

CALC

China Aircraft Leasing Group Holdings Limited

(Incorporated under the laws of the Cayman Islands with limited liability)

Stock code: 01848

Resilient Growth Future in Motion



2024
RISK MANAGEMENT REPORT

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1 MAIN FEATURES OF RISK MANAGEMENT AND INTERNAL CONTROL

The Board has overall responsibility for evaluating and determining the nature and extent of the risks it is willing to take in achieving the Group's strategic objectives and ensuring that the company establishes and maintains appropriate and effective risk management and internal control systems and review their effectiveness. Such risks include, amongst others, material risks relating to ESG. The Board oversees management in the design, implementation and monitoring of the risk management and internal control systems. Such internal control systems are designed to manage instead of eliminating the risk of failure to achieve business objectives, and can only provide reasonable but not absolute assurance against material misstatement or loss. In this connection, the Board ensures the adequacy of resources, staff qualifications and experiences, training programs and budget for the accounting, internal audit and financial reporting functions, as well as those relating to the Group's ESG performance and reporting.

The internal control system is designed to achieve a robust management of material and overall risks in pursuit of the Group's business objectives.

The Board operates within the clearly defined terms of reference, and has appropriate committees established, namely, Strategy Committee, Audit Committee, Nomination Committee and Remuneration Committee to oversee risk and internal control activities. Each of these Committees also have clearly defined terms of reference.

The Board aims at achieving an appropriate balance between taking risks and generating returns for shareholders while executing its responsibility for ongoing monitoring of risk and internal controls.

Our Audit Committee is designated to oversee the risk management and internal control processes, particularly, standards of financial reporting, risk management and internal controls.

On the operational level, the Aviation Risk Management team oversees the operational and business risks of the aircraft leasing business. On the Group level, the internal audit function directly reports to the Audit Committee for independent monitoring and reporting of risks and controls.

The Group has established the following objectives of risk management and internal control:

- (i) Continue to optimize its business model, integrating it with the Group's enhanced corporate governance structure to reduce the inherent risks in its business activities, such as liquidity risk and credit risk;
- (ii) Continue to leverage its business network to effectively enhance its industry knowledge so as to reduce the probability of and the impact from defaulted and discontinued lease transactions; and
- (iii) Continue to cultivate a strong risk management corporate culture throughout the organization. The Group has implemented its risk management system and policies aligned with the business model and strategic dimension.

RISK MANAGEMENT REPORT

Business model dimension

The Group's business is organized and operated on transaction basis to ensure each transaction is reviewed from different perspectives, facilitating stringent selection of suitable aircraft assets and rigorous review of credit assessment and approval.

Strategic dimension

Risk management initiatives are led by the Board (through its Audit Committee) and executed by the CEO and the senior management team, through an independent internal audit function.

The Group's risk management and internal control framework is designed to minimize the risks in achieving the Group's strategic objectives. The key principles of the framework are as follows:

- The Board and the Management shall promote a culture to identify, assess and report risks in an open, transparent and objective manner.
- The priority of the Group is to protect its long-term and sustainable interests.

Risk management is embedded within all businesses and operations of the Group. The Group expects all individual behavior to demonstrate and share the culture and core values of the Group. All employees have the responsibility of upholding the Group's risk and control culture and supporting effective risk management to deliver its strategy.

The Group operates a "three lines of defense" framework for managing and identifying risks.

The first line of defense against undesirable outcomes is undertaken by the business function and the respective line managers. Department heads of all business areas are responsible for implementing and maintaining appropriate controls.

Line management is supported and monitored by middle and back office functions like, Transaction Support, Finance and Accounting, Legal, Company Secretary, Human Resources, Information Technology and Aviation Risk Management, which constitute the second line of defense. This line of defense monitors and facilitates the implementation of effective risk management practices by risk owners and reports risk related information throughout the organization.

The third line of defense is carried out by the internal audit function. It provides an independent review on the operation of controls.

On top of the three lines of defense, the Board reviews the effectiveness of the Group's risk management and internal control system, with the assistance of Audit Committee, which covers all material controls including financial, operational and compliance controls, and the risk management system.

RISK MANAGEMENT REPORT

2 ANNUAL REVIEW OF THE RISK MANAGEMENT AND INTERNAL CONTROL

On behalf of the Board and the Audit Committee, the internal audit function carried out the annual review of the effectiveness of the Group's risk management and internal control system for the year ended 31 December 2024. The results were reported to the Audit Committee and the Board. The Board acknowledged that the risk management and internal control system of the Group during the review period were effective and adequate.

The annual review conducted by the internal audit function is set out as follows:

2.1 Ongoing Monitoring of Risk and Internal Control

2.1.1 *Scope and quality*

During the year, the Board reviewed the business of the Group through its regular meetings in order to ensure that business risks had been considered, assessed and managed as an integral part of the business. There was an ongoing process for identifying, evaluating and managing the Group's significant risks. The Group's risk assessment process included the monitoring of key strategic, financial, compliance, reporting and ESG risks. In addition, the Group reviewed the impact of any changes and developments on its risk profile, strategic risk and reputation and the work of its internal audit function.

The impact and likelihood of each significant risk was evaluated with reference to associated measures and key performance indicators. The adequacy of the risk mitigation plans was assessed and, if necessary, improvements were made.

2.1.2 *Extent and frequency of communication*

The Audit Committee held regular meetings and reviewed quarterly for assessing control of the Group and the effectiveness of risk management.

Risks and risk events are captured by the business and reported to the second line of defense. Specific reports and periodic updates are submitted to the Board after the review by the Audit Committee, if necessary. Issues would be raised when there were control failures, weaknesses and inefficient processes identified or through continuous monitoring reviews by the second and third line of defense teams.

2.2 Significant Control Failings or Weaknesses

The Group has underlying procedures to handle significant control failures or weaknesses, which include material adverse event assessment, mitigation plan and follow up action. Significant control failure is required to be reported by senior management to the Audit Committee and the Board. No significant control failures or weaknesses were identified during the year upon the internal audit function's annual review.

RISK MANAGEMENT REPORT

2.3 Effectiveness of Financial Reporting and Listing Rule Compliance

With the support and input from the External Auditor, our Audit Committee carried out its review and assessment of the Group's financial reporting, covering key areas such as whether suitable accounting policies were adopted, whether management made appropriate estimates and judgments and whether disclosures in published financial statements were fair, balanced and understandable.

The Audit Committee carries out its compliance review to assess whether the Group has been complying with the relevant regulatory requirements on a quarterly basis. The compliance review summarized the compliance status, corrective actions and the enhancement recommendations.

In light of the above, the Audit Committee considered the Group's processes in financial reporting and Listing Rules' Compliance were effective.

2.4 Risk Mitigating Measures and Key Changes

The Group is exposed to various risks including but not limited to financial market risk, counterparty risk, compliance risk, business risk and ESG risk. Risk management and internal controls are the day-to-day responsibility of every employee. In order to cope with these risks, the Group monitors and implements mitigating measures both as part of our governance and our day-to-day decision making. In the sphere of aviation, these are coordinated and overseen by the Aviation Risk Management team.

In 2024, air travel continued its strong recovery and remains central to global connectivity. According to IATA, airlines served almost 5 billion passengers on 22,718 unique city pairs in 2024 – 32% more than ten years previously, but fares at inflation adjusted were 44% lower. Despite this fare pressure, the industry recorded a net profit margin of 3.3% (2023: 3.9%) and is on track to exceed US\$1 trillion in annual revenues for the first time in 2025. Commensurate with this background, in 2024 most of the airline customers who leased aircraft from the Group's portfolio shown an improvement in liquidity and profitability although, in line with the wider industry, the performance of some continues to be weighed down by pandemic era debt and trade liability. The Group's customers continued to erase deferred balances which at 2024 year end stood at just 0.69% of cumulative invoicing since 1 January 2020. There were no uncured payment defaults in 2024.

Demand for leased aircraft remained strong throughout the period; in particular, demand for used equipment continued to benefit from a shortage of new deliveries. As a result, the Group was generally able to either extend leases at favourable terms or enhance the in average credit profile through remarketing and portfolio trading. This trend is expected to continue through 2025/2026 at least. Uncertainties do, as always, threaten this positive outlook — particularly around geopolitical/trade considerations and regional conflicts. The Group believes its well diversified customer base and fleet of predominantly liquid, desirable, fuel efficient narrowbody aircraft to be an effective hedge against any disruptions in demand.

The 'upward slope' of each airline industry cycle represents an opportunity to prepare for the next 'downward slope' by shaping the portfolio and improving the quality of our leases, particularly in respect of credit and security. The Aviation Risk Management team continues to improve the Group's risk oversight/mitigation capability through such measures as the introduction of Risk Adjusted Pricing, the development of a robust concentration model, modernization/improvement of our qualitative rating methodology, maintenance and review of the Group's 'Watch List' (together with recommendations for mitigating actions), monitoring of aircraft-on-ground situations and oversight of components installed on non-title aircraft or in maintenance. The Aviation Risk Management team also leads in receivables monitoring and credit/market analysis. Team members are focal to each 'Deal Team' in reviewing lease documentation, performing due diligence and proposing enhanced security measures. The team also acts as the primary contact for all outbound 'Know Your Customer' (KYC) requests.

RISK MANAGEMENT REPORT

Regarding the market performance of Mainland China in 2024, the domestic market formally entered the second year in the post-pandemic recovery. The impact of the pandemic on the domestic aviation industry's operations further diminished. Compared to 2023, the domestic civil aviation market in the year focused more on post-pandemic air transport recovery and demand growth. The domestic passenger flight market demand has surpassed pre-pandemic levels and reached historical highs, while the international passenger flight market has gradually recovered to approximately 80% of the level in 2019.

The Group benefited from the continued improvement in the operating environment of the domestic civil aviation market and enhanced cash flow of airlines, resulting in a further reduction in the overall overdue receivables balance for 2024. As of 2024, the overall credit risk structure of the Group in the Mainland China market remained dominated by airlines with higher credit ratings in aircraft leasing. To maintain a stable credit rating, the Group has adopted methods such as asset transactions to reduce aircraft leasing exposure to airlines with lower credit ratings.

Regarding daily operational risk management, this primarily involved continuous assessment of key operational indicators and cash reserves of the airlines. Airlines showing elevated default risks were placed on a watch list for close monitoring, with mitigation plans formulated to reduce impacts and prevent further risk deterioration. Primary measures included, but are not limited to, issuing payment demand letters to overdue airlines, conducting site visits, and initiating legal proceedings to safeguard the Group's interests. Concurrently, the Group proactively adopted measures such as aircraft repossession and litigation to minimize impacts from high-default-risk airlines.

During the year, the Group undertook the following measures in order to further mitigate finance/ portfolio related risks:

- (i) Took new delivery of 17 aircraft and disposed of 25 aircraft to third party to reduce geographical and portfolio concentration risks.
- (ii) Received its first long-term credit rating of Ag- by China Chengxin (Asia Pacific) Credit Ratings Company Limited, with a stable outlook in 2024. This marks the Group's first investment-grade international rating of Ag-, reflecting a positive recognition of the Group's comprehensive strength and strong development prospects by Chinese credit rating agency. It is beneficial for enhancing the Group's image in the international capital markets.
- (iii) With the relatively stable interest rate environment and abundant liquidity supply in China, the Group managed to issue RMB1.2 billion and RMB0.3 billion medium-term notes with a term of 5 years and 3 years, at the coupon rate of 3.3% and 2.75% respectively.
- (iv) Successfully issued its sustainability-linked perpetual medium-term notes with a term of 2+N years and the amount of RMB1 billion, with coupon rate hitting the historical lowest of 2.7%.
- (v) Continues to maintain abundant standby credits and committed working capital facilities from financial institutions to ensure sufficient liquidity.

RISK MANAGEMENT REPORT

- (vi) The Group closely monitors currency exchange risks and hedges the exposure where necessary and appropriate. In order to mitigate RMB exchange rate risks, the Company uses currency forward contracts to hedge its exposure to currency exchange risk.
- (vii) With the interest rate swap arrangements, the Group's floating interest rate borrowings were hedged as per its prudent interest rate hedging policy. The interest rate risk would be monitored on an ongoing basis.

Regarding environmental risk, the Group has identified pertinent climate change risks, with a particular focus on both the physical and transitional risks across various time horizons. To mitigate these climate-related risks, the Group has developed a climate change policy. This policy delineates detailed mechanisms for identifying and addressing each potential financial and operational impact stemming from climate change.

In terms of governance risk, the Group recognizes its exposure to internal governance risks, including legal compliance and anti-bribery measures. These risks are overseen by the internal audit function. The internal audit function independently implements the Company's internal control system and conducts assessments of control effectiveness for each identifiable risk. Additionally, our internal audit function conducts annual assessments of the overall internal control system and performs operational audits to evaluate the effectiveness and adequacy of internal controls, providing recommendations for improvement.