# Non-rating Action Commentary: China’s civil aviation recovery not affirmed, but government support remains strong for national airlines

**Chinese airlines still suffering after the first wave of the coronavirus pandemic.** Since the beginning of 2020, China’s civil aviation industry has been hit hard by the outbreak of the coronavirus pandemic, and air passenger traffic has dropped sharply, causing heavy losses. Chinese airlines are suffering even as we witnessed some recovery in other industries domestically in 2021-22 as business activity resumed following a complete lockdown in the first half of 2020, and overseas airlines’ conditions also improved from their downturn in 2020. To elaborate, the Big Three state-owned airlines in China, namely Air China, China Southern Airlines, and China Eastern Airlines, initially saw their combined revenue reduced by 46% year-on-year (YoY), and their combined net loss amounted to RMB37.1 billion in 2020. Despite a 10% YoY rebound in combined revenue in 2021, these airlines’ combined net loss further widened to RMB41.0 billion due to a resurgence in jet fuel prices. From January to September 2022, the Big Three’s combined revenue fell again by 21% YoY, due to occasional lockdowns and travel restrictions, while the combined net loss for the period already reached RMB73.8 billion amid a further increase in fuel costs. In addition, these airlines' combined cost of sales (excluding depreciation and amortization expense) was higher than their combined revenue in the first half of 2022, which implies that the Big Three were losing money even on operating cash levels.

**Exhibit 1: Big three Chinese airlines – revenue, cost and profitability**

| (RMB million) | 2019 | 2020 | 2021 | 1H22 | 9M22 |
|---|---|---|---|---|---|
| **Air China** | | | | | |
| Revenue | 136,181 | 69,504 | 74,532 | 23,953 | 42,089 |
| YoY% | 0% | -49% | 7% | -36% | -27% |
| Ex-depreciation cost of sales | 93,928 | 56,975 | 66,440 | 28,206 | n.a. |
| Net profit/loss | 6,409 | -14,409 | -16,642 | -19,435 | -28,103 |
| **China Southern Airlines** | | | | | |
| Revenue | 154,322 | 92,561 | 101,644 | 40,817 | 70,161 |
| YoY% | 7% | -40% | 10% | -21% | -11% |
| Ex-depreciation cost of sales | 112,191 | 71,621 | 81,381 | 38,108 | n.a. |
| Net profit/loss | 2,651 | -10,842 | -12,103 | -11,488 | -17,587 |
| **China Eastern Airlines** | | | | | |
| Revenue | 120,860 | 58,639 | 67,127 | 19,354 | 35,850 |
| YoY% | 5% | -51% | 14% | -44% | -32% |
| Ex-depreciation cost of sales | 85,667 | 49,095 | 57,816 | 23,532 | n.a. |
| Net profit/loss | 3,195 | -11,835 | -12,214 | -18,736 | -28,116 |

Sources: Air China, China Southern Airlines, China Eastern Airlines, Pengyuan International

**Exhibit 2: China import jet kerosene price trend (RMB per tonne)**


Sources: Xinhua, Pengyuan International

**Ongoing changes in the local pandemic situation make the recovery path unpredictable.** In 2020, global air passenger traffic (measured in revenue passenger kilometre (RPK)) fell by 66% YoY, while China’s traffic fared better, with a decline of only 46%, due to the passenger traffic recovery amid the easing of the domestic pandemic and the consequent relaxation of domestic traffic restrictions in the second half of the year. In early 2021, we predicted that it might take as short as two years for China’s air passenger traffic to return to the pre-pandemic level, while international organisations such as the International Air Transport Association (IATA) mostly expected global air traffic to return to the level of 2019 in 2024. Unfortunately, the new waves of the pandemic outbreak have hindered the recovery of China’s air passenger traffic since the second half of 2021, and the country’s year-to-September 2022 RPK decreased by 40% YoY, with RPK in September 2022 just equivalent to 31% of RPK in the same month of 2019. In comparison, global air passenger traffic has been steadily recovering since mid-2020, with RPK in September 2022 already equivalent to 74% of RPK in the same month of 2019.

Looking ahead, IATA still expects the overall global air passenger level to return to the pre-pandemic level by 2024, but expects China to achieve this by 2025. While we believe air traffic in China should return to recovery mode soon as restrictions on domestic and international travel gradually ease, any changes in the outbreak could pose a risk to traffic flows, as has happened over the past two years.

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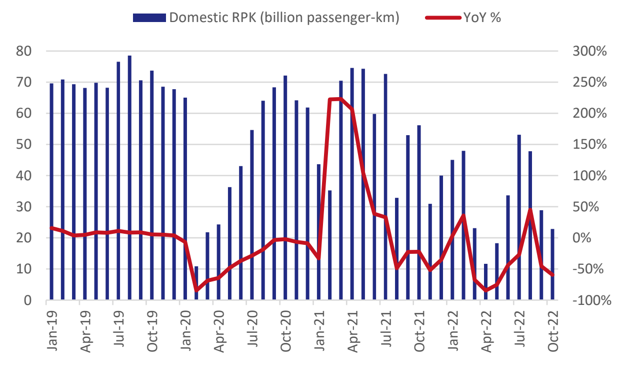
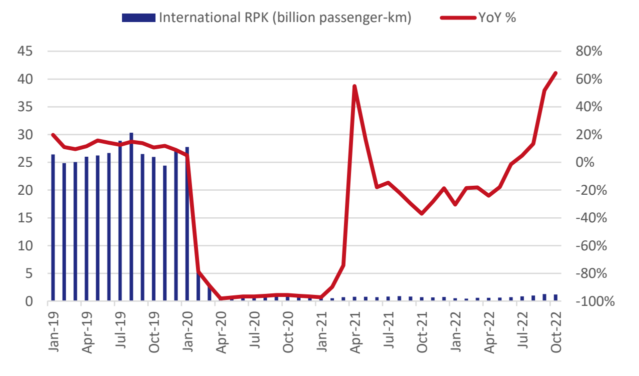
**Exhibit 3: China – monthly domestic air passenger traffic trend**




Sources: Civil Aviation Administration of China (CAAC), Pengyuan International

**Exhibit 4: China – monthly international air passenger traffic trend**




Sources: CAAC, Pengyuan International

**Government support for Chinese state-owned airlines is sufficient.** An airline's stand-alone credit profile could be under pressure if it is expected to experience a prolonged period of revenue weakness. This is because the aviation industry is capital-intensive, airlines are typically leveraged to fund their aircraft fleets, and fuel is a major cost item as long as some aircraft remain in operation. In other words, a drop in revenue due to a lack of demand will severely hamper airlines' ability to cover cash costs (especially when fuel prices are high), service their debts, and refinance. Notably, we have seen some airlines around the world cease operations in the past few years, such as Alitalia.

As far as China's top three state-owned airlines are concerned, although two of them reported negative operating cash flow in January-September 2022, they do not face an imminent credit crisis due to continued government support. These airlines in combination received more than RMB33 billion of government subsidies of various types between the beginning of 2020 and the end of September 2022. In addition, to supplement the equity base of the Big Three airlines, the government, with the support of additional strategic investors in some cases, has been injecting capital into these airlines, with RMB34.5 billion (of which RMB15.0 billion came from their parent companies) planned for the second half of 2022 and beyond. Last but not least, since the Chinese central government is the ultimate parent of the Big Three airlines, these airlines can still easily obtain loans from financial institutions. All in all, we believe the overall creditworthiness of China's aviation industry remains sound despite the lack of recovery in air passenger traffic so far.

**Exhibit 3: Big Three Chinese state-owned airlines – government subsidies and capital injection (in RMB million)**

| (RMB million) | | | | | | |
|---|---|---|---|---|---|---|
| **Government subsidies (in other income)** | **2019** | **2020** | **2021** | **9M22** | | |
| Air China | 3,643 | 4,076 | 3,841 | 2,154 | | |
| China Southern Airlines | 4,084 | 4,179 | 3,964 | 2,478 | | |
| China Eastern Airlines | 6,324 | 5,348 | 4,882 | 2,332 | | |
| | | | | | | |
| **Capital injection*** | **2019** | **2020** | **2021** | **9M22** | **Planned** | **Remarks** |
| Air China | 400 | 0 | 490 | 0 | 15,000 | A-share private placement plan announced in August 2022 to raise not more than RMB15.0 billion; Air China's parent will commit not less than RMB5.5 billion |
| China Southern Airlines | 0 | 15,951 | 0 | 1,549 | 4,500 | A-share private placement plan announced in October 2021 to raise not more than RMB4.5 billion from China Southern Airlines' parent; Completed in November 2022 |
| China Eastern Airlines | 9,442 | 0 | 10,820 | 0 | 15,000 | A-share private placement plan announced in May 2022 to raise not more than RMB15.0 billion; China Eastern Airlines' parent will commit not less than RMB5.0 billion |

* Including capital funding from state-owned and privately owned strategic investors for Air China and China Eastern Airlines
Sources: Air China, China Southern Airlines, China Eastern Airlines, Pengyuan International

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