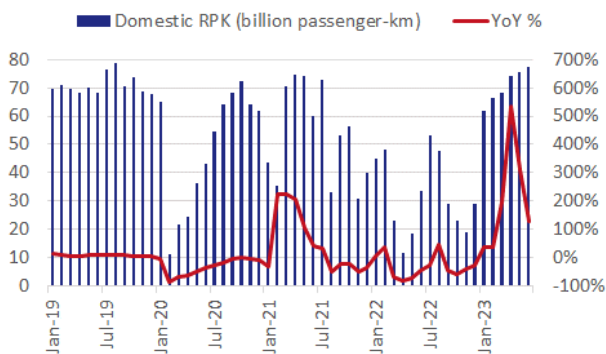


Non-rating Action Commentary: China civil aviation on recovery path with outlook turning more favourable

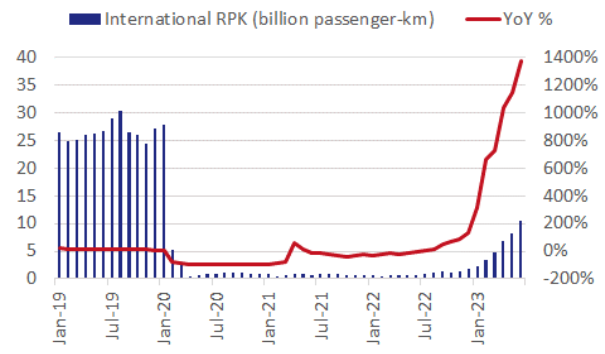
Chinese airlines not recovering in full as international passenger traffic still lags. The China civil aviation industry was badly hit by the coronavirus pandemic outbreak in 2020-22, with a plunge in air passenger traffic and deep losses. To elaborate, the country's air passenger traffic in 2022, in terms of revenue passenger kilometre (RPK), was only equivalent to one-third of the level in 2019, with the Big Three state-owned airlines in China, namely Air China, China Southern Airlines and China Eastern Airlines, recording combined net loss of RMB186.7 billion in 2020-22. Amid the subsiding of the pandemic and pent-up demand for traveling, the domestic air passenger traffic in China rebounded in 2023, with year-to-June RPK up by 135% year-on-year (YoY), surpassing the same-period level in 2019. On the other hand, the air passenger traffic into and out of China in the first half of 2023, while rebounding, was only 23% of 1H19 level. We attribute the slow recovery to 1) tightening of entry requirements for Chinese visitors by some foreign countries in early 2023, 2) lead time to re-establish international flights and supporting functions, and 3) high air ticket prices as a result of limited seat supply.

Exhibit 1: China – monthly domestic air passenger traffic trend



Sources: Civil Aviation Administration of China (CAAC), CSPI Ratings

Exhibit 2: China – monthly international air passenger traffic trend



Sources: CAAC, CSPI Ratings

Still loss-making on paper but cash profit in sight. Despite the rebound in air traffic and revenue, the Chinese airline industry remained loss-making in early 2023. In brief, the Big Three airlines recorded combined net loss of RMB8.7 billion in 1Q23 and expect to book net loss of RMB11.2-14.1 billion in the first half of 2023. According to the airlines, the continual loss was mainly attributable to the slow international air traffic recovery, high fuel cost and Renminbi depreciation that led to foreign exchange loss. While the loss continued in 2Q23, we observe that the implied loss for the period was RMB2.5-5.4 billion, significantly below the 1Q23 level. What is more, if excluding the non-cash items such as depreciation and foreign exchange loss, we estimate that the Chinese airline industry should have achieved cash earnings again in the second quarter of 2023.

Exhibit 3: Big three Chinese airlines – revenue, cost and profitability

(RMB million)	2019	2020	2021	2022	1Q23
Air China					
Revenue	136,181	69,504	74,532	52,898	25,068
YoY%	0%	-49%	7%	-29%	94%
Ex-depreciation cost of sales	93,928	56,975	66,440	63,532	n.a.
Net profit/loss	6,409	-14,409	-16,642	-38,619	-2,926
China Southern Airlines					
Revenue	154,322	92,561	101,644	87,059	34,055
YoY%	7%	-40%	10%	-14%	59%
Ex-depreciation cost of sales	112,191	71,621	81,381	82,906	n.a.
Net profit/loss	2,651	-10,842	-12,103	-32,682	-1,898
China Eastern Airlines					
Revenue	120,860	58,639	67,127	46,111	22,261
YoY%	5%	-51%	14%	-31%	76%
Ex-depreciation cost of sales	87,496	51,807	60,950	56,055	n.a.
Net profit/loss	3,195	-11,835	-12,214	-37,386	-3,803

Sources: Air China, China Southern Airlines, China Eastern Airlines, CSPI Ratings

26 July 2023

Exhibit 4: US Gulf Coast jet fuel spot price (USD/gallon)



Sources: US Energy Information Administration (EIA), CSPI Ratings

Macro trends appear favourable to warrant further passenger traffic and earnings recovery for Chinese airlines. We expect the Chinese airlines' passenger traffic to further recover sequentially during the summer peak season. In terms of international air passenger traffic, the number of international passenger flights into and out of China is back to 60% of 2019 level during the 2023 summer-autumn air traffic season, and is expected to further recover in the upcoming winter-spring season considering the strong demand. For the fuel cost, we have been witnessing a significant retreat in both crude oil and jet fuel prices since mid-2022, and we do not foresee any strong surge in fuel price in the near future, considering the moderate global economic growth outlook. Last but not least, despite the 7% Renminbi depreciation vs. the US dollar from the peak in January this year, we think that further depreciation is unlikely given the Chinese government's goal and efforts to stabilise the exchange rate, such as raising the Cross-border Financing Macro Cautious Adjustment Parameter (跨境融资宏观审慎调节参数) for corporate and financial institutions. All in all, we believe that the Chinese airline industry will experience sequential improvement in profitability and cash flow in the second half of 2023 and beyond, thus enhancing the stand-alone credit profile of airlines. This is not to mention the continual support from the government on state-owned airlines.

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