

SECTOR UPDATE

Aviation – China

Airlines: July 23 Operation Data

Operation data of the three major Chinese airlines continued to improve in Jul 23. Overall pax capacity supply largely matched pre-pandemic levels, led by domestic capacity growth (at 120-130% of pre-pandemic levels) but offset by still-subdued international/regional capacity (51-54%). Pax load recovery outpaced capacity supply growth, leading to improved load factors. Maintain UNDERWEIGHT as we believe the recovery is well expected and has been largely priced in. Top pick: Air China.

WHAT'S NEW

- The three major Chinese airlines released Jul 23 operation data on 15 and 16 August.

ESSENTIALS

- Jul 23 operation data: Overall pax capacity supply matched pre-pandemic levels while pax loads were still catching up.**
 - Overall pax capacity of the three major Chinese airlines rose 3.5-5.8ppt mom to 98-101% of their respective pre-pandemic levels. Domestic capacity supply surpassed pre-pandemic levels at 120-130%. Supply of international and regional capacities, though improved 4.5-9.8ppt mom, was still subdued, at 51-54% of the pre-pandemic levels.
 - Overall pax loads of the three airlines rose 4.9-9.0ppt mom to 93-95% of their respective pre-pandemic levels, with domestic loads at 116-119% of the pre-pandemic levels and international and regional loads at 49-52%. Although Air China and China Eastern Airlines' (CEA) pax load recovery was catching up during the month, China Southern Airlines' (CSA) overall pax load recovery was still slightly ahead of the other two, at 95% of the pre-pandemic levels, thanks to its relatively larger exposure to China domestic and Southeast Asian markets.
 - Overall pax load factors of the three airlines rose 1.5-2.7ppt mom to 75.4-80.9%, driven by higher pax load factors across all routes. The overall pax load factors were still 2.2-6.2ppt below their respective pre-pandemic levels, implying some surplus in overall capacity supply. Among the three airlines, CSA enjoyed the highest load factors in both domestic and international & regional routes, whereas Air China had the lowest, likely due to Air China's pricing first strategy.
 - We derive comfort from the fact that pax load recovery outpaced capacity supply increase in Jul 23, which means that the sector's surplus capacity is being absorbed by the recovering demand. However, whether the surplus capacity can be fully absorbed by demand remains to be seen, which depends on China's economic well-being and the pace of international travel demand recovery.

JUL 23 PAX OPERATION DATA OF THE THREE MAJOR CHINESE AIRLINES

	Overall			Domestic			International & Regional		
	Air China	CSA	CEA	Air China	CSA	CEA	Air China	CSA	CEA
Pax capacity (m seat-km)	29,368	30,549	23,626	23,639	25,449	18,983	5,729	5,100	4,643
as % of pre-pandemic	101%	98%	99%	130%	120%	124%	52%	51%	54%
mom change	+5.8ppt	+3.5ppt	+5.6ppt	+3.6ppt	+2.6ppt	+2.4ppt	+5.6ppt	+4.5ppt	+9.8ppt
Pax load (m pax-km)	22,136	24,720	18,526	17,949	20,476	14,914	4,187	4,243	3,612
as % of pre-pandemic	93%	95%	94%	119%	116%	118%	49%	51%	52%
mom change	+7.9ppt	+4.9ppt	+9.0ppt	+4.4ppt	+4.7ppt	+6.2ppt	+9.6ppt	+4.8ppt	+12.2ppt
Pax load factors	75.4%	80.9%	78.4%	75.9%	80.5%	78.6%	73.1%	83.2%	77.8%
mom change	+2.7ppt	+1.5ppt	+2.5ppt	+1.6ppt	+1.5ppt	+2.3ppt	+7.3ppt	+1.4ppt	+3.7ppt
diff. vs pre-pandemic	-6.2ppt	-2.2ppt	-3.5ppt	-7.6ppt	-2.5ppt	-4.2ppt	-5.3ppt	-0.1ppt	-2.7ppt

Source: Respective companies, UOB Kay Hia

PEER COMPARISON

Company	Ticker	Rec	Price @ 14 Jul 23 (HK\$)	Target Price (HK\$)	Upside To TP (%)	Market Cap (US\$m)	PE*			EV/EBIT			P/B FY23F (x)	Yield 23-25F (%)	Net Gearing End-22 (%)
							23F (x)	24F (x)	25F (x)	23F (x)	24F (x)	25F (x)			
Air China	753 HK	BUY	6.14	6.32	3.0	12,704	16.7	13.4	12.2	9.9	9.8	9.3	1.9	0.0	295.1
CSA	1055 HK	SELL	4.42	3.68	(16.7)	10,229	11.4	16.6	14.9	9.6	12.7	12.0	1.4	0.0	150.2
CEA	670 HK	SELL	2.88	2.35	(18.5)	8,199	22.3	16.9	15.0	12.3	12.6	11.9	1.6	0.0	321.2
Average							16.8	15.6	14.1	10.6	11.7	11.1	1.7	0.0	255.5

*PE estimates were adjusted for potential dilutions from new equity raisings
Source: Bloomberg, UOB Kay Hian

UNDERWEIGHT (Maintained)

SECTOR PICKS

Company	Ticker	Rec	Share Price (HK\$)	Target Price (HK\$)
Air China	753 HK	BUY	6.14	6.32
China Southern Airlines	1055 HK	SELL	4.42	3.68
China Eastern Airlines	670 HK	SELL	2.88	2.35

Source: Bloomberg, UOB Kay Hian

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• **The three major airlines to report losses for 1H/2Q23.** The three major airlines would report their 1H/2Q23 financial performance in two weeks' time (expected end-Aug 23). To recap, all three have guided for reporting losses based on their preliminary estimates:

- Air China is expected to record a net loss of Rmb3.2b-3.9b in 1H23, implying a net loss of Rmb0.3b-1.0b in 2Q23 (1Q23: Rmb2.9b loss).
- CSA is expected to record a net loss of Rmb2.5b-3.3b in 1H23, implying a net loss of Rmb0.6b-1.4b in 2Q23 (1Q23: Rmb1.9b loss).
- CEA is expected to record a net loss of Rmb5.5b-6.9b in 1H23, implying a net loss of Rmb1.7b-3.1b in 2Q23 (1Q23: Rmb3.8b loss).

1H AND 2Q23 REPORTED AND CORE NET PROFIT OF THE THREE AIRLINES

	1H23 (preliminary)			2Q23 (preliminary)			1Q23		
Rmb'b	Air China	CSA	CEA	Air China	CSA	CEA	Air China	CSA	CEA
Reported earnings	-3.2 ~ -3.9	-2.5 ~ -3.3	-5.5 ~ -6.9	-0.3 ~ -1.0	-0.6 ~ -1.4	-1.7 ~ -3.1	-2.9	-1.9	-3.8
Core earnings*	-3.3 ~ -4.3	-2.2 ~ -3.3	-4.9 ~ -6.3	-0.9 ~ +0.1	-0.7 ~ +0.4	-0.6 ~ -2.0	-3.4	-2.6	-4.3

* Core earnings were derived by excluding forex gains/losses from the airlines' reported earnings ex. non-recurring items.
Source: respective companies, UOB Kay Hian

• **Expecting turnaround in 3Q23.** The still-improving Jul 23 operation data marked a good start for 3Q23, adding to our case that the three airlines' earnings are likely to make a turnaround in 3Q23.

EARNINGS REVISION

• **Earnings projection under review.** The overall operation data of the three airlines in the past few months was broadly in line with our expectation, with domestic route capacity recovery slightly ahead of our projections but international route capacity recovery slightly behind. Our earnings projections are subject to refinement pending better clarity on pax yield levels of the three airlines for respective route regions in the upcoming 1H23 results announcement.

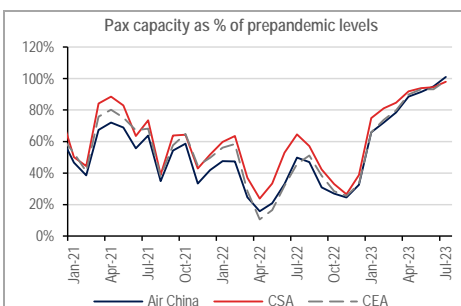
ACTION

• **Maintain UNDERWEIGHT on the Chinese airlines segment.** While we are sanguine about the segment's recovery, we note that the recovery is well expected by the market and largely priced in. We maintain our case that earnings in the next few years are likely to be fully retained by the three major Chinese airlines to rebuild their balance sheet strengths (making up for the huge negative earnings reserves before a dividend can be paid) and provide for their lifted capex plans. Air China (753 HK/BUY/Target: HK\$6.32) is our preferred pick among the three major Chinese airlines for its national flag carrier status and relatively cheaper valuation against its steady-state (2024) profit potential.

RISKS

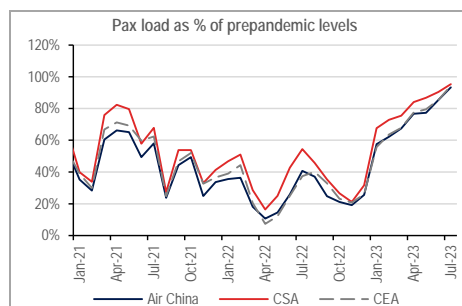
- **Upside risks:** Market sentiments stirred up by: a) positive newsflow about China tourism spending and air travel recovery, and b) airlines potentially making a turnaround in earnings in 3Q23.
- **Downside risks:** a) Slower-than-expected earnings recovery possibly due to macroeconomic headwinds damping demand, sharp rise of jet fuel price and/or weakened renminbi, b) EPS-dilutive equity-raising, and c) dissipation of the market's excitement about the airlines' recovery story.

OVERALL PAX CAPACITY RECOVERY



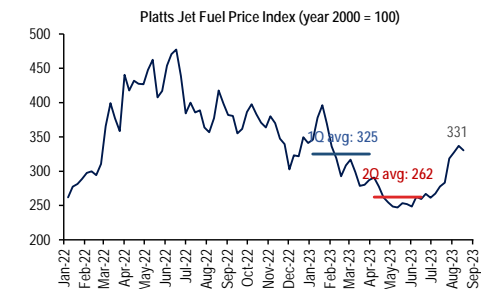
Source: Respective companies, UOB Kay Hian

OVERALL PAX LOAD RECOVERY



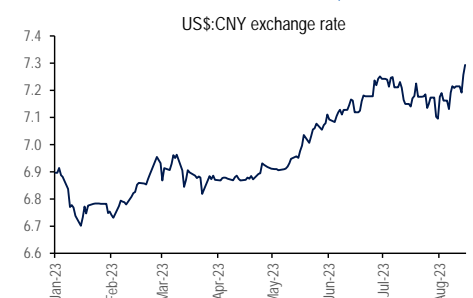
Source: Respective companies, UOB Kay Hian

JET FUEL PRICES ROSE 27% SINCE END-JUN 23



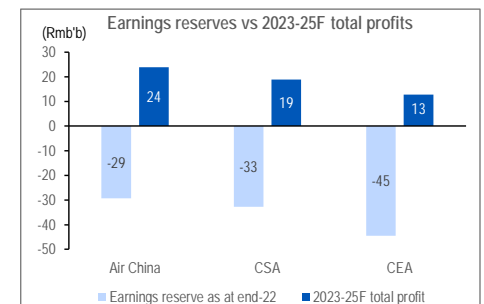
Source: S&P Global

WEEKEND RENMINBI AGAINST US\$



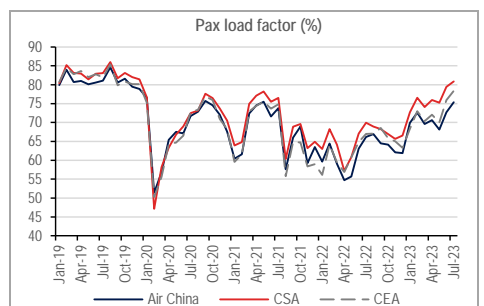
Source: Bloomberg

2023-25 EARNINGS NOT ENOUGH TO MAKE UP FOR NEGATIVE EARNINGS RESERVES AT END-22



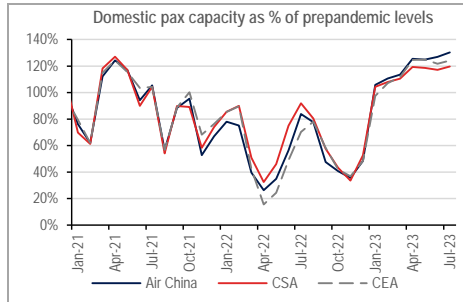
Source: Respective companies, UOB Kay Hian

OVERALL PAX LOAD FACTORS



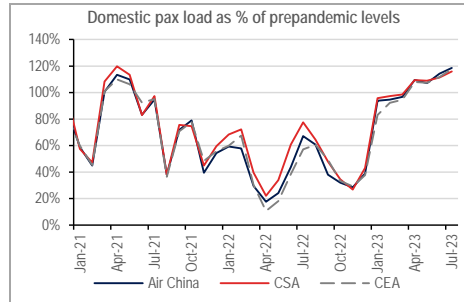
Source: Respective companies, UOB Kay Hian

DOMESTIC PAX CAPACITY RECOVERY



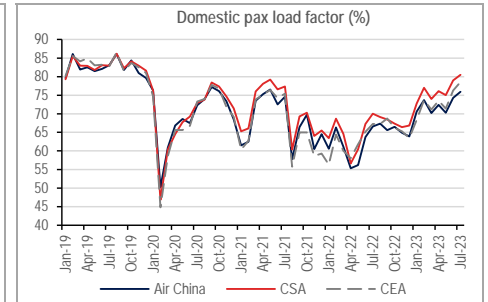
Source: Respective companies, UOB Kay Hian

DOMESTIC PAX LOAD RECOVERY



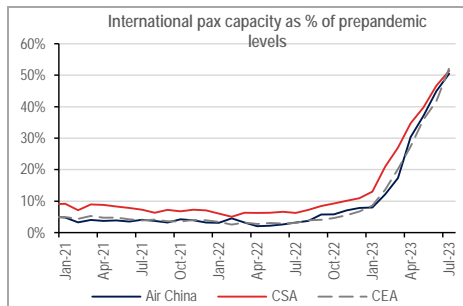
Source: Respective companies, UOB Kay Hian

DOMESTIC PAX LOAD FACTOR



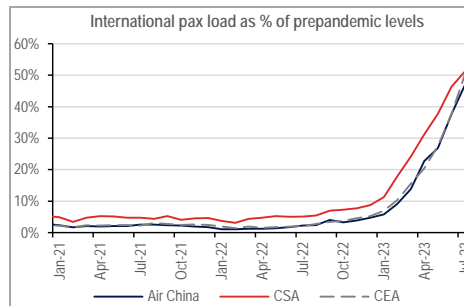
Source: Respective companies, UOB Kay Hian

INTERNATIONAL PAX CAPACITY RECOVERY



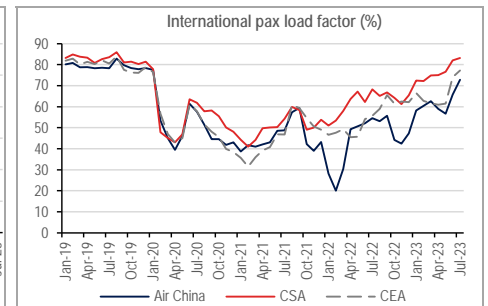
Source: Respective companies, UOB Kay Hian

INTERNATIONAL PAX LOAD RECOVERY



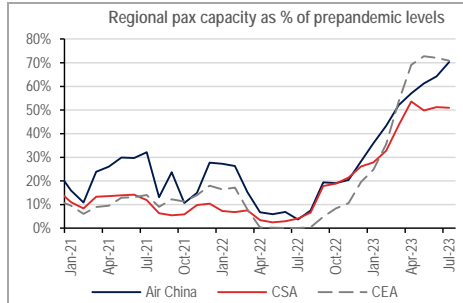
Source: Respective companies, UOB Kay Hian

INTERNATIONAL PAX LOAD FACTOR



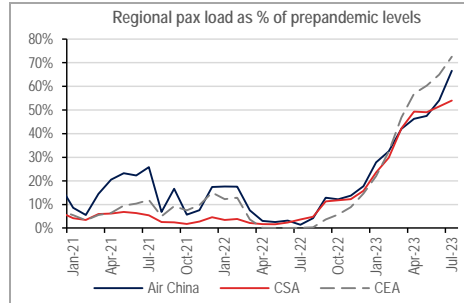
Source: Respective companies, UOB Kay Hian

REGIONAL PAX CAPACITY RECOVERY



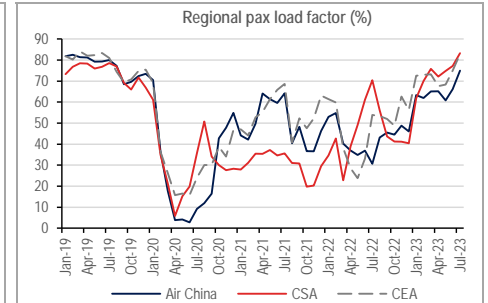
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REGIONAL PAX LOAD RECOVERY



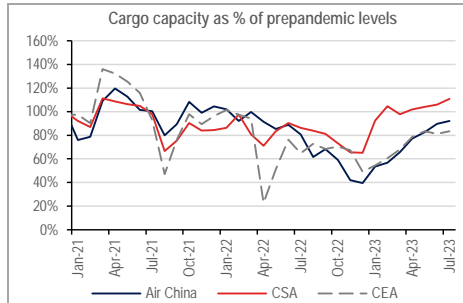
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REGIONAL PAX LOAD FACTOR



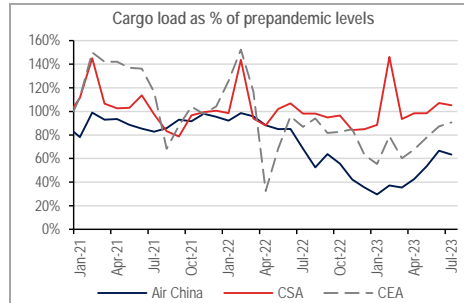
Source: Respective companies, UOB Kay Hian

CARGO CAPACITY RECOVERY



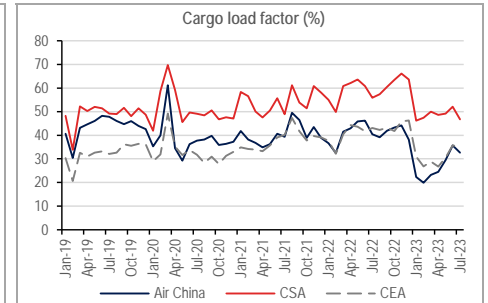
Source: Respective companies, UOB Kay Hian

CARGO LOAD RECOVERY



Source: Respective companies, UOB Kay Hian

CARGO LOAD FACTOR



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