

SECTOR UPDATE

Aviation – China

Airlines: Aug 23 Operation Data

Aug 23 pax loads of the three Chinese airlines were at 92-93% of their pre-pandemic levels, having retraced slightly from Jul 23's 93-95% and behind our projected 97-98%. Pax load factors were still 5.1-8.4ppt below pre-pandemic levels, signalling an overcapacity situation, although August was already a seasonally strong month. This may put pressure on airfare levels and pax yields. Maintain UNDERWEIGHT as we believe the recovery is well expected and likely priced in. Top pick: Air China.

WHAT'S NEW

- The three major Chinese airlines released Aug 23 operation data on 15 Sep 23.

ESSENTIALS

- Aug 23 data behind our projections; overall pax load still recovering, but momentum seemed to be moderating.**
 - Overall pax loads of the three airlines were behind our projections in August.** In absolute terms, pax loads of the three airlines still improved modestly by 1.1-3.6% mom. However, pax loads as a percentage of pre-pandemic levels, which effectively removes seasonality differences, have retraced to 92-93% from 93-95% in Jul 23 and were below our projected 97-98%. We believe this corresponds with some airlines' managements' observations that the summer peak travel period has tapered and ended earlier this year vs previous years.
 - Overall pax capacities of the three major Chinese airlines rose 0.1-3.3ppt mom to 98-103% of their respective pre-pandemic levels. Domestic capacity supply significantly surpassed pre-pandemic levels at 120-131%. Supply of international and regional capacities improved 0.4-4.7ppt mom, standing at 52-58% of pre-pandemic levels.
 - Air China's overall pax load factor improved 1.2ppt mom to 76.6%, thanks to pax load recovering faster than the growth in capacity supply during the month. China Southern Airlines' (CSA) pax load factor was flat mom at 80.9%. China Eastern Airlines' (CEA) pax load factor dipped 0.8ppt mom to 77.6% due to faster growth of capacity supply than pax load recovery.
 - Overcapacity issue still present, putting pressure on pax yields.** With pax load factors of three airlines still 5.1-8.4ppt below their respective pre-pandemic levels (little improvement achieved during the seasonally strong August), the aviation sector remains in an overcapacity situation. This overcapacity situation is likely to put pressure on airfare levels and hence pax yields.

AUG 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)	29,935	30,892	24,217	23,944	25,700	19,225	5,991	5,192	4,993
mom change	+1.9%	+1.1%	+2.5%	+1.3%	+1.0%	+1.3%	+4.6%	+1.8%	+7.5%
as % of pre-pandemic	103%	98%	102%	131%	120%	127%	55%	52%	58%
% recovery mom change	+1.9ppt	+0.1ppt	+3.3ppt	+0.8ppt	-0.1ppt	+2.4ppt	+2.9ppt	+0.4ppt	+4.7ppt
Pax load (m pax-km)	22,934	24,989	18,786	18,400	20,554	14,898	4,534	4,435	3,888
mom change	+3.6%	+1.1%	+1.4%	+2.5%	+0.4%	-	+8.3%	+4.5%	+7.6%
as % of pre-pandemic	93%	92%	93%	116%	111%	113%	51%	52%	55%
recovery % mom change	-0.6ppt	-3.2ppt	-1.8ppt	-2.1ppt	-5.1ppt	-4.5ppt	+1.9ppt	+0.4ppt	+2.7ppt
Pax load factors	76.6%	80.9%	77.6%	76.8%	80.0%	77.5%	75.7%	85.4%	77.9%
mom change	+1.2ppt	-0.0ppt	-0.8ppt	+0.9ppt	-0.5ppt	-1.1ppt	+2.6ppt	+2.2ppt	+0.1ppt
diff. vs pre-pandemic	-8.4ppt	-5.1ppt	-7.8ppt	-9.8ppt	-6.2ppt	-9.1ppt	-6.7ppt	-0.2ppt	-5.5ppt

Source: Respective companies, UOB Kay Hian

PEER COMPARISON

Company	Ticker	Rec	Price @ 15 Sep 23 (HK\$)	Target Price (HK\$)	Upside To TP (%)	Market Cap (US\$m)	2023F (x)	PE* 2024F (x)	2025F (x)	2023F (x)	EV/EBIT 2024F (x)	2025F (x)	P/B 2023F (x)	Yield 2023-25F (%)	Net Gearing End-1H23 (%)
Air China	753 HK	BUY	5.67	6.32	11.4	11,732	33.1	12.4	11.7	14.2	9.9	9.7	1.9	0.0	361.9
CSA	1055 HK	SELL	4.00	3.68	(8.0)	9,257	17.8	15.0	13.5	12.8	12.9	12.1	1.4	0.0	185.0
CEA	670 HK	SELL	2.76	2.35	(14.9)	7,857	n.a.	16.2	14.8	23.9	13.2	12.6	1.7	0.0	420.8
Average							25.5	14.5	13.3	17.0	12.0	11.4	1.7	0.0	322.6

*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	5.67	6.32
China Southern Airlines	1055 HK	SELL	4.00	3.68
China Eastern Airlines	670 HK	SELL	2.76	2.35

Source: UOB Kay Hian

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• **Expecting a turnaround in 3Q23.** We expect all three airlines to make a turnaround into profitability in 3Q23, partly helped by favourable seasonality (July-August is the summer peak travel period with student holidays). For the full year, we maintain our expectations that Air China and CSA would end the year positively while CEA is likely to record a slight loss due to the higher losses incurred in 1H23.

• **Capacity and yield outlook.** During their analyst briefings at end-Aug 23, CSA and CEA guided for their international-route capacity to reach about 80% of pre-pandemic levels by end-23, while Air China targeted a 70% recovery. According to managements, as the capacity of international routes recover further and more wide-body aircrafts get deployed to long-haul international routes, the current overcapacity pressure for domestic routes would be alleviated. We believe that this would provide some support to domestic-route yields (1H23: only single-digit percentage higher than 1H19 levels) while driving the moderation of international-route yields (1H23: 67-90% higher than 1H19 levels).

EARNINGS REVISION

• **No change.** Even though Aug 23 operation statistics of the three airlines came in behind our projections, we have retained our earnings forecasts for now as we remain hopeful that the pace of recovery may catch up again in the remaining months of 2023.

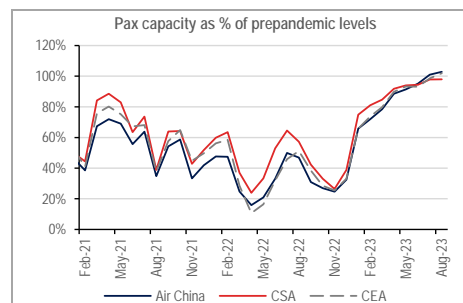
ACTION

• **Maintain UNDERWEIGHT.** While the Chinese aviation sector's recovery is expected to continue in the medium term, we note that the recovery is well expected by the market and hence largely, if not fully, 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 profit potential.

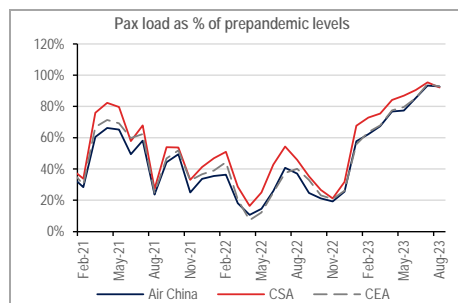
RISKS

- **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 due to macroeconomic headwinds damping demand, sharp rise of jet fuel price and/or weaker renminbi (rendering overseas travel more expensive), b) EPS-dilutive equity-raising, and c) dissipation of the market's excitement about the airlines' recovery story.

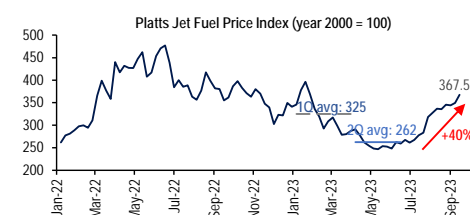
OVERALL PAX CAPACITY RECOVERY



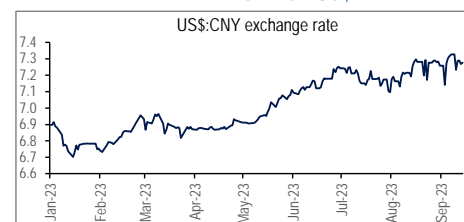
OVERALL PAX LOAD RECOVERY



JET FUEL PRICES ROSE 40% SINCE END-JUN 23



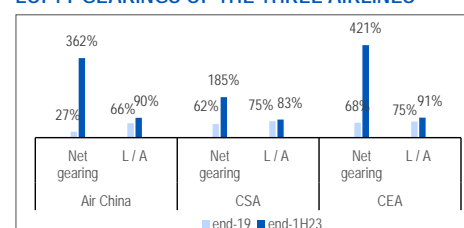
WEAKENED RENMINBI AGAINST US\$



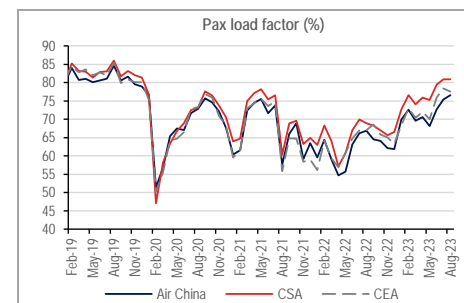
2023-25 EARNINGS NOT ENOUGH TO MAKE UP FOR THE HUGE NEGATIVE EARNINGS RESERVES



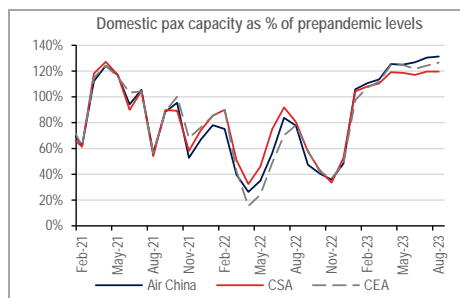
LOFTY GEARINGS OF THE THREE AIRLINES



OVERALL PAX LOAD FACTORS

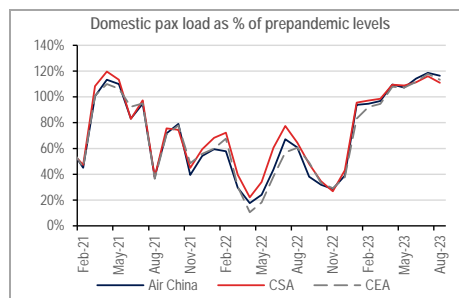


DOMESTIC PAX CAPACITY RECOVERY



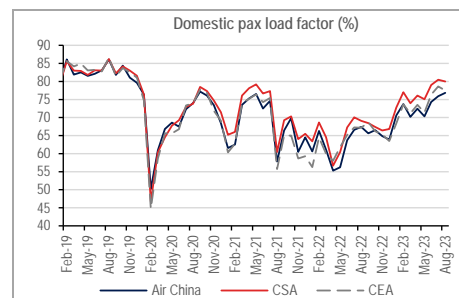
Source: Respective companies, UOB Kay Hian

DOMESTIC PAX LOAD RECOVERY



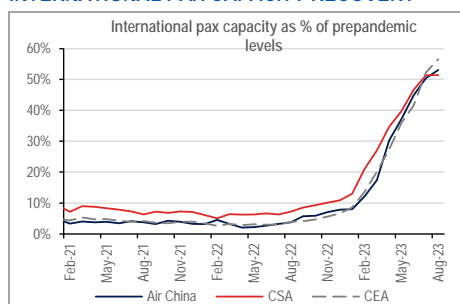
Source: Respective companies, UOB Kay Hian

DOMESTIC PAX LOAD FACTOR



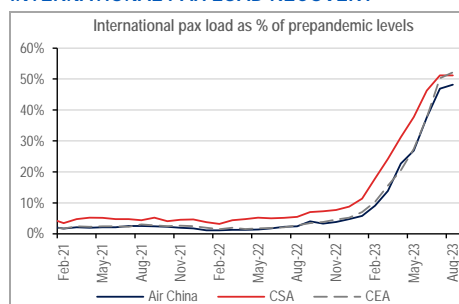
Source: Respective companies, UOB Kay Hian

INTERNATIONAL PAX CAPACITY RECOVERY



Source: Respective companies, UOB Kay Hian

INTERNATIONAL PAX LOAD RECOVERY



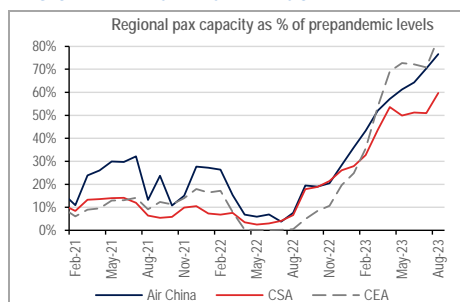
Source: Respective companies, UOB Kay Hian

INTERNATIONAL PAX LOAD FACTOR



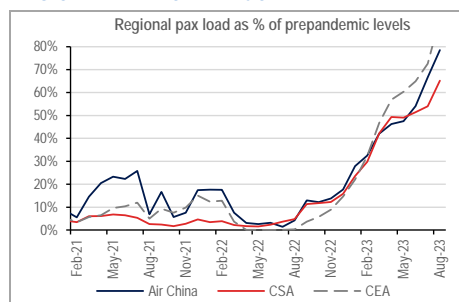
Source: Respective companies, UOB Kay Hian

REGIONAL PAX CAPACITY RECOVERY



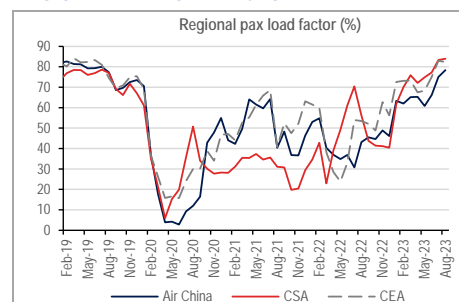
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REGIONAL PAX LOAD RECOVERY



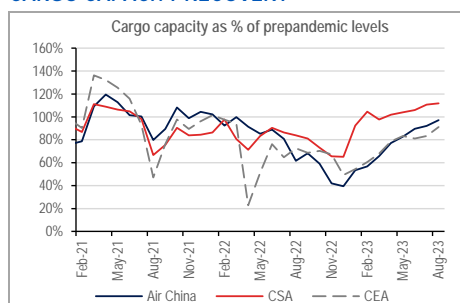
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REGIONAL PAX LOAD FACTOR



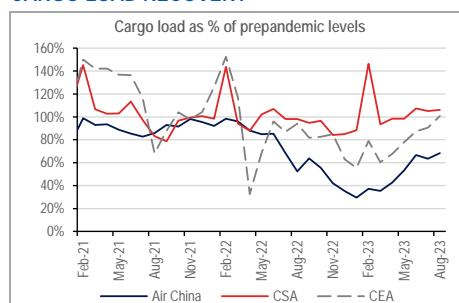
Source: Respective companies, UOB Kay Hian

CARGO CAPACITY RECOVERY



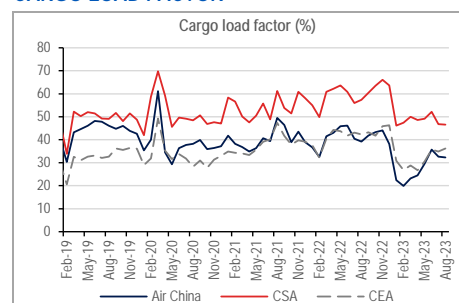
Source: Respective companies, UOB Kay Hian

CARGO LOAD RECOVERY



Source: Respective companies, UOB Kay Hian

CARGO LOAD FACTOR



Source: Respective companies, UOB Kay Hian

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