ 259,174 | $ 229,667 |

The Company’s shares of other comprehensive income of subsidiaries, associates and jointly controlled entities were losses of $(223,164) thousand and $(238,854) thousand in 2017 and 2016, respectively.

The financial statements used as a basis of the amounts of and related information on the investments accounted for using the equity method and the share of profit or loss and other comprehensive income of those investments for the years ended December 31, 2017 and 2016 were all independently audited, except of China Aircraft Services and Nordam Asia Limited. However, the management determined that there would have been no significant adjustments had this investee’s financial statements been independently audited.

For details on services, major business offices and the country where the above associates and jointly controlled entities are registered, refer to Table 6, "Names, Locations, And Other Information of Investees Over Which the Company Exercises Significant Influence" and, Table 7, "Investments In Mainland China", following the Notes to Financial Statements.

## 14. PROPERTY, PLANT AND EQUIPMENT

| | Freehold Land | Buildings | Flight Equipment | Equipment under Finance Leases | Others | Total |
|---|---|---|---|---|---|---|
| Cost | | | | | | |
| Balance at January 1, 2016 | $ 193,013 | $ 7,323,803 | $ 228,454,181 | $ 27,481,679 | $ 5,892,037 | $ 269,344,713 |
| Additions | - | 61,704 | 1,814,211 | - | 320,106 | 2,196,021 |
| Disposals | - | (108,160) | (6,336,888) | (393,403) | (158,177) | (6,996,628) |
| Reclassification | - | 406 | 22,377,045 | 1,218,979 | 22,261 | 23,618,691 |
| Balance at December 31, 2016 | $ 193,013 | $ 7,277,753 | $ 246,308,549 | $ 28,307,255 | $ 6,076,227 | $ 288,162,797 |
| Accumulated depreciation and impairment | | | | | | |
| Balance at January 1, 2016 | $ - | $ (3,449,160) | $ (128,886,336) | $ (13,715,235) | $ (4,847,510) | $ (150,898,241) |
| Depreciation expense | - | (174,689) | (14,058,579) | (2,031,998) | (323,492) | (16,588,758) |
| Disposals | - | 73,847 | 5,609,896 | 393,403 | 155,518 | 6,232,664 |
| Impairment losses | - | - | (717,758) | - | - | (717,758) |
| Reclassification | - | - | 2,923,255 | 6,690 | 983 | 2,930,928 |
| Balance at December 31, 2016 | $ - | $ (3,550,002) | $ (135,129,522) | $ (15,347,140) | $ (5,014,501) | $ (159,041,165) |
| Cost | | | | | | |
| Balance at January 1, 2017 | $ 193,013 | $ 7,277,753 | $ 246,308,549 | $ 28,307,255 | $ 6,076,227 | $ 288,162,797 |
| Additions | - | 32,517 | 662,706 | - | 257,995 | 953,218 |
| Disposals | - | (5,942) | (4,549,486) | (479,936) | (211,216) | (5,246,580) |
| Reclassification | - | - | 18,692,862 | (2,232,883) | 40,430 | 16,500,409 |
| Balance at December 31, 2017 | $ 193,013 | $ 7,304,328 | $ 261,114,631 | $ 25,594,436 | $ 6,163,436 | $ 300,369,844 |
| Accumulated depreciation and impairment | | | | | | |
| Balance at January 1, 2017 | $ - | $ (3,550,002) | $ (135,129,522) | $ (15,347,140) | $ (5,014,501) | $ (159,041,165) |
| Depreciation expense | - | (170,979) | (15,017,928) | (1,889,207) | (297,080) | (17,375,194) |
| Disposals | - | 3,926 | 4,022,065 | 619,775 | 200,761 | 4,846,527 |
| Impairment losses | - | - | (690,579) | - | - | (690,579) |
| Reclassification | - | - | 11,144,330 | 3,003,549 | 8,236 | 14,156,115 |
| Balance at December 31, 2017 | $ - | $ (3,717,055) | $ (135,671,634) | $ (13,613,023) | $ (5,102,584) | $ (158,104,296) |

Reclassification is mainly from prepaid equipment.

The above items of property, plant and equipment were depreciated on a straight-line basis over the estimated useful life of the asset:

| | |
|---|---|
| Building | |
| Main buildings | 45-55 years |
| Others | 10-25 years |
| Machinery and equipment | |
| Electro-mechanical equipment | 25 years |
| Others | 3-13 years |
| Office equipment | 3-15 years |
| Leasehold improvements | |
| Building improvements | 5 years |
| Others | 3-5 years |
| Flight equipment and equipment under finance leases | |
| Airframes | 18-25 years |
| Aircraft cabins | 10-20 years |
| Engines | 12-20 years |
| Heavy maintenance on aircrafts | 6-8 years |
| Engine overhauls | 3-10 years |
| Landing gear overhauls | 8-12 years |
| Repairable spare parts | 3-15 years |
| Improvement of aircrafts | 5-12 years |

Regarding changes in fleet composition, current and forecasted market values, and other technical factors, the Company recognized impairment losses on a part of aircraft equipment of $690,579 thousand and $717,758 thousand in 2017 and 2016, respectively.

Refer to Note 32 for the carrying amounts of property, plant and equipment pledged by the Company.

Based on the particularity of risk in the aviation industry, all of the Company’s assets such as aircrafts, real estate, and movable property are adequately insured to diversify the potential risk related to operations.

## 15. INVESTMENT PROPERTIES

| | December 31 | |
|---|---|---|
| | **2017** | **2016** |
| Carrying amount | | |
| Investment properties | $ 2,047,448 | $ 2,047,448 |

The investment properties (land) held by the Company located in Nankan were leased to others.

The fair value of the investment properties held by the Company are $2,473,771 thousand and $2,316,300 thousand as of December 31, 2017 and 2016, respectively. The fair value valuation was performed by independent qualified professional valuers, and the future income evaluated by management was based on market transactions.

All of the Company’s investment properties were held under freehold interest.

## 16. OTHER INTANGIBLE ASSETS

| | Computer Software Costs | Accumulated Amortization | Net Value |
|---|---|---|---|
| Balance at January 1, 2016 | $ 1,520,055 | $ (529,748) | $ 990,307 |
| Additions | 265,615 | - | 265,615 |
| Amortization expense | - | (138,554) | (138,554) |
| Reclassification | (2,267) | - | (2,267) |
| Balance at December 31, 2016 | $ 1,783,403 | $ (668,302) | $ 1,115,101 |
| Balance at January 1, 2017 | $ 1,783,403 | $ (668,302) | $ 1,115,101 |
| Additions | 121,951 | - | 121,951 |
| Amortization expense | - | (247,725) | (247,725) |
| Balance at December 31, 2017 | $ 1,905,354 | $ (916,027) | $ 989,327 |

The above items of other intangible assets were amortized on a straight-line basis over 2-10 years.

## 17. OTHER ASSETS

| | December 31 | |
|---|---|---|
| | 2017 | 2016 |
| Current | | |
| Temporary payments | $ 315,372 | $ 166,236 |
| Prepayments | 2,391,132 | 2,091,371 |
| Others | 513,231 | 219,193 |
| | $ 3,219,735 | $ 2,476,800 |
| Noncurrent | | |
| Prepayments for aircrafts | $ 10,578,892 | $ 21,845,682 |
| Prepayments - long-term | 1,069,595 | 1,036,525 |
| Refundable deposits | 424,196 | 521,229 |
| Other financial assets | 18,803 | 18,827 |
| | $ 12,091,486 | $ 23,422,263 |

The prepayments for aircrafts comprised the prepaid deposits and capitalized interest from the purchase of A350-900 aircrafts. For details of the A350-900 aircrafts purchase contracts, refer to Note 33. The rights to purchase the six confirmed orders of 777-300ER aircrafts were transferred to the aircraft leasing company upon delivery of the aircrafts. Then, all six aircrafts were leased back. As of May 2016, all the aircrafts had been delivered, and the Company was refunded with deposits for the aircraft purchases.

## 18. BORROWINGS

a. Short-term bills payable

| | December 31 | |
|---|---|---|
| | 2017 | 2016 |
| Commercial paper | $ - | $ 900,000 |
| Less: Unamortized discount on bills payable | - | - |
| | $ - | $ 900,000 |
| Annual discount rate | - | 0.758% |

b. Long-term debts

| | December 31 | |
|---|---|---|
| | 2017 | 2016 |
| Unsecured bank loans | $ 23,949,000 | $ 31,183,999 |
| Secured bank loans | 30,711,508 | 16,329,805 |
| Commercial paper | | |
| Proceeds from issue | 26,100,000 | 37,200,000 |
| Less: Unamortized discount | 37,897 | 64,186 |
| | 80,722,611 | 84,649,618 |
| Less: Current portion | 18,814,633 | 31,816,140 |
| | $ 61,907,978 | $ 52,833,478 |

For information on secured bank loans which were secured by buildings, machinery equipment and flight equipment, refer to Note 32.

Bank loans (New Taiwan dollars and U.S. dollars) are repayable quarterly, semiannually or in lump sum upon maturity. Related information is summarized as follows:

| | Currency | |
|---|---|---|
| | New Taiwan Dollars | U.S. Dollars |
| Original currency | | |
| December 31, 2017 | $ 54,660,508 | $ - |
| December 31, 2016 | 46,464,267 | 32,536 |
| Translated to New Taiwan dollars | | |
| December 31, 2017 | 54,660,508 | - |
| December 31, 2016 | 46,464,267 | 1,049,537 |
| Interest rates | | |
| December 31, 2017 | 0.92%-1.56% | - |
| December 31, 2016 | 0.92%-1.60% | 0.8539%-4.39% |

(Continued)

| | Currency | |
|---|---|---|
| | New Taiwan Dollars | U.S. Dollars |
| Periods | | |
| December 31, 2017 | 2007/5/24-2029/11/9 | - |
| December 31, 2016 | 2005/3/4-2028/10/18 | 2005/1/18-2017/9/21 |

(Concluded)

The Company has note issuance facilities (NIFs) obtained from certain financial institutions. The NIFs, with various maturities until December 2021, were used by the Company to guarantee commercial paper which it issued. The commercial paper was issued at discount rates of 0.9983%-1.2897% in 2017 and 1.0510%-1.4580% in 2016.

## 19. BONDS PAYABLE

| | December 31 | |
|---|---|---|
| | 2017 | 2016 |
| Unsecured corporate bonds first-time issued in 2013 | $ 8,200,000 | $ 10,900,000 |
| Unsecured corporate bonds first-time issued in 2016 | 5,000,000 | 5,000,000 |
| Unsecured corporate bonds second-time issued in 2016 | 5,000,000 | 5,000,000 |
| Unsecured corporate bonds first-time issued in 2017 | 2,350,000 | - |
| Unsecured corporate bonds second-time issued in 2017 | 3,500,000 | - |
| Convertible bonds - fifth issue | 1,667,100 | 1,638,044 |
| | 25,717,100 | 22,538,044 |
| Less: Current portion and put option of convertible bonds | 4,367,100 | 2,700,000 |
| | $ 21,350,000 | $ 19,838,044 |

Related issuance conditions were as follows:

| Category | Period | Conditions | Rate (%) |
|---|---|---|---|
| Five-year private unsecured bonds - issued at par in January 2013; repayable in January 2017 and 2018; 1.6% interest p.a., payable annually | 2013.01.17-2018.01.17 | Principal repayable in January of 2017 and 2018; indicator rate; payable annually | 1.6 |
| Seven-year private unsecured bonds - issued at par in January 2013; repayable in January 2019 and 2020; 1.85% interest p.a., payable annually | 2013.01.17-2020.01.17 | Principal repayable in January of 2019 and 2020; indicator rate; payable annually | 1.85 |
| Five-year unsecured bonds - issued at par in May 2016; repayable in May 2020 and 2021; 1.19% interest p.a., payable annually | 2016.05.26-2021.05.26 | Principal repayable in May of 2020 and 2021; interest p.a. payable annually | 1.19 |

(Continued)

| Category | Period | Conditions | Rate (%) |
| --- | --- | --- | --- |
| Five-year unsecured bonds - issued at par in September 2016; repayable in September 2020 and 2021; 1.08% interest p.a., payable annually | 2016.09.27-2021.09.27 | Principal repayable in September of 2020 and 2021; interest p.a. payable annually | 1.08 |
| Three-year private unsecured bonds - issued at par in May 2017; repayable on due date; interest of 1.2% p.a., payable annually | 2017.5.19-2020.5.19 | Principal repayable on due date; indicator rate; payable annually | 1.20 |
| Seven-year private unsecured bonds - issued at par in May 2017; repayable on due date; interest of 1.75% p.a., payable annually | 2017.5.19-2024.5.19 | Principal repayable on due date; indicator rate; payable annually | 1.75 |
| Three-year private unsecured bonds - issued at par in October 2017; repayable on due date; interest of 1.14% p.a., payable annually | 2017.10.12-2020.10.12 | Principal repayable on due date; indicator rate; payable annually | 1.14 |
| Five-year private unsecured bonds - issued at par in October 2017; repayable in October 2021 and 2022; 1.45% interest p.a., payable annually | 2017.10.12-2022.10.12 | Principal repayable in October of 2021 and 2022; indicator rate; payable annually | 1.45 |
| Five-year convertible bonds - issued at discount in December 2013; repayable in lump sum upon maturity; 1.8245% discount rate p.a. | 2013.12.26-2018.12.26 | Except for converting to share capital or buying back, principal repayable in December of 2018 | - |

(Concluded)

The Company issued its 2016 first unsecured corporate bonds with a face value of $5,000,000 thousand, and the purchasers of the bonds included Mandarin Airlines Co., Ltd. and Sabre Travel Network (Taiwan) Co., Ltd., who held a face value of $300,000 thousand which were eliminated in the Company’s consolidated financial statements.

The Company issued the fifth issue of unsecured convertible bonds, and the issuance conditions were as follows:

a. The holders may demand a lump-sum payment for the bonds upon maturity.

b. The holders can request that the Company repurchase their bonds at 100.75% face value on the third anniversary of the offering date. Because the holders can exercise selling rights on December 26, 2016, the Company reclassified the bonds payable to “current portion of bonds payable” in December 2015. The Company paid $994,705 thousand to the holders of the bonds payable who exercised the put options, and the difference between the payment amount and carrying amount recognized was a loss on the bonds payable buy back of $41,943 thousand, for which the Company reclassified the remaining face value to noncurrent assets.

c. The Company may redeem the bonds at face value between March 26, 2014 and November 16, 2018 under certain conditions.

d. Between January 26, 2014 and December 16, 2018 (except for the period between the former dividend date and the date of the dividend declaration on record), holders may convert the bonds to the Company's common shares. The initial conversion price was set at NT$12.24, which is subject to adjustment if there is a capital injection by cash, share dividend distribution, and the proportion of cash dividends per share in market price exceeding 1.5%. Because the Company distributed cash dividends as of July 31, 2016, there was adjustment the conversion price to NT$11.64, corporate bonds with a face value of $3,316,800 thousand had been converted to 270,985 thousand units of common shares.

The convertible bonds contain both liability and equity components. The equity component was presented in equity under the heading of capital surplus - options. The effective interest rate of the liability component was 1.8245% per annum on initial recognition.

| | |
|---|---|
| Proceeds from issuance | $ 6,000,000 |
| Equity component | (518,621) |
| Liability component at the date of issuance | $ 5,481,379 |

On November 5, 2017, the Company's board of directors resolved to issue its 2018 second, five-year unsecured convertible bonds for $6,012,000 thousand, at a coupon rate of 100.2% and a conversion price set at NT$13.2, on January 30, 2018.

## 20. LEASING

a. Sale-leasebacks - finance leases

| | December 31 | |
|---|---|---|
| | **2017** | **2016** |
| Minimum lease payments - flight equipment | | |
| Within one year | $ 1,580,000 | $ 1,254,000 |
| Beyond one year and within five years | 596,000 | 3,562,000 |
| Present value of minimum lease payments | $ 2,176,000 | $ 4,816,000 |
| Current | $ 1,580,000 | $ 1,254,000 |
| Noncurrent | 596,000 | 3,562,000 |
| | $ 2,176,000 | $ 4,816,000 |
| Interest rate | 1.0617%-1.1317% | 1.0323%-1.0980% |

The Company had leased A330-300 aircrafts, totaling three aircrafts, under sale-leaseback finance leases as of December 31, 2017. The lease terms are from June 2006 to April 2019. During the lease term, the Company retained all risks and rewards attached to the aircrafts and engines and enjoyed the same substantive rights as were enjoyed prior to the transaction. Interest rate underlying all obligations under finance leases were floated. Therefore, the minimum lease payments under the sale-leaseback aircraft contracts are not inclusive of interest expense.

b. Operating leases (including sale-leasebacks - operating leases)

The Company rented planes, headquarters, and hangars under various operating lease contracts expiring on various dates until May 2028. The Company does not have a bargain purchase option to acquire the leased planes and hangars at the expiration of the lease periods.

The rental rates stated in the aircraft lease agreements are fixed or floated. If the agreed-upon rental rate is floating and will be revised monthly or semiannually. Subleasing is not allowed for all the lease arrangements. As of December 31, 2017, the Company has rented eleven A330-300 aircrafts, fifteen 737-800 aircrafts and ten 777-300ER aircrafts under operating contracts; the lease terms range from 8 to 12 years.

As of December 31, 2017 and 2016, the refundable deposits paid by the Company under operating lease contracts were $208,995 thousand and $293,188 thousand, respectively. Part of the refundable deposits is secured by credit guarantees. The credit guarantees were $1,394,791 thousand and $1,459,935 thousand, respectively.

The minimum lease payments in the future for the non-cancelable operating lease commitments were as follows:

| | December 31 | |
|---|---|---|
| | 2017 | 2016 |
| Up to 1 year | $ 10,145,139 | $ 9,889,910 |
| Over 1 year to 5 years | 39,313,550 | 38,106,256 |
| Over 5 years | 26,841,927 | 33,266,660 |
| | $ 76,300,616 | $ 81,262,826 |

The lease payments recognized in profit or loss for the current period were as follows:

| | For the Year Ended December 31 | |
|---|---|---|
| | 2017 | 2016 |
| Minimum lease payments | $ 9,989,732 | $ 9,662,625 |

## 21. OTHER PAYABLES

| | December 31 | |
|---|---|---|
| | 2017 | 2016 |
| Fuel costs | $ 3,243,742 | $ 2,490,290 |
| Ground service expenses | 1,089,306 | 1,158,563 |
| Repair expenses | 842,845 | 848,200 |
| Interest expenses | 290,902 | 288,038 |
| Short-term employee benefits | 2,332,644 | 1,668,366 |
| Terminal surcharges | 659,454 | 668,710 |
| Commission expenses | 407,109 | 391,857 |
| Others | 2,042,750 | 2,119,998 |
| | $ 10,908,752 | $ 9,634,022 |

## 22. DEFERRED REVENUE

| | December 31 2017 | December 31 2016 |
|---|---|---|
| Frequent flyer programs | $ 2,450,702 | $ 2,427,565 |
| Advance ticket sales | 13,415,588 | 12,785,565 |
| | $ 15,866,290 | $ 15,213,130 |
| Current | $ 14,048,025 | $ 13,404,227 |
| Noncurrent | 1,818,265 | 1,808,903 |
| | $ 15,866,290 | $ 15,213,130 |

## 23. PROVISIONS

| | December 31 2017 | December 31 2016 |
|---|---|---|
| Operating leases - aircrafts | $ 7,758,651 | $ 6,770,951 |
| Current | $ 406,457 | $ - |
| Noncurrent | 7,352,194 | 6,770,951 |
| | $ 7,758,651 | $ 6,770,951 |

The Company rented flight equipment under operating lease agreements. Under the contracts (some of the leased flight equipment's lease payments are calculated monthly), when the lease expires and the equipment is returned to the lessor, the flight equipment has to be repaired according to the expected years of use, number of flight hours, flight cycle and the number of engine revolutions. The Company had existing obligations to recognize provisions when signing a lease or during the lease term.

| | Aircraft Lease Contract |
|---|---|
| Balance at January 1, 2016 | $ 5,033,257 |
| Additional provisions recognized | 2,011,115 |
| Usage | (366,218) |
| Effect of exchange rate changes | 92,797 |
| Balance at December 31, 2016 | $ 6,770,951 |
| Balance at January 1, 2017 | $ 6,770,951 |
| Additional provisions recognized | 2,524,079 |
| Usage | (1,138,140) |
| Effect of exchange rate changes | (398,239) |
| Balance at December 31, 2017 | $ 7,758,651 |

## 24. RETIREMENT BENEFIT PLANS

a. Defined contribution plans

The Company adopted a pension plan under the Labor Pension Act (the "LPA"), which is a state-managed defined contribution plan. Under the LPA, an entity makes monthly contributions to employees' individual pension accounts at 6% of monthly salaries and wages.

b. Defined benefit plans

The Company adopted the defined benefit plan under the Labor Standards Law, under which pension benefits are calculated on the basis of the length of service and average monthly salaries of the six months before retirement. The Company contribute amounts equal to 15% of total monthly salaries and wages to a pension fund administered by the pension fund monitoring committee. Pension contributions are deposited in the Bank of Taiwan in the committee's name.

Before the end of each year, the Company assesses the balance in the pension fund. If the amount of the balance in the pension fund is inadequate to pay retirement benefits for employees who conform to retirement requirements in the next year, the Company is required to fund the difference in one appropriation that should be made before the end of March of the next year. The pension fund is managed by the Bureau of Labor Funds, Ministry of Labor ("the Bureau"); the Company has no right to influence the investment policy and strategy.

The amounts included in the balance sheets in respect of the Company's defined benefit plans were as follows:

| | December 31 | |
|---|---|---|
| | **2017** | **2016** |
| Present value of defined benefit obligation | $ 11,956,223 | $ 11,176,204 |
| Fair value of plan assets | (5,797,479) | (4,958,858) |
| Net defined benefit liabilities | $ 6,158,744 | $ 6,217,346 |

Movements in net defined benefit liabilities (assets) were as follows:

| | **Present Value of the Defined Benefit Obligation** | **Fair Value of the Plan Assets** | **Net Defined Benefit Liabilities (Assets)** |
|---|---|---|---|
| Balance at January 1, 2016 | $ 10,769,419 | $ (1,803,890) | $ 8,965,529 |
| Service cost | | | |
| Current service cost | 639,972 | - | 639,972 |
| Net interest expense (income) | 114,773 | (18,079) | 96,694 |
| Recognized in profit or loss | 754,745 | (18,079) | 736,666 |
| Remeasurement | | | |
| Return on plan assets (excluding amounts included in net interest) | - | (4,826) | (4,826) |
| Actuarial gain - changes in financial assumptions | (147,479) | - | (147,479) |
| Actuarial loss - experience adjustments | 741,687 | - | 741,687 |
| Recognized in other comprehensive income | 594,208 | (4,826) | 589,382 |

(Continued)

| | Present Value of the Defined Benefit Obligation | Fair Value of the Plan Assets | Net Defined Benefit Liabilities (Assets) |
|---|---|---|---|
| Contributions from the employer | $ - | $ (3,908,253) | $ (3,908,253) |
| Benefits paid | (776,190) | 776,190 | - |
| Payment to employees direct from the employer | (165,978) | - | (165,978) |
| Balance at December 31, 2016 | 11,176,204 | (4,958,858) | 6,217,346 |
| Service cost | | | |
| Current service cost | 832,125 | - | 832,125 |
| Net interest expense (income) | 126,826 | (61,568) | 65,258 |
| Recognized in profit or loss | 958,951 | (61,568) | 897,383 |
| Remeasurement | | | |
| Return on plan assets (excluding amounts included in net interest) | - | 15,362 | 15,362 |
| Actuarial gain - changes in financial assumptions | 372,284 | - | 372,284 |
| Actuarial loss - experience adjustments | 257,573 | - | 257,573 |
| Recognized in other comprehensive income | 629,857 | 15,362 | 645,219 |
| Contributions from the employer | - | (1,482,710) | (1,482,710) |
| Benefits paid | (690,295) | 690,295 | - |
| Payment to employees direct from the employer | (118,494) | - | (118,494) |
| Balance at December 31, 2017 | $ 11,956,223 | $ (5,797,479) | $ 6,158,744 |

(Concluded)

Through the defined benefit plans under the Labor Standards Law, the Company is exposed to the following risks:

1) Investment risk: The plan assets are invested in domestic and foreign equity and debt securities, bank deposits, etc. The investment is conducted at the discretion of the Bureau or under the mandated management. Based on relevant regulations, the return generated by plan assets should not be below the interest rate for a two-year time deposit with local banks.

2) Interest risk: A decrease in the government bond interest rate will increase the present value of the defined benefit obligation; however, this will be partially offset by an increase in the return on the plan’s debt investments.

3) Salary risk: The present value of the defined benefit obligation is calculated by reference to the future salaries of plan participants. Thus, an increase in the salaries of the plan participants will increase the present value of the defined benefit obligations.

The actuarial valuations of the present value of the defined benefit obligation were carried out by qualified actuaries. The significant assumptions used for the purposes of the actuarial valuations were as follows:

| | December 31 | |
|---|---|---|
| | 2017 | 2016 |
| Discount rate | 1.01% | 1.29% |
| Expected rate of salary increase | 1.00% | 1.00% |

If possible reasonable change in each of the significant actuarial assumptions will occur and all other assumptions will remain constant, the present value of the defined benefit obligation would increase (decrease) as follows:

| | December 31 | |
|---|---|---|
| | 2017 | 2016 |
| Discount rate | | |
| 0.5% increase | $ (534,890) | $ (496,081) |
| 0.5% decrease | $ 580,412 | $ 538,301 |
| Expected rate of salary increase | | |
| 0.5% increase | $ 557,651 | $ 517,191 |
| 0.5% decrease | $ (523,509) | $ (485,527) |

The sensitivity analysis presented above may not be representative of the actual change in the present value of the defined benefit obligation as it is unlikely that the change in assumptions would occur in isolation of one another as some of the assumptions may be correlated.

| | December 31 | |
|---|---|---|
| | 2017 | 2016 |
| The expected contributions to the plan for the next year | $ 688,096 | $ 691,530 |
| The average duration of the defined benefit obligation | 10 years | 10 years |

## 25. EQUITY

a. Share capital

Common shares

| | December 31 | |
|---|---|---|
| | 2017 | 2016 |
| Numbers of shares authorized (in thousands) | 6,000,000 | 6,000,000 |
| Amount of shares authorized | $ 60,000,000 | $ 60,000,000 |
| Amount of shares issued | $ 54,709,846 | $ 54,708,901 |

For the years ended December 31, 2017, the Company issued the 5th domestic unsecured convertible bonds, and holders of such bonds amounting to $1,100 thousand applied for conversion, for which 95 thousand of the Company’s common shares were exchanged. In accordance with the law, the Company may apply for a change of registration after issuing new shares.

b. Capital surplus

| | December 31 | |
|---|---|---|
| | 2017 | 2016 |
| Issue of shares in excess of par value and conversion premium | $ 552,696 | $ 552,470 |
| Distribution of cash dividends to treasury shares held by subsidiaries | 2,673 | 2,673 |
| Expired employee share options | 11,747 | 11,747 |
| Long-term investments | 955 | 1,019 |
| Bonds payable equity component | 146,589 | 146,684 |
| Others | 85,339 | 85,339 |
| | $ 799,999 | $ 799,932 |

The capital surplus from shares issued in excess of par (additional paid-in capital from issuance of common shares) may be used to offset a deficit; in addition, when the Company has no deficit, such capital surplus may be distributed as cash dividends or transferred to capital (limited to a certain percentage of the Company's paid-in capital).

The capital surplus from long-term investments and employee shares options expired and dividends distributed to subsidiaries may not be used for any purpose, expect for offsetting a deficit. As for capital surplus from conversion of convertible bonds payable may not be used for any purpose.

c. Appropriation of earnings and dividend policy

According to amended Company Act, where the Company made profit in a fiscal year, the profit shall be first utilized for paying taxes, offsetting losses of previous years, setting aside as legal reserve 10% of the remaining profit, setting aside or reversing a special reserve in accordance with the laws and regulations, and then any remaining profit together with any undistributed retained earnings shall be used by the Company's board of directors as the basis for proposing a distribution plan with due consideration of any future aircraft acquisition plans and fund demand, which should be resolved in the shareholders' meeting for the distribution of dividends and bonuses to shareholders by cash or shares (cash dividends cannot be less than 30% of total dividends distributed). However, if the Company's profit before tax in a fiscal year after deductions for the abovementioned items is not sufficient for earnings distribution, retained earnings can be used as a supplement for the deficiency. If the Company has no deficit in a fiscal year, the Company can distribute all or part of the capital surplus by cash or shares with due consideration of finance, marketing and management requirements in accordance with the laws and regulations.

The distribution of profit surplus shall be approved in the annual shareholders' meeting held in the following year and shall be accounted for in that year.

1) Appropriation of earnings and dividends per share in 2015

The appropriation and dividends per share resolved in the shareholders' meeting on June 24, 2016 were as follows:

| | Appropriation of Earnings | Dividends Per Share (NT$) |
|---|---|---|
| Legal reserve | $ 287,224 | |
| Special reserve | 76,486 | |
| Cash dividends | 2,508,525 | $0.458522382 |

2) Appropriation of earnings in 2016

The legal reserve of $81,132 thousand and special reserve of $76,486 thousand used to offset deficits was resolved by the shareholders in their meeting on June 22, 2017.

3) Appropriation of earnings and dividends per share in 2017

The appropriation of earnings for 2017 should be resolved in the board of directors meeting to be held on March 22, 2018. The appropriation and dividends per share were as follows:

| | **Appropriation of Earnings** | **Dividends Per Share (NT$)** |
|---|---|---|
| Legal reserve | $ 145,831 | |
| Special reserve | 118,810 | |
| Cash dividends | 1,193,670 | $0.2181820086 |

The appropriation of earnings should be resolved in the shareholders' meeting to be held on June 27, 2018.

When the Company distributes undistributed earnings for the years after 1998, except for non-ROC residents shareholders, all shareholders can receive an imputation tax credit calculated according to the Tax Deduction Ratio on the distribution date.

d. Other equity items

The movement of other equity items is as follows:

| | **Exchange Differences on Translating Foreign Operations** | **Unrealized Gain (Loss) on Available-for-sale Financial Assets** | **Cash Flow Hedges** | **Total** |
|---|---|---|---|---|
| Balance at January 1, 2016 | $ 157,959 | $ 1,755 | $ (225,997) | $ (66,283) |
| Exchange differences on translating the foreign operations | (80,104) | - | - | (80,104) |
| Cumulative loss arising on changes in fair value of hedging instruments | - | - | (282,556) | (282,556) |
| Cumulative gain arising on changes in fair value of hedging instruments reclassified to profit or loss | - | - | 582,665 | 582,665 |
| Share of associates accounted for using the equity method | (12,909) | (41) | 8,893 | (4,057) |
| Effect of income tax | 13,618 | - | (51,019) | (37,401) |
| Balance at December 31, 2016 | $ 78,564 | $ 1,714 | $ 31,986 | $ 112,264 |

(Continued)

| | Exchange Differences on Translating Foreign Operations | Unrealized Gain (Loss) on Available-for-sale Financial Assets | Cash Flow Hedges | Total |
|---|---|---|---|---|
| Balance at January 1, 2017 | $ 78,564 | $ 1,714 | $ 31,986 | $ 112,264 |
| Exchange differences arising on translating the foreign operations | (134,857) | - | - | (134,857) |
| Cumulative loss arising on changes in fair value of hedging instruments | - | - | (283,449) | (283,449) |
| Cumulative gain arising on changes in fair value of hedging instruments reclassified to profit or loss | - | - | 166,869 | 166,869 |
| Share of associates accounted for using the equity method | (1,619) | 60 | (9,653) | (11,212) |
| Effect of income tax | 22,926 | - | 19,818 | 42,744 |
| Balance at December 31, 2017 | $ (34,986) | $ 1,774 | $ (74,429) | $ (107,641) |

(Concluded)

e. Treasury shares

Treasury shares are the Company's shares held by its subsidiaries, as of December 31, 2017 and 2016 were as follows:

**(Shares in Thousands)**

| Purpose of Treasury Shares | Number of Shares, Beginning of Year | Reduction During the Year | Number of Shares, End of Year |
|---|---|---|---|
| For the year ended December 31, 2017 | | | |
| Company's shares held by its subsidiaries reclassified from investment in shares to treasury shares | 2,889 | - | 2,889 |
| For the year ended December 31, 2016 | | | |
| Company's shares held by its subsidiaries reclassified from investment in shares to treasury shares | 2,889 | - | 2,889 |

| Subsidiary | Shares (In Thousands) | Carrying Amount | Market Value |
|---|---|---|---|
| December 31, 2017 | | | |
| Mandarin Airlines | 2,075 | $ 24,169 | $ 24,169 |
| Hwa Hsia | 814 | 9,485 | 9,485 |
| | | $ 33,654 | $ 33,654 |
| December 31, 2016 | | | |
| Mandarin Airlines | 2,075 | $ 19,294 | $ 19,294 |
| Hwa Hsia | 814 | 7,572 | 7,572 |
| | | $ 26,866 | $ 26,866 |

The above acquisitions by subsidiaries of the Company's shares in previous years was due to investment planning. The shares of the Company held by its subsidiaries were treated as treasury shares. The subsidiaries can exercise shareholders' rights on these treasury shares, except for the rights to subscribe for the Company's new shares and voting rights.

## 26. NET INCOME

a. Revenue

| | For the Year Ended December 31 | |
|---|---|---|
| | 2017 | 2016 |
| Passenger | $ 90,560,375 | $ 86,298,238 |
| Cargo | 42,970,102 | 35,353,349 |
| Others | 6,284,734 | 5,873,277 |
| | $ 139,815,211 | $ 127,524,864 |

b. Other income

| | For the Year Ended December 31 | |
|---|---|---|
| | 2017 | 2016 |
| Interest income | $ 176,329 | $ 188,006 |
| Subsidy income | 32,332 | 168,377 |
| Dividend income | 9,564 | 59,099 |
| Others | 142,755 | 177,969 |
| | $ 360,980 | $ 593,451 |

c. Other gains and losses

| | For the Year Ended December 31 | |
|---|---|---|
| | 2017 | 2016 |
| Gain on disposal property, plant and equipment and noncurrent assets held for sale | $ 258,306 | $ 54,188 |
| Net loss on financial assets as held for trading | (33,385) | (29,909) |
| Gain (loss) on disposal of investment | 101,105 | (164) |
| Gain (loss) on foreign exchange, net | 4,920 | (495,350) |
| Impairment loss recognized on noncurrent assets held for sale | (3,571,301) | (347,868) |
| Impairment loss recognized on flight equipment | (690,579) | (717,758) |
| Impairment loss on financial assets carried at cost | (56,023) | - |
| Others | (993,913) | (874,060) |
| | $ (4,980,870) | $ (2,410,921) |

The Company has been named as a defendant, together with other airline members of the Association of Asia Pacific Airlines, in a civil class action lawsuit filed at the U.S. Northern District Court of California by a group of passengers who alleged that there was an antitrust violation in December 2007. After consulting with the lawyers and considering the cost of litigation, the Company settled with the plaintiff in the amount of US$19,500 thousand, and the settlement was recognized in 2017 financial statement. The settlement funds will be divided into four-phase payments in three years.

d. Finance costs

| | For the Year Ended December 31 | |
|---|---|---|
| | 2017 | 2016 |
| Interest expense | | |
| Bonds payable | $ 321,457 | $ 297,032 |
| Bank loans | 907,915 | 845,987 |
| Interest on obligations under finance leases | 45,621 | 68,179 |
| Loss on derivatives designated as hedging instruments in cash flow hedge accounting relationships reclassified from equity to profit or loss | 2,814 | 10,390 |
| | $ 1,277,807 | $ 1,221,588 |

Information about capitalized interest was as follows:

| | | |
|---|---|---|
| Capitalization interest | $ 212,557 | $ 419,593 |
| Capitalization rate | 1.31%-1.41% | 1.45%-1.73% |

e. Depreciation and amortization expenses

| | For the Year Ended December 31 | |
|---|---|---|
| | 2017 | 2016 |
| Property, plant and equipment | $ 17,375,194 | $ 16,588,758 |
| Intangible assets | 247,725 | 138,554 |
| | $ 17,622,919 | $ 16,727,312 |

(Continued)

| | For the Year Ended December 31 | |
|---|---|---|
| | 2017 | 2016 |
| An analysis of deprecation by function | | |
| Operating costs | $ 17,097,228 | $ 16,290,250 |
| Operating expenses | 277,966 | 298,508 |
| | $ 17,375,194 | $ 16,588,758 |
| An analysis of amortization by function | | |
| Operating expenses | $ 247,725 | $ 138,554 |

(Concluded)

f. Employee benefits expense

| | For the Year Ended December 31 | |
|---|---|---|
| | 2017 | 2016 |
| Post-employment benefits | | |
| Defined contribution plans | $ 344,228 | $ 312,512 |
| Defined benefit plans | 897,383 | 736,666 |
| | $ 1,241,611 | $ 1,049,178 |
| Other employee benefits | | |
| Salary expenses | $ 15,179,456 | $ 14,176,230 |
| Labor and health insurance | 1,167,348 | 1,175,417 |
| Personnel service expenses | 3,636,354 | 3,318,811 |
| | $ 19,983,158 | $ 18,670,458 |
| An analysis of employee benefits expense by function | | |
| Operating costs | $ 17,376,793 | $ 15,901,818 |
| Operating expenses | 3,847,976 | 3,817,818 |
| | $ 21,224,769 | $ 19,719,636 |

The Company distributes employees' compensation at rates of no less than 3% of net profit before income tax and employees' compensation. For the years ended December 31, 2017 and 2016, employees' compensation was $799,768 thousand and $382,318 thousand, respectively, of the base net profit.

Material differences between such estimated amounts and the amounts proposed by the board of directors on or before the date the annual financial statements are authorized for issue are adjusted in the year that the bonus and remuneration were recognized. If there is a change in the proposed amounts after the annual financial statements were authorized for issue, the differences are recorded as a change in the accounting estimate.

Information on the employees' compensation and remuneration of directors and supervisors resolved by the Company's board of directors in 2017 and 2016 are available on the Market Observation Post System website of the Taiwan Stock Exchange.

## 27. INCOME TAX

a. Income tax recognized in profit or loss

The major components of tax expense were as follows:

| | For the Year Ended December 31 | |
|---|---|---|
| | 2017 | 2016 |
| Current tax | | |
| Current year | $ 27,142 | $ 19,624 |
| Prior year adjustment | 1,617 | (116) |
| Deferred tax | | |
| Current year | 851,378 | 946,203 |
| Income tax expense recognized in profit or loss | $ 880,137 | $ 965,711 |

A reconciliation of accounting profit and income tax expense is as follows:

| | For the Year Ended December 31 | |
|---|---|---|
| | 2017 | 2016 |
| Profit before tax | $ 3,088,203 | $ 1,537,251 |
| Income tax expense calculated at the statutory rate (17%) | $ 524,995 | $ 261,333 |
| Add (deduct) tax effects of: | | |
| Nondeductible expenses in determining taxable income | 5,122 | 142,079 |
| Temporary differences | 691,804 | (393,931) |
| Tax-exempt income | (283,157) | (9,481) |
| Loss carryforwards - current used | (938,764) | - |
| Overseas income tax expense | 17,236 | 19,624 |
| Additional income tax under the Alternative Minimum Tax Act | 9,906 | - |
| Deferred tax | | |
| Temporary differences | 239,378 | 470,203 |
| Unrecognized loss carryforwards and investment tax credits | 612,000 | 476,000 |
| Adjustments for prior years' tax | 1,617 | (116) |
| Income tax expense recognized in profit or loss | $ 880,137 | $ 965,711 |

b. Income tax recognized in other comprehensive income

| | For the Year Ended December 31 | |
|---|---|---|
| | 2017 | 2016 |
| Deferred tax | | |
| Recognized in other comprehensive income | | |
| Translation of foreign operations | $ 22,926 | $ 13,618 |
| Fair value revaluation of hedging instruments for cash flow hedges | 19,818 | (51,019) |
| Actuarial gain or loss on defined benefit plan | 109,687 | 100,195 |
| Total income tax recognized in other comprehensive income | $ 152,431 | $ 62,794 |

c. Deferred tax assets and liabilities

For the year ended December 31, 2017

| | Beginning Balance | Recognized in Profit or Loss | Recognized in Other Comprehen-sive Income | Ending Balance |
|---|---|---|---|---|
| Deferred tax assets | | | | |
| Temporary differences | | | | |
| Defined benefit plans | $ 1,061,207 | $ (114,922) | $ 109,687 | $ 1,055,972 |
| Frequent flyer programs | 421,695 | 4,411 | - | 426,106 |
| Maintenance reserves | 1,151,061 | 244,744 | - | 1,395,805 |
| Allowance for reduction of inventory | 199,092 | 38,274 | - | 237,366 |
| Others | 593,708 | 465,069 | 21,146 | 1,079,923 |
| Loss carryforwards | 2,322,951 | (1,543,182) | - | 779,769 |
| | $ 5,749,714 | $ (905,606) | $ 130,833 | $ 4,974,941 |
| Deferred tax liabilities | | | | |
| Temporary differences | | | | |
| Depreciation difference from fixed assets | $ 85,949 | $ (54,939) | $ - | $ 31,010 |
| Unrealized exchange gains | - | 915 | - | 915 |
| Others | 28,823 | (204) | (21,598) | 7,021 |
| | $ 114,772 | $ (54,228) | $ (21,598) | $ 38,946 |

For the year ended December 31, 2016

| | Beginning Balance | Recognized in Profit or Loss | Recognized in Other Comprehen-sive Income | Ending Balance |
|---|---|---|---|---|
| Deferred tax assets | | | | |
| Temporary differences | | | | |
| Defined benefit plans | $ 1,525,482 | $ (564,470) | $ 100,195 | $ 1,061,207 |
| Frequent flyer programs | 452,949 | (31,254) | - | 421,695 |
| Maintenance reserve | 855,653 | 295,408 | - | 1,151,061 |
| Allowance for reduction of inventory | 172,901 | 26,191 | - | 199,092 |
| Others | 849,476 | (210,207) | (45,561) | 593,708 |
| Loss carryforwards | 2,834,341 | (511,390) | - | 2,322,951 |
| | $ 6,690,802 | $ (995,722) | $ 54,634 | $ 5,749,714 |

(Continued)

| | Beginning Balance | Recognized in Profit or Loss | Recognized in Other Comprehen-sive Income | Ending Balance |
|---|---|---|---|---|
| Deferred tax liabilities | | | | |
| Temporary differences | | | | |
| Depreciation difference from fixed assets | $ 125,008 | $ (39,059) | $ - | $ 85,949 |
| Others | 47,443 | (10,460) | (8,160) | 28,823 |
| | $ 172,451 | $ (49,519) | $ (8,160) | $ 114,772 |

(Concluded)

In February 2018, the President of the Republic of China announced the amendment of the Income Tax Law, which adjusted the income tax rate from 17% to 20%, and it will be implemented in 2018. In addition, the tax rate applicable to undistributed earnings in 2018 will be reduced from 10% to 5%. Deferred tax assets and liabilities that were recognized on December 31, 2017 are expected to increase by $877,931 thousand and $6,873 thousand, respectively, due to changes in tax rates.

Deductible temporary differences, unused loss carryforwards and unused investment credits for which no deferred tax assets have been recognized in the balance sheets are as follows:

| | December 31 | |
|---|---|---|
| | 2017 | 2016 |
| Loss carryforwards | | |
| Expiry in 2019 | $ 10,900,000 | $ 7,300,000 |

d. Unused tax loss carryforwards as of December 31, 2017 were as follows:

| Expiry Year | Unused Amount |
|---|---|
| 2019 | $ 11,764,885 |
| 2021 | 2,899,496 |
| 2022 | 619,799 |
| 2026 | 202,699 |
| | $ 15,486,879 |

e. Integrated income tax

| | December 31 | |
|---|---|---|
| | 2017 | 2016 |
| Imputation credit accounts | $ 195,252 | $ 102,527 |

The Company accumulated deficit as of December 31, 2016; thus, there were no expected creditable tax ratios.

Due to the amendment of Income Tax Law promulgated in February 2018, which repeals integrated income tax, the Company expect that there were no creditable tax ratios when distributing earnings in 2018.

f. Income tax returns

The income tax returns of the Company through 2015 have been examined by the tax authorities.

## 28. EARNINGS PER SHARE

| | For the Year Ended December 31 | |
|---|---|---|
| | 2017 | 2016 |
| Basic earnings per share | $ 0.40 | $ 0.10 |
| Diluted earnings per share | $ 0.39 | $ 0.10 |

| | For the Year Ended December 31 | |
|---|---|---|
| | 2017 | 2016 |
| Earnings used in the computation of basic earnings per share | $ 2,208,066 | $ 571,540 |
| Effect of potentially dilutive common shares: | | |
| Interest on convertible bonds (after tax) | 24,801 | - |
| Earnings used in the computation of diluted earnings per share | $ 2,232,867 | $ 571,540 |
| Weighted average number of common shares in computation of basic earnings per share | 5,468,030 | 5,468,002 |
| Effect of potentially dilutive common shares: | | |
| Convertible bonds | 145,763 | - |
| Employees' compensation or bonuses issued to employees | 70,259 | 47,337 |
| Weighted average number of common shares used in the computation of diluted earnings per share | 5,684,052 | 5,515,339 |

If the Company offers to settle compensation or bonuses paid to employees in cash or shares, the Company assumes the entire amount of the compensation or bonuses would be settled in shares, and the resulting potential shares were included in the weighted average number of shares outstanding used in the computation of diluted earnings per share, if the effect is dilutive. Such dilutive effect of the potential shares was included in the computation of diluted earnings per share until the number of shares to be distributed to employees is resolved in the following year.

## 29. CAPITAL MANAGEMENT

The Company manages its capital to ensure that entities in the Company will be able to continue as going concerns while maximizing the return to stakeholders through the optimization of the debt and equity balance. The capital structure of the Company consists of net debt (borrowings offset by cash and cash equivalents) and equity of the Company comprising issued capital, reserves, retained earnings, other equity and non-controlling interests.

To support its operating activities and purchase of aircraft, the Company needs to maintain sufficient capital. Therefore, the goal of capital management is to ensure financial resources and operating plan is able to support the future working capital, capital expenditures, debt repayment and dividend expenses and other needs.

## 30. FINANCIAL INSTRUMENTS

a. Fair values of financial instruments

1) Fair value of financial instruments not carried at fair value

| | December 31 | | | |
|---|---|---|---|---|
| | 2017 | | 2016 | |
| | Carrying Amount | Fair Value | Carrying Amount | Fair Value |
| Financial liabilities | | | | |
| Bonds payable | $ 25,717,100 | $ 25,818,511 | $ 22,538,044 | $ 22,580,069 |
| Bank loans | 80,722,611 | 82,735,255 | 84,649,618 | 86,734,531 |

Some long-term debts and capital lease obligations are floating-rate financial liabilities, so their carrying amounts are their fair values. The fair values of long-term debts and private bonds with fixed interest rates are estimated at the present value of expected cash flows discounted at rates of 0.75% in 2017 and 1.191% in 2016 prevailing in the market for long-term debts (Level 2). The fair values of bonds payable are based on those which are traded in the stock exchange and based on quoted market prices (Level 1).

2) Fair value measurements recognized in the balance sheets

The following table provides an analysis of financial instruments that are measured subsequent to initial recognition at fair value, grouped into Levels 1 to 3 based on the degree to which the fair value is observable:

a) Level 1 fair value measurements are those derived from quoted prices (unadjusted) in active markets for identical assets or liabilities;

b) Level 2 fair value measurements are those derived from inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices); and

c) Level 3 fair value measurements are those derived from valuation techniques that include inputs for the asset or liability that are not based on observable market data (unobservable inputs).

December 31, 2017

| | Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|
| Financial assets at FVTPL | | | | |
| Derivative instruments | $ - | $ 9,581 | $ - | $ 9,581 |
| Derivative financial assets for hedging | $ - | $ 293 | $ - | $ 293 |
| Derivative financial liabilities for hedging | $ - | $ 84,633 | $ - | $ 84,633 |

December 31, 2016

| | Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|
| Financial assets at FVTPL | | | | |
| Derivative instruments | $ - | $ 1,200 | $ - | $ 1,200 |
| Derivative financial assets for hedging | $ - | $ 54,671 | $ - | $ 54,671 |
| Derivative financial liabilities for hedging | $ - | $ 23,629 | $ - | $ 23,629 |

There were no transfers between Level 2 and 3 in the current and prior periods.

d) Valuation techniques and inputs applied for Level 2 fair value measurement

| Financial Instruments | Valuation Techniques and Inputs |
|---|---|
| Derivatives - foreign exchange forward contracts and interest rate swaps | The fair values of derivatives (except options) have been determined based on discounted cash flow analyses using interest yield curves applicable for the duration of the derivatives. The estimates and assumptions that the Company used to determine the fair values are identical to those used in the pricing of financial instruments for market participants. |

e) Valuation techniques and inputs applied for Level 3 fair value measurement

The fair values of currency options and fuel options are determined using option pricing models where the significant unobservable inputs are implied fluctuation. An increase in the implied fluctuation used in isolation would result in a decrease in the fair value of currency options and fuel options.

Because the individual fair values of some financial instruments and non-financial instruments need not be disclosed, the total fair value disclosed is not the total value of the Company's financial and non-financial instruments.

b. Categories of financial instruments

| | December 31 | |
|---|---|---|
| | 2017 | 2016 |
| Financial assets | | |
| Financial assets at FVTPL | $ - | $ 1,200 |
| Available-for-sale financial assets (Note 3) | 64,177 | 120,200 |
| Derivative financial assets for hedging | 293 | 54,671 |
| Loans and receivables (Note 1) | 26,095,060 | 29,522,622 |
| Financial liabilities | | |
| Financial liabilities at FVTPL | 9,581 | - |
| Derivative financial liabilities for hedging | 84,633 | 23,629 |
| Financial liabilities at amortized cost (Note 2) | 121,598,470 | 122,866,720 |

Note 1: The balances of loans and receivables measured at amortized cost comprised cash and cash equivalents, notes and accounts receivable, accounts receivable - related parties, other receivables, refundable deposits, other financial assets and other restricted financial assets.

Note 2: The balances of financial liabilities measured at amortized cost comprised short-term loans, short-term notes payable, notes and accounts payable, accounts payable - related parties, other payables, bonds payable and long-term loans, capital lease obligations, provisions, part of other current liabilities, part of other noncurrent liabilities and guarantee deposits.

Note 3: The balances include financial assets measured at cost.

c. Financial risk management objectives and policies

The Company has risk management and hedging strategies to respond to changes in the economic, financial environment and in the fuel market. To reduce the financial risks from changes in interest rates, in exchange rates and in fuel prices, the Company has its operating costs stay within a specified range by using appropriate financial hedging instruments and hedging percentages in accordance with the "Processing Program of Derivative Financial Instrument Transactions" approved by Company shareholders to reduce the impact of market price on earnings. These risks include market risk (including foreign currency risk, interest rate risk and other price risk), credit risk and liquidity risk.

In addition, the Company has a risk management committee, which meets periodically to evaluate the performance of derivative instruments and determine the appropriate hedging portion. This committee informs the Company of global economic and financial conditions, controls the Company's entire financial risk resulting from changes in the financial environment and fuel prices, and develops the strategy and response to avoid financial risk with the assistance of financial risk experts to effect risk management.

1) Market risk

The Company is primarily exposed to the financial risks of changes in foreign currency exchange rates and interest rates. The Company entered into derivative financial instruments to manage its exposure to foreign currency risk and interest rate risk.

The Company enters into forward contracts, foreign currency option contracts, and interest swap contracts with fair values that are highly negatively correlated to the fair values of hedged items and evaluates the hedging effectiveness of these instruments periodically.

a) Foreign currency risk

The Company enters into currency option to hedge against the risks of changes in related exchange rates, and enters into foreign exchange forward contracts to hedge against the risks of changes in the related exchange rates of foreign-currency assets, liabilities and commitments.

Sensitivity analysis

The Company is mainly exposed to the U.S. dollar.

The following details the Company's sensitivity to a one dollar increase and decrease in the New Taiwan dollar (i.e. the functional currency) against the U.S. dollar. The sensitivity amount used when reporting foreign currency risk internally to key management personnel and which represents management's assessment of the reasonably possible change in foreign exchange rates is one dollar. The sensitivity analysis included only outstanding foreign currency denominated monetary items and foreign exchange forward contracts designated as cash flow hedges and adjusts their translation at the end of the reporting period for the New Taiwan dollar strengthening or weakening one dollar against the U.S. dollar.

When the New Taiwan dollar increases one dollar against the U.S. dollar and all other variables are held constant, there will be an increase in pre-tax profit in 2017 of $109,319 thousand and an increase in pre-tax profit in 2016 of $9,026 thousand.

b) Interest rate risk

The Company enters into interest swap contracts to hedge against the risks on change in net liabilities interest rates.

The risk is managed by the Company through maintaining an appropriate mix of fixed and floating rate borrowings, and using interest rate swap contracts and forward interest rate contracts.

The carrying amount of the Company's financial liabilities with exposure to interest rates at the end of the reporting period were as follows.

| | December 31 | |
|---|---|---|
| | **2017** | **2016** |
| Fair value interest rate risk | $ 27,717,100 | $ 26,258,421 |
| Cash flow interest rate risk | 80,898,611 | 86,645,240 |

Sensitivity analysis

The sensitivity analyses below were determined based on the Company's exposure to interest rates for both derivatives and non-derivative instruments at the end of the reporting period. For floating rate liabilities, the analysis was prepared assuming the amount of the liability outstanding at the end of the reporting period was outstanding for the whole year. One yard (25 basis) increase or decrease was used when reporting interest rate risk internally to key management personnel and represents management's assessment of the reasonably possible change in interest rates.

Had interest rates increased one yard (25 basis) and had all other variables been held constant, the Company's pre-tax profit for the year ended December 31, 2017 would have decreased by $202,247 thousand.

Had interest rates increased one yard (25 basis) and had all other variables been held constant, the Company's pre-tax profit for the year ended December 31, 2016 would have decreased by $216,613 thousand.

c) Other price risk

The Company is exposed to fuel price risk on its purchase of aviation fuel.

After considering the fuel market conditions and the cost of hedging, the Company will set fuel options contracts with financial institution to avoid the risk of fuel price fluctuations. The Company has not signed contracts still not settling as of December 31, 2017.

2) Credit risk

Credit risk refers to the risk that a counterparty will default on its contractual obligations resulting in financial loss to the Company. The Company's credit risk, primarily comes from accounts receivable generated from operating activities and bank deposits generated from investing activities, fixed investment income and other financial instruments, operation related credit risk and financial credit risk are managed separately.

<u>Operation - related credit risk</u>

The Company has established procedures to management operations related credit risk to maintain the quality of accounts receivable.

To assess individual customers, the Company consider into the financial condition of the customers, the credit rating agency rating, the Company's internal credit rating, transaction history and current economic conditions and many other factors that may affect the repayment. Sometimes, the Company uses certain credit enhancement tools to reduce the credit risk of specific customers.

Since the customers of the industry is dispersed and non-related, the credit risk concentration is not critical aviation.

<u>Financial credit risk</u>

Credit risk on bank deposits, investments income and other financial instruments are measured and monitor by the Company's finance department. The Company's trading partners and other parties were well-performing banks and financial institutions, corporations, and government agencies, and so the risk of counterparties failing to discharge an obligation is low; therefore, there is no significant credit risk.

Endorsements given by the Company on behalf of its subsidiaries can be found in Note 31,g.

3) Liquidity risk

The objective of the Company's management of liquidity is to maintain cash and cash equivalents sufficient for operating purposes, marketable securities with high liquidity and loan commitments that are sufficient to ensure that the Group has adequate financial flexibility.

<u>Liquidity and interest risk rate table</u>

The following table shows the remaining contractual maturity analysis of the Company's financial liabilities with agreed-upon repayment periods, which were based on the date the Company may be required to pay the first repayment and financial liabilities is evaluated based on undiscounted cash flows, including cash flows of interest and principal.

Bank loans with a repayment on demand clause were included in the second column of the table below regardless of whether or not the banks would choose to exercise early their rights to repayment. The maturity dates for other non-derivative financial liabilities were based on the agreed-upon repayment dates. The Company's liquidity analysis for its derivative financial instruments is also shown in the following table. The table was based on the undiscounted contractual net cash inflows and outflows on derivative instruments that settle on a net basis, and the undiscounted gross cash inflows and outflows on those derivatives that require gross settlement. When the amount payable or receivable is not fixed, the amount disclosed has been determined by reference to the projected interest rates as illustrated by yield curves at the end of the reporting period.

December 31, 2017

| | The Weighted Average Effective Interest Rate (%) | 1-3 Months | 3 Months to 1 Year | 1-2 Years | 2-5 Years | 5+ Years |
|---|---|---|---|---|---|---|
| Capital lease obligations | 1.0789 | $ 225,869 | $ 1,375,827 | $ 154,430 | $ 452,833 | $ - |
| Floating interest rate liabilities | 1.1084 | 7,069,453 | 12,558,373 | 17,915,408 | 27,019,287 | 16,291,168 |
| Fixed interest rate liabilities | 1.1800 | 5,900 | 17,700 | 2,023,600 | - | - |
| Derivative instruments | - | 26,922 | 50,717 | 6,994 | - | - |
| Bonds payable | 1.4142 | 2,790,923 | 1,911,231 | 301,932 | 20,651,932 | 1,014,142 |
| | | $ 10,119,067 | $ 15,913,848 | $ 20,402,364 | $ 48,124,052 | $ 17,305,310 |

December 31, 2016

| | The Weighted Average Effective Interest Rate (%) | 1-3 Months | 3 Months to 1 Year | 1-2 Years | 2-5 Years | 5+ Years |
|---|---|---|---|---|---|---|
| Capital lease obligations | 1.0508 | $ 326,152 | $ 975,984 | $ 3,003,429 | $ 602,263 | $ - |
| Floating interest rate liabilities | 1.2477 | 4,521,325 | 27,424,092 | 15,213,937 | 31,768,363 | 5,033,023 |
| Fixed interest rate liabilities | 0.016 | 401,382 | 419,399 | 2,000,320 | - | - |
| Derivative instruments | - | 2,654 | 18,200 | 2,775 | - | - |
| Bonds payable | 1.3384 | 75,412 | 2,926,237 | 4,603,556 | 15,707,452 | - |
| | | $ 5,326,925 | $ 31,763,912 | $ 24,824,017 | $ 48,078,078 | $ 5,033,023 |

Loan commitments

| | December 31 | |
|---|---|---|
| | 2017 | 2016 |
| Unused bank loan limit (unsecured) | $ 25,181,000 | $ 14,424,006 |

## 31. RELATED-PARTY TRANSACTIONS

Except for the disclosures stated in other notes, transactions between the Company and its related parties are disclosed below:

a. Related parties' names and relationships

| Name | Relationship with the Company |
|---|---|
| Taiwan Aircargo Terminal Company | Subsidiary |
| Taoyuan International Airport Service Co., Ltd. | Subsidiary |
| Sabre Travel Network (Taiwan), Ltd. | Subsidiary |
| Taiwan Airport Service Co., Ltd. | Subsidiary |
| Taiwan Airport Service (Samoa) | Subsidiary |
| Hwa Hsia | Subsidiary |

(Continued)

| Name | Relationship with the Company |
|---|---|
| Yestrip | Subsidiary |
| Global Sky Express | Subsidiary |
| Mandarin Airlines | Subsidiary |
| Cal Park | Subsidiary |
| Cal Hotel Co., Ltd. | Subsidiary |
| Cal-Asia Investment | Subsidiary |
| Dynasty Holidays, Inc. | Subsidiary |
| Cal-Dynasty International Inc. | Subsidiary |
| Tigerair Taiwan Co., Ltd. | Subsidiary |
| Taiwan Aircraft Maintenance and Engineering Co., Ltd. | Subsidiary |
| Kaohsiung Catering Services | Associate |
| Science Park Logistics | Associate (disposal in August 2017) |
| Asian Compressor Technology Services | Associate |
| China Aircraft Service | Associate |
| Airport Air Cargo Terminal (Xiamen) Co., Ltd. | Associate |
| Airport Air Cargo Service (Xiamen) Co., Ltd. | Associate |
| Eastern United International Logistics (Hong Kong) | Associate |
| China Pacific Catering Services | Joint venture investment |
| China Pacific Laundry Services | Joint venture investment |
| Nordam Asia Ltd. | Joint venture investment |
| China Aviation Development Foundation | Director of the Company and major shareholder |
| Others | Director, key management personnel, chairman, general manager of the Company, spouse and second-degree relative |

(Concluded)

b. Operating income

| Account Items | Related Party Type | For the Year Ended December 31 2017 | 2016 |
|---|---|---|---|
| Other income | Subsidiary | $ 2,937,333 | $ 3,051,374 |
| | Major shareholder of the Company | $ 31,971 | $ 28,328 |
| | Associate | $ 1,938 | $ 2,552 |
| | Joint venture investment | $ 46,461 | $ 14,325 |

c. Purchases

| Related Party Type | For the Year Ended December 31 2017 | 2016 |
|---|---|---|
| Subsidiary | $ 3,081,697 | $ 2,881,974 |
| Major shareholder of the Company | $ 71,852 | $ 63,084 |
| Associate | $ 745,686 | $ 656,653 |
| Joint venture investment | $ 1,857,684 | $ 1,613,899 |

d. Accounts receivable - related parties (generated by operations)

| Related Party Type | December 31 2017 | December 31 2016 |
|---|---|---|
| Subsidiary | $ 502,229 | $ 435,946 |
| Associate | - | 501 |
| Joint venture investment | 6,431 | 1,550 |
| Major shareholder of the Company | 1,928 | 1,512 |
| | $ 510,588 | $ 439,509 |

The receivables are not guaranteed, and there is no allowance for doubtful accounts related to accounts receivable - related parties. The payment periods of such accounts were within 30 to 90 days, and there are no overdue payments.

e. Accounts payable - related parties (generated by operations)

| Related Party Type | December 31 2017 | December 31 2016 |
|---|---|---|
| Subsidiary | $ 903,200 | $ 791,178 |
| Associate | 116,525 | 120,824 |
| Joint venture investment | 469,827 | 431,502 |
| Major shareholder of the Company | 4,454 | 3,503 |
| | $ 1,494,006 | $ 1,347,007 |

The remaining balance of notes and accounts payable - related parties will be paid in cash if they are not secured.

f. Leases of properties (operating leases)

The Company rented out planes to Mandarin Airlines under an operating lease contract. The monthly rent received is based on flight hours. In 2017 and 2016, the rentals received amounted to $1,105,171 thousand and $1,022,817 thousand, respectively.

For fleet scheduling, the Company rented planes from Mandarin Airlines under an operating lease agreements beginning from July 2003. The Company paid the rental by flight hours. The contract was terminated in May 2016. The payments of flight rentals were $17,519 thousand in 2016.

Under an operating lease agreement, the Company rented flight training machines and flight simulators from China Aviation Development Foundation to train pilots. The Company paid the rental based on usage hours. In 2017 and 2016, the Company paid rentals of about $71,852 thousand and $63,084 thousand, respectively.

In March 2010, the Company signed with CAL Park a yearly renewable operating lease agreement to use the Operating and Aviation Headquarters building of the Taiwan Taoyuan International Airport. In 2017 and 2016, the Company paid rentals of about $228,942 thousand and $217,210 thousand, respectively.

g. Endorsements and guarantees

| | December 31 | | | |
|---|---|---|---|---|
| | 2017 | | 2016 | |
| | **Authorized Amount** | **Actual Amount Used** | **Authorized Amount** | **Actual Amount Used** |
| The Company | | | | |
| Cal Park | $ 3,850,000 | $ 2,850,000 | $ 3,850,000 | $ 2,783,000 |
| Taiwan Air Cargo Terminal | 1,080,000 | 318,611 | 1,080,000 | 436,418 |
| Cal Hotel | - | - | 180,000 | - |
| Tigerair Taiwan | 1,055,604 | 405,998 | 919,742 | 438,740 |

h. Bonds payable - related parties

Related parties that invested in the first issue of unsecured bonds in 2016 (Note 19) are summarized as follows:

| | December 31, 2016 | |
|---|---|---|
| **Related Party** | **Units** | **Aggregate Par/Dollars** |
| The first issue of unsecured bonds in 2016 | | |
| Mandarin Airlines | 250 | $ 250,000 |
| Sabre Travel Network (Taiwan) | 50 | 50,000 |

In 2017, interest expenses was $3,570 thousand. This bonds payable will be paid off in May 2021. As of December 31, 2017 the interest payable was $2,142 thousand.

i. Compensation of key management personnel

| | For the Year Ended December 31 | |
|---|---|---|
| | **2017** | **2016** |
| Short-term employee benefits | $ 46,805 | $ 47,748 |
| Post-employment benefits | 4,007 | 12,269 |
| | $ 50,812 | $ 60,017 |

The remuneration of directors and key executives was determined by the remuneration committee having regard to the performance of individuals and market trends.

## 32. PLEDGED ASSETS

The following assets were pledged or mortgaged as collateral for long-term bank loans, lease obligations and business transactions:

| | December 31 | |
|---|---|---|
| | **2017** | **2016** |
| Property, plant and equipment | $ 39,041,679 | $ 52,801,264 |

## 33. COMMITMENTS AND CONTINGENT LIABILITIES

As of December 31, 2017, the Company had commitments and contingent liabilities which were as follows:

In January 2008, the Company entered into a contract to buy fourteen A350-900 aircrafts from Airbus, with the option to buy six more A350-900 aircrafts, with aggregate listing purchase prices of US$3,933,235 thousand and US$1,802,645 thousand, respectively. The expected period of delivery of the aircrafts was from 2016 to 2018. As of December 31, 2017, ten of the aircrafts had been delivered to the Company, and the aggregated listing purchase price of the remaining ten aircrafts was $1,150,984 thousand, which has been paid in the amount of US$287,746 thousand (recognized as prepayments for aircrafts).

## 34. SIGNIFICANT ASSETS AND LIABILITIES DENOMINATED IN FOREIGN CURRENCIES

The following information was aggregated by the foreign currencies other than functional currencies of the Company entities and the exchange rates between foreign currencies and respective functional currencies were disclosed. The significant assets and liabilities denominated in foreign currencies were as follows:

December 31, 2017

| | Foreign Currencies (In Thousands) | Exchange Rate | Carrying Amount |
|---|---|---|---|
| Financial assets | | | |
| Monetary items | | | |
| USD | $ 290,336 | 29.8507 | $ 8,666,739 |
| EUR | 21,347 | 35.7143 | 762,410 |
| HKD | 293,677 | 3.8183 | 1,212,346 |
| JPY | 5,164,642 | 0.2648 | 1,367,597 |
| RMB | 365,624 | 4.5830 | 1,675,654 |
| Financial liabilities | | | |
| Monetary items | | | |
| USD | 406,155 | 29.8507 | 12,124,021 |
| EUR | 5,957 | 35.7143 | 212,759 |
| HKD | 77,929 | 3.8183 | 297,556 |
| JPY | 4,848,134 | 0.2648 | 1,283,786 |
| RMB | 120,472 | 4.5830 | 552,123 |

December 31, 2016

| | Foreign Currencies (In Thousands) | Exchange Rate | Carrying Amount |
|---|---|---|---|
| Financial assets | | | |
| Monetary items | | | |
| USD | $ 240,758 | 32.2581 | $ 7,764,768 |
| EUR | 15,642 | 34.0136 | 532,068 |
| HKD | 273,058 | 4.1580 | 1,135,374 |
| JPY | 4,799,620 | 0.2770 | 1,329,495 |
| RMB | 428,196 | 4.6425 | 1,987,898 |
| Financial liabilities | | | |
| Monetary items | | | |
| USD | 250,734 | 32.2581 | 8,088,204 |
| EUR | 6,511 | 34.0136 | 221,448 |
| HKD | 84,450 | 4.1580 | 351,141 |
| JPY | 4,408,042 | 0.2770 | 1,221,028 |
| RMB | 106,305 | 4.6425 | 493,520 |

For the years ended December 31, 2017 and 2016, the Company's net foreign exchange gains (losses) were $4,920 thousand and $(495,350) thousand, respectively. It is impractical to disclose net foreign exchange gains (losses) by each significant foreign currency due to the variety of the foreign currency transactions.

## 35. ADDITIONAL DISCLOSURES

a. Following are the additional disclosures required by the Securities and Futures Bureau for the Company and its investees:

1) Financing provided: None.

2) Endorsements/guarantees provided: Table 1 (attached).

3) Marketable securities held: Table 2 (attached).

4) Marketable securities acquired and disposed of at costs or prices of at least NT$300 million or 20% of the paid-in capital: Table 3 (attached).

5) Acquisitions of individual real estates at costs or price of at least NT$100 million or 20% of the paid-in capital: None.

6) Disposals of individual real estates at costs or prices of at least NT$100 million or 20% of the paid-in capital: None.

7) Total purchases from or sales to related parties amounting to at least NT$100 million or 20% of the paid-in capital: Table 4 (attached).

8) Receivables from related parties amounting to at least NT$100 million or 20% of the paid-in capital: Table 5 (attached).

9) Names, locations, and related information of investees over which the Company exercises significant influence: Table 6 (attached).

10) Derivative financial transactions: Notes 7 and 8.

b. Investment in mainland China: Table 7 (attached).

## 36. SEGMENT INFORMATION

The Company mainly engages in air transportation services for passengers, cargo and others. The major revenue-generating asset is the fleet, which is jointly used for passenger and cargo services. Thus, the Company's sole reportable segment is the flight segment. For operating segment reporting in the financial statements, the Company's reportable segment comprises the flight and the non-flight business departments.

TABLE 1

# CHINA AIRLINES, LTD. AND INVESTEES

**ENDORSEMENT/GUARANTEE PROVIDED**
**FOR THE YEAR ENDED DECEMBER 31, 2017**
**(In Thousands of New Taiwan Dollars, Unless Stated Otherwise)**

| No. | Endorsement/ Guarantee Provider | Counterparty | | Limit on Each Counterparty's Endorsement/ Guarantee Amount (Note 1) | Maximum Balance for the Period | Ending Balance | Actual Borrowing Amount | Value of Collaterals Property, Plant or Equipment | Ratio of Accumulated Amount of Collateral to Net Equity of the Latest Financial Statement (%) | Maximum Collateral/ Guarantee Amounts Allowable (Note 2) | Endorsement/ Guarantee Given by Parent on Behalf of Subsidiaries | Endorsement/ Guarantee Given by Subsidiaries on Behalf of Parent | Endorsement/ Guarantee Given on Behalf of Companies in Mainland China |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | Name | Nature of Relationship | | | | | | | | | | |
| 0 | China Airlines (the "Company") | Cal Park | 100% subsidiary | $ 11,404,647 | $ 3,850,000 | $ 3,850,000 | $ 2,850,000 | - | 6.75 | $ 28,511,619 | Y | N | N |
| | | Taiwan Air Cargo Terminal | 54% subsidiary | 11,404,647 | 1,080,000 | 1,080,000 | 318,611 | - | 1.89 | 28,511,619 | Y | N | N |
| | | Cal Hotel | 100% subsidiary | 11,404,647 | 180,000 | - | - | - | - | 28,511,619 | Y | N | N |
| | | Tigerair Taiwan Ltd. | 100% subsidiary by direct and indirect holdings | 11,404,647 | 1,079,101 | 1,055,604 | 405,998 | - | 1.85 | 28,511,619 | Y | N | N |

Note 1: Based on the Company's guidelines, the maximum amount of guarantee to an individual counterparty is up to 20% of the Company's shareholders' equity.

Note 2: Based on the Company's guidelines, the allowable aggregate amount of collateral guarantee is up to 50% of the Company's shareholders' equity.

# CHINA AIRLINES, LTD. AND INVESTEES

**MARKETABLE SECURITIES HELD**
**DECEMBER 31, 2017**
**(In Thousands of New Taiwan Dollars, Unless Stated Otherwise)**

| Holding Company Name | Marketable Security Type and Issuer/Name | Relationship with the Holding Company | Financial Statement Account | December 31, 2017 | | | | Note |
|---|---|---|---|---|---|---|---|---|
| | | | | Number of Shares/Units | Carrying Amount | Percentage of Ownership (%) | Market Value or Net Asset Value | |
| China Airlines ("Parent company") | Shares | | | | | | | |
| | Everest Investment Holdings Ltd. - common shares | - | Financial assets carried at cost - noncurrent | 1,359,368 | $ 52,704 | 13.59 | $ 60,524 | Note 1 |
| | Everest Investment Holdings Ltd. - preference shares | - | Financial assets carried at cost - noncurrent | 135,937 | 473 | - | - | Note 1 |
| | Chung Hua Express Co. | - | Financial assets carried at cost - noncurrent | 1,100,000 | 11,000 | 11.00 | 27,960 | - |
| | Jardine Air Terminal Services | - | Financial assets carried at cost - noncurrent | 12,000,000 | - | 15.00 | 9,167 | - |
| Mandarin Airlines | Shares | | | | | | | |
| | China Airlines | Parent company | Available-for-sale financial assets - current | 2,074,628 | 24,169 | - | 24,169 | - |
| | Beneficiary certificates | | | | | | | |
| | Barclays America Bonds Fund | - | Financial assets at fair value through profit or loss - current | 1,000,000 | 30,030 | - | 30,030 | - |
| Cal-Asia Investment | Shares | | | | | | | |
| | Taikoo (Xiamen) Landing Gear Services | - | Financial assets carried at cost - noncurrent | - | - | 2.59 | 31,152 | Note 2 |
| | Taikoo Spirit Aerospace Systems (Jinjiang) Composite | - | Financial assets carried at cost - noncurrent | - | 19,898 | 5.45 | 25,434 | Note 2 |
| Sabre Travel Network (Taiwan) | Beneficiary certificates | | | | | | | |
| | Franklin Templeton SinoAm Money Market Fund | - | Financial assets at fair value through profit or loss - current | 6,709,255 | 68,926 | - | 68,926 | - |
| | FSITC Taiwan Money Market Fund | - | Financial assets at fair value through profit or loss - current | 5,664,992 | 86,148 | - | 86,148 | - |
| | Allianz Global Investors Money Market Fund | - | Financial assets at fair value through profit or loss - current | 5,368,495 | 66,869 | - | 66,869 | - |
| Taiwan Airport Services | Shares | | | | | | | |
| | TransAsia Airways | - | Available-for-sale financial assets - noncurrent | 2,277,786 | - | 0.40 | - | - |
| | Beneficial certificates | | | | | | | |
| | Fuh Hwa Emerging Market Short-term Income Fund | - | Financial assets at fair value through profit or loss - current | 4,568,824 | 50,166 | - | 50,166 | - |
| Hwa Hsia | Shares | | | | | | | |
| | China Airlines | Parent company | Available-for-sale financial assets - current | 814,152 | 9,485 | - | 9,485 | - |
| | Beneficiary certificates | | | | | | | |
| | Taishin 1699 Money Market Fund | - | Financial assets at fair value through profit or loss - current | 349,523 | 4,700 | - | 4,700 | - |

Note 1: The subsidiary's net asset value was $60,524 thousand, which included common shares and preference shares as of and for the year ended December 31, 2017.

Note 2: The Company does not issue shares because it is a limited company.

## CHINA AIRLINES, LTD. AND SUBSIDIARIES

**MARKETABLE SECURITIES ACQUIRED AND DISPOSED OF AT COSTS OR PRICES OF AT LEAST NT$300 MILLION OR 20% OF THE PAID-IN CAPITAL**
**FOR THE YEAR ENDED DECEMBER 31, 2017**
**(In Thousands of New Taiwan Dollars, Unless Stated Otherwise)**

| Company Name | Type and Name of Marketable Securities (Note 1) | Financial Statement Account | Counterparty (Note 2) | Relationship (Note 2) | Beginning Balance | | Acquisition (Note 3) | | Disposal (Note 3) | | | | Ending Balance | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | Number of Shares | Amount | Number of Shares | Amount | Number of Shares | Amount | Carrying Amount | Gain (Loss) on Disposal | Number of Shares | Amount |
| China Airlines, Ltd. | <u>Shares</u> | | | | | | | | | | | | | |
| | Science Park Logistics | Investments accounted for using the equity method | HCT Logistics Co., Ltd. | Non-related party | - | $ - | - | $ - | - | $ - | $ - | $ - | - | $ - |
| | Taiwan Aircraft Maintenance and Engineering Co., Ltd. | Investments accounted for using the equity method | Taiwan Aircraft Maintenance and Engineering Co., Ltd. | Subsidiary | - | - | - | - | - | - | - | - | - | - |

Note 1: The marketable securities in this table refer to shares, bonds, beneficial certificates and the securities derived from the above items.

Note 2: Marketable securities which are recognized as investments accounts for using the equity method are required to be filled in the second column.

Note 3: The cumulative amount of acquired and disposed of marketable securities are required to be calculated separately to determine whether they are at least NT$300 million or 20% of the paid-in capital.

Note 4: Paid-in capital refers to paid-in capital of the indicated parent company. If the shares issued by an issuer have no par value or a par value other than NT$10 per share, the threshold of 20% of paid-in capital, as set out in the preceding item, shall be replaced by 10% of equity attributable to owners of the indicated parent company, as stated in the respective balance sheet.

# CHINA AIRLINES, LTD. AND INVESTEES

**TOTAL PURCHASES FROM OR SALES TO RELATED PARTIES AMOUNTING TO AT LEAST NT$100 MILLION OR 20% OF THE PAID-IN CAPITAL**
**FOR THE YEAR ENDED DECEMBER 31, 2017**
**(In Thousands of New Taiwan Dollars, Unless Stated Otherwise)**

| Company Name | Related Party | Nature of Relationship | Transaction Details | | | | Abnormal Transaction | | Note/Account Payable or Receivable | | Note |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | Purchase/ Sale | Amount | % of Total | Payment Terms | Unit Price | Payment Terms | Ending Balance | % of Total | |
| China Airlines, Ltd. | Taiwan Air Cargo Terminal | Subsidiary | Purchase | $ 507,489 | 0.42 | 30 days | $ - | - | $ (48,735) | (3.34) | - |
| (“China Airlines”) | Hua Hsia | Subsidiary | Purchase | 334,375 | 0.27 | 2 months | - | - | (49,140) | (3.37) | - |
| | Mandarin Airlines | Subsidiary | Sale | (2,495,101) | (1.78) | 2 months | - | - | 452,488 | 4.99 | - |
| | Mandarin Airlines | Subsidiary | Purchase | 147,914 | 0.12 | 2 months | - | - | (339,274) | (23.28) | - |
| | China Pacific Catering Services | Equity-method investee | Purchase | 1,737,819 | 1.43 | 90 days | - | - | (440,739) | (30.24) | - |
| | Cal Park | Subsidiary | Purchase | 228,942 | 0.19 | 2 months | - | - | - | - | - |
| | Taiwan Airport Services | Subsidiary | Purchase | 375,579 | 0.31 | 40 days | - | - | (67,871) | (4.66) | - |
| | Taoyuan International Airport Service | Subsidiary | Purchase | 1,193,551 | 0.98 | 40 days | - | - | (355,885) | (24.42) | - |
| | Kaohsiung Catering Services | Equity-method investee | Purchase | 376,678 | 0.31 | 60 days | - | - | (70,948) | (4.87) | - |
| | China Aircraft Services | Equity-method investee | Purchase | 197,713 | 0.16 | 30 days | - | - | (30,260) | (2.08) | - |
| | Cal Hotel | Subsidiary | Purchase | 136,681 | 0.11 | 1 month | - | - | (10,140) | (0.70) | - |
| | Tigerair Taiwan | Subsidiary | Sale | (288,954) | (0.21) | 1 month | - | - | 38,796 | 0.43 | - |
| | China Pacific Laundry Services | Equity-method investee | Purchase | 119,865 | 0.10 | 2 months | - | - | (29,088) | (2.00) | - |
| | Eastern United International Logistics | Equity-method investee | Purchase | 138,905 | 0.11 | 2 months | - | - | (14,769) | (1.01) | - |
| Tigerair Taiwan | Taoyuan International Airport Service | Same parent company | Purchase | 152,384 | 2.59 | 30 days | - | - | (30,344) | (4.79) | - |
| Mandarin Airlines | Taiwan Airport Services | Same parent company | Purchase | 121,505 | 1.78 | 1 month | - | - | (17,825) | (1.42) | - |

# CHINA AIRLINES, LTD. AND INVESTEES

**RECEIVABLES FROM RELATED PARTIES AMOUNTING TO AT LEAST NT$100 MILLION OR 20% OF THE PAID-IN CAPITAL**
**DECEMBER 31, 2017**
**(In Thousands of New Taiwan Dollars, Unless Stated Otherwise)**

| Company Name | Related Party | Nature of Relationship | Ending Balance (Note) | Turnover Rate | Overdue | | Amounts Received in Subsequent Period | Allowance for Bad Debts |
|---|---|---|---|---|---|---|---|---|
| | | | | | Amount | Action Taken | | |
| China Airlines, Ltd. (“China Airlines”) | Mandarin Airlines | Subsidiary | $ 452,488 | Note | $ - | - | $ 271,899 | $ - |
| Mandarin Airlines | China Airlines | Parent company | 339,274 | Note | - | - | 307,390 | - |
| China Pacific Catering Services | China Airlines | Parent company | 440,739 | 4.08 | - | - | 440,698 | - |
| Taoyuan International Airport Service | China Airlines | Parent company | 355,885 | 3.51 | - | - | 355,764 | - |

Note: Accounts receivable and revenue were not directly correlated because of the particular industry characteristics, and therefore the turnover rate was not applicable.

# CHINA AIRLINES, LTD. AND INVESTEES

**NAMES, LOCATIONS, AND OTHER INFORMATION OF INVESTEES OVER WHICH THE COMPANY EXERCISES SIGNIFICANT INFLUENCE**
**FOR THE YEAR ENDED DECEMBER 31, 2017**
**(New Taiwan Dollars and Foreign Currencies in Thousands, Unless Stated Otherwise)**

| Investor Company | Investee Company | Location | Main Business and Product | Investment Amount | | Balance as of December 31, 2017 | | | Net Income (Loss) of the Investee | Investment Income (Loss) | Note |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | | December 31, 2017 | December 31, 2016 | Number of Shares/Units | Percentage of Ownership (%) | Carrying Amount | | | |
| China Airlines, Ltd. | Cal Park | Taoyuan, Taiwan | Real estate lease and international trade | $ 1,500,000 | $ 1,500,000 | 150,000,000 | 100.00 | $ 1,522,696 | $ 10,017 | $ 10,017 | - |
| | Mandarin Airlines | Taipei, Taiwan | Air transportation and maintenance of aircraft | 2,042,368 | 2,042,368 | 188,154,025 | 93.99 | 1,211,739 | 125,570 | 118,023 | Note 1 |
| | Taiwan Air Cargo Terminal | Taoyuan, Taiwan | Air cargo and storage | 1,350,000 | 1,350,000 | 135,000,000 | 54.00 | 1,339,450 | 190,444 | 102,840 | - |
| | Cal-Dynasty International | Los Angeles, U.S.A. | A holding company, real estate and hotel services | US$ 26,145 | US$ 26,145 | 2,614,500 | 100.00 | 1,185,323 | 34,695 | 34,695 | Note 2 |
| | China Pacific Catering Services | Taoyuan, Taiwan | In-flight catering | 439,110 | 439,110 | 43,911,000 | 51.00 | 756,965 | 472,248 | 235,871 | - |
| | Taoyuan International Airport Services | Taoyuan, Taiwan | Airport services | 147,000 | 147,000 | 34,300,000 | 49.00 | 654,104 | 248,207 | 121,622 | - |
| | Cal-Asia Investment | Territory of the British Virgin Islands | General investment | US$ 7,172 | US$ 7,172 | 7,172,346 | 100.00 | 478,933 | 31,191 | 31,191 | - |
| | Sabre Travel Network (Taiwan) | Taipei, Taiwan | Sale and maintenance of hardware and software | 52,200 | 52,200 | 13,021,042 | 93.93 | 450,600 | 182,046 | 171,004 | - |
| | China Aircraft Service | Hong Kong International Airport | Airport services | HK$ 58,000 | HK$ 58,000 | 28,400,000 | 20.00 | 493,077 | 122,349 | 24,470 | - |
| | Asian Compressor Technology Services | Taoyuan, Taiwan | Research, manufacture and maintenance of engines | 3,704 | 77,322 | 370,440 | - | - | 363,033 | 88,943 | Note 5 |
| | Taiwan Airport Services | Taipei, Taiwan | Airport services | 12,289 | 12,289 | 20,626,644 | 47.35 | 259,459 | 108,331 | 51,295 | - |
| | Kaohsiung Catering Services | Kaohsiung, Taiwan | In-flight catering | 140,240 | 140,240 | 14,329,759 | 35.78 | 300,400 | 242,473 | 86,757 | - |
| | Cal Hotel Co., Ltd | Taoyuan, Taiwan | Hotel business | 465,000 | 465,000 | 46,500,000 | 100.00 | 435,965 | 48,590 | 48,590 | - |
| | Science Park Logistics | Tainan, Taiwan | Storage and customs of services | - | 214,745 | - | - | - | 83,919 | 21,819 | - |
| | China Pacific Laundry Services | Taoyuan, Taiwan | Cleaning and leasing of the towel of airlines, hotels, restaurants and health clubs | 137,500 | 137,500 | 13,750,000 | 55.00 | 171,229 | 42,461 | 23,354 | - |
| | Hwa Hsia | Taoyuan, Taiwan | Cleaning of aircraft and maintenance of machine and equipment | 77,270 | 77,270 | 77,270 | 100.00 | 83,014 | 11,280 | 11,280 | Note 1 |
| | Yestrip | Taipei, Taiwan | Travel business | 26,265 | 26,265 | 1,600,000 | 100.00 | 25,904 | 440 | 440 | - |
| | Dynasty Holidays | Tokyo, Japan | Travel business | JPY 20,400 | JPY 20,400 | 408 | 51.00 | 25,992 | (4,725) | (2,410) | - |
| | Global Sky Express | Taipei, Taiwan | Forwarding and storage of air cargo | 2,500 | 2,500 | 250,000 | 25.00 | 7,437 | 6,876 | 1,719 | - |
| | Freighter Princess Ltd. | Cayman Islands | Aircraft lease | US$ - | US$ 1 | - | - | - | - | - | - |
| | Freighter Prince Ltd. | Cayman Islands | Aircraft lease | - | US$ 1 | - | - | - | - | - | - |
| | Tigerair Taiwan Co., Ltd. | Taipei, Taiwan | Air transportation and maintenance of aircraft | 1,648,387 | 1,600,000 | 180,000,000 | 90.00 | 915,135 | 572,953 | 514,897 | - |
| | Taiwan Aircraft Maintenance and Engineering Co., Ltd. | Taoyuan, Taiwan | Aircraft maintenance | 1,350,000 | 160,000 | 135,000,000 | 100.00 | 1,231,548 | (68,580) | (68,580) | Note 4 |
| | Nordam Asia Ltd. | Taoyuan, Taiwan | Aircraft maintenance | 2,450 | - | 245,000 | 49.00 | 2,399 | (104) | (51) | - |
| Mandarin Airlines | Tigerair Taiwan Co., Ltd. | Taipei, Taiwan | Air transportation and maintenance of aircraft | 200,000 | 200,000 | 20,000,000 | 10.00 | 101,682 | 572,953 | 57,295 | - |
| | Taiwan Airport Services | Taipei, Taiwan | Airport services | 11,658 | 11,658 | 469,755 | 1.08 | 5,902 | 108,330 | 1,167 | - |
| Cal-Asia Investment | Eastern United International Logistics | Hong Kong | Forwarding and storage of air cargo | HK$ 3,329 | HK$ 3,329 | 1,050,000 | 35.00 | 43,171 | 13,726 | 4,804 | - |
| Taiwan Airport Services | Taiwan Airport Service (Samoa) | Samoa | Airport services and investment | US$ 5,877 | US$ 5,877 | - | 100.00 | 370,322 | 25,143 | 25,143 | Note 3 |

Note 1: Adopted the treasury shares method in recognizing investment income or loss.

Note 2: Represents the consolidated financial information of the foreign holding company disclosed in accordance with local regulations.

Note 3: The Company does not issue shares because it is a limited company.

Note 4: Taiwan Aircraft Maintenance and Engineering Co., Ltd. invested capital in the amount of $490,000 thousand and $700,000 thousand in April 2017 and November 2017, respectively.

Note 5: The Company signed a contract to sell all of its holding in Asian Compressor Technology Services, and reclassified it as noncurrent assets held for sale at book value.

# CHINA AIRLINES, LTD. AND INVESTEES

**INVESTMENTS IN MAINLAND CHINA**
**FOR THE YEAR ENDED DECEMBER 31, 2017**
**(New Taiwan Dollars/Renminibi/U.S. Dollars In Thousands, Unless Stated Otherwise)**

China Airlines

| Investee Company Name | Main Business and Product | Total Amount of Paid-in Capital | Investment Type | Accumulated Outflow of Investment from Taiwan as of January 1, 2017 | Investment Flow | | Accumulated Outflow of Investment from Taiwan as of December 31, 2017 | Net Income (Loss) of the Investee | % Ownership of Direct or Indirect Investment | Investment Gain (Loss) | Carrying Amount as of December 31, 2017 | Accumulated Inward Remittance of Earnings as of December 31, 2017 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | Outflow | Inflow | | | | | | |
| Airport Air Cargo Terminal (Xiamen) Co., Ltd. | Forwarding and storage of air cargo | $ 1,028,781 (RMB 224,480) | Indirect (Note 1) | $ 124,955 (US$ 4,186) | $ - | $ - | $ 124,955 (US$ 4,186) | $ 79,880 (RMB 17,741) | 14.00 | $ 12,098 (RMB 2,484) | $ 242,549 (RMB 52,924) | $ 83,634 (US$ 2,802) (Note 2) |
| Airport Air Cargo Service (Xiamen) Co., Ltd. | Forwarding and storage of air cargo | 64,161 (RMB 14,000) | Indirect (Note 1) | 58,133 (US$ 1,947) | - | - | 58,133 (US$ 1,947) | 99,528 (RMB 22,105) | 14.00 | 13,952 (RMB 3,095) | 128,035 (RMB 27,937) | $ 26,129 (US$ 875) (Note 2) |
| Taikoo (Xiamen) Landing Gear Services | Landing gear maintenance services | 1,101,194 (US$ 36,890) | Indirect (Note 1) | 64,215 (US$ 2,151) | - | - | 64,215 (US$ 2,151) | - | 2.59 | - | - | - |
| Taikoo Spirit Aerospace Systems (Jinjang) | Composite material | 348,149 (US$ 11,663) | Indirect (Note 1) | 18,985 (US$ 636) | - | - | 18,985 (US$ 636) | - | 5.45 | - | 19,898 (RMB 4,342) | - |

| Accumulated Investment in Mainland China as of December 31, 2017 | Investment Amount Authorized by Investment Commission, MOEA | Limit on Investment |
|---|---|---|
| $266,287 (US$8,920) | $647,805 (Note 3) | $34,213,942 (Note 4) |

(Continued)

Taiwan Airport Services

| Investee Company | Main Business and Product | Paid-in Capital | Method of Investment | Accumulated Outward Remittance for Investment from Taiwan as of January 1, 2017 | Remittance of Funds: Outward | Remittance of Funds: Inward | Accumulated Outward Remittance for Investment from Taiwan as of December 31, 2017 | Net Income (Loss) of the Investee | % Ownership of Direct or Indirect Investment | Investment Income (Loss) | Carrying Amount as of December 31, 2017 | Accumulated Repatriation of Investment Income as of December 31, 2017 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Airport Air Cargo Terminal (Xiamen) Co., Ltd. | Forwarding and storage of air cargo | $ 1,028,781 (RMB 224,480) | Indirect (Note 5) | $ 119,951 (US$ 4,018) | $ - | $ - | $ 119,951 (US$ 4,018) | $ 79,880 (RMB 17,741) | 14.00 | $ 11,183 (RMB 2,484) | $ 241,265 (RMB 52,644) | $ 113,622 (US$ 3,806) |
| Airport Air Cargo Service (Xiamen) Co., Ltd. | Forwarding and storage of air cargo | 64,161 (RMB 14,000) | Indirect (Note 5) | 57,515 (US$ 1,927) | - | - | 57,515 (US$ 1,927) | 99,528 (RMB 22,105) | 14.00 | 13,934 (RMB 3,095) | 128,256 (RMB 27,985) | 41,988 (US$ 1,407) |

| Accumulated Outward Remittance for Investment in Mainland China as of December 31, 2017 | Investment Amounts Authorized by Investment Commission, MOEA | Upper Limit on the Amount of Investment Stipulated by Investment Commission, MOEA |
|---|---|---|
| $177,466 (US$5,945) | $177,466 (US$5,945) | $328,776 (Note 4) |

Note 1: China Airlines, Ltd. the "Company" invested in Cal-Asia Investment, which, in turn, invested in a company located in mainland China.

Note 2: The inward remittance of earnings in 2017 amounted to US$2,801,749 and US$875,330.

Note 3: The amount comprised US$19,828,324, RMB4,200,000 and NT$36,666,667.

Note 4: The limit stated in the Investment Commission's regulation, "Investment or Technical Cooperation in Mainland China Adjustment Rule," is the larger of the Company's net asset value or 60% of the consolidated net asset value.

Note 5: Taiwan Airport Services invested in Taiwan Airport Services (Samoa), which in return, invested in a company located in mainland China.

Note 6: The RMB and U.S. dollar amounts of assets are translated at year-end rates and those of gains (losses), at the average of the year-end rates of refer for the reporting period.

(Concluded)