

China / Hong Kong Company Update

BOC Aviation Ltd

Bloomberg: 2588 HK Equity | Reuters: 2588.HK

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DBS Group Research . Equity

19 Aug 2022

BUY

Last Traded Price (18 Aug 2022): HK\$65.95 (HSI : 19,764)
Price Target 12-mth: HK\$76.00 (15% upside)

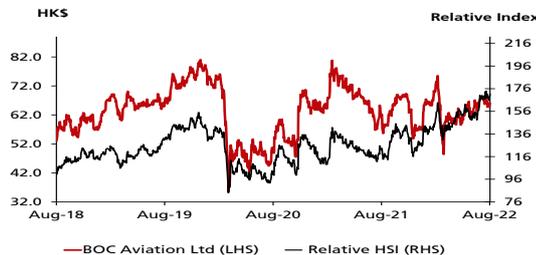
Analyst

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What's New

- 1HFY22 net loss of US\$312.5m was close to the higher end of BOCA's profit warning range
- Interim dividend of US\$0.0889 per share declared
- Positive medium-term outlook remains intact
- Maintain BUY with unchanged TP of HK\$76

Price Relative



Forecasts and Valuation

FY Dec (US\$m)	2020A	2021A	2022F	2023F
Turnover	2,054	2,183	2,286	2,326
EBITDA	1,953	1,959	1,917	2,196
Pre-tax Profit	563	639	(4)	763
Net Profit	510	561	(4)	672
Net Pft (Pre Ex) (core profit)	719	618	531	663
Net Profit Gth (Pre-ex) (%)	(0.8)	(14.1)	(14.0)	24.8
EPS (US\$)	0.73	0.81	(0.01)	0.97
EPS (HK\$)	5.76	6.34	(0.04)	7.59
Core EPS (US\$)	1.04	0.89	0.77	0.96
Core EPS (HK\$)	8.12	6.98	6.01	7.49
EPS Gth (%)	(27.4)	10.1	N/A	N/A
Core EPS Gth (%)	(0.8)	(14.1)	(14.0)	24.8
Diluted EPS (HK\$)	5.76	6.34	(0.04)	7.59
DPS (HK\$)	2.02	2.22	2.10	2.66
BV Per Share (HK\$)	53.99	59.52	57.38	62.32
PE (X)	11.4	10.4	nm	8.7
CorePE (X)	8.1	9.5	11.0	8.8
P/Cash Flow (X)	4.4	4.5	3.6	3.6
P/Free CF (X)	nm	24.1	100.4	nm
EV/EBITDA (X)	11.3	11.3	11.6	10.7
Net Div Yield (%)	3.1	3.4	3.2	4.0
P/Book Value (X)	1.2	1.1	1.1	1.1
Net Debt/Equity (X)	3.4	3.1	3.2	3.2
ROAE(%)	10.9	11.2	(0.1)	12.7
Earnings Rev (%):			(101)	(12)
Consensus EPS (US\$)			0.54	1.08
Other Broker Recs:		B:16	S:0	H:1

Source of all data on this page: Company, DBS Bank (Hong Kong) Limited ("DBS HK"), Thomson Reuters

Sound fundamentals despite Russia saga

Investment Thesis

Solid portfolio quality and strategy underpin long-term outperformance. BOC Aviation (BOCA) has strong operational metrics – the lessor has the longest weighted average lease expiry along with the youngest fleet and a relatively higher proportion of new-generation narrowbody aircraft than its peers. Additionally, BOCA has an excellent track record in capital management throughout the cycle.

Setup for 2023 and beyond appears promising. Looking beyond the impact of the sanctions on Russia, we project BOCA's earnings to grow at a 9.7% CAGR between FY21-23, underpinned by its robust orderbook and strengthening lease rates. Over the longer term, we expect positive trends in the sector to drive a structural shift towards leasing.

Valuation remains attractive. BOCA is currently trading at 1.0x P/BV (FY23F), which is around 1.0 standard deviation (SD) below its five-year average, undemanding, considering its solid earnings outlook. Furthermore, there is potential upside to our book value estimates once the insurance claims on its Russian fleet are resolved.

Valuation:

Our target price (TP) of HK\$76 is based on a 1.2x FY22/23F book value, which is around its five-year average.

Where we differ:

Our FY22/23F earnings projections are below the consensus as we are more conservative on net lease yields and the pace of aircraft deliveries. However, we are more optimistic on BOCA's longer-term earnings trajectory given its massive orderbook and secular tailwinds in the sector.

Key Risks to Our View:

Continued aircraft delivery delays due to production constraints among OEMs, and prolonged recovery in demand for air travel globally could lead to further impairments on receivables or aircraft asset values.

At A Glance

Issued Capital (m shrs)	694
Mkt Cap (HKm/US\$m)	45,769 / 5,835
Major Shareholders (%)	
Central Huijin Investment Ltd.	70.0
Free Float (%)	30.0
3m Avg. Daily Val. (US\$m)	3.56
GICS Industry: Industrials / Capital Goods	



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BOC Aviation Ltd

WHAT'S NEW

1HFY22 results consistent with profit warning; remain positive on longer-term outlook

Results highlights

- **BOCA booked a net loss of US\$312.5m, towards the higher end of its profit warning range (net loss between US\$310-330m).** Net loss during the period was mainly attributable to the full write-off of its Russian fleet, which had a net after-tax negative impact of US\$518m. Core profit before tax (excluding asset and bad debt impairments and recognition of cash collateral) declined to US\$286.7m (-20.4% y-o-y, -16.3% q-o-q) in 1HFY22, primarily the result of lower lease rental income (-5.4% y-o-y, -6.6% q-o-q).
- **Rental income fell for the first time on a sequential basis since FY15 by US\$61.8m.** We estimate that BOCA's Russian aircraft accounted for around half of the shortfall (three months of non-payment in 1HFY22), while the remainder was largely due to 17 aircraft in transition between leases during the period. Meanwhile, BOCA's net lease yield fell to 9.1% in 1HFY22 from 9.7% in FY21, primarily the function of the reduction in rental revenue as its cost of debt remained flat at 2.9%.
- **Interim dividend of US\$0.0889 per share declared,** representing 30% (similar to previous years) of BOCA's core net profit.
- **Lease commitments for 14 out of 17 aircraft off lease have been secured,** and these aircraft will be delivered to their aircraft customers in 2HFY22.
- **Supply chain issues will persist, but OEM deliveries should gather momentum from FY23F.** Airbus has announced that while it is maintaining its 2025 goal of 75 A320neos a month, it is moderating its interim target to 65 a month by early-2024 as compared to the second half of 2023 previously. Similarly, Boeing has announced that it will not be able to ramp up production of the B737 MAX in the near-term to 38 as initially planned and will maintain production at 31 aircraft per month until the supply chain is able to catch up. Nonetheless, both OEMs have indicated that aircraft demand is robust and production rates will improve in 2023. Additionally, Boeing was recently cleared by the FAA to resume deliveries of the B787 in August.

Outlook and recommendation

Other highlights

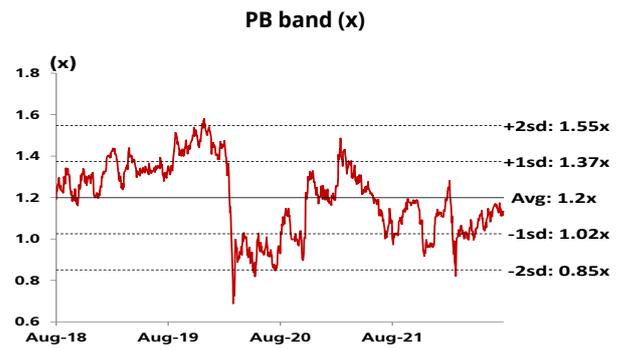
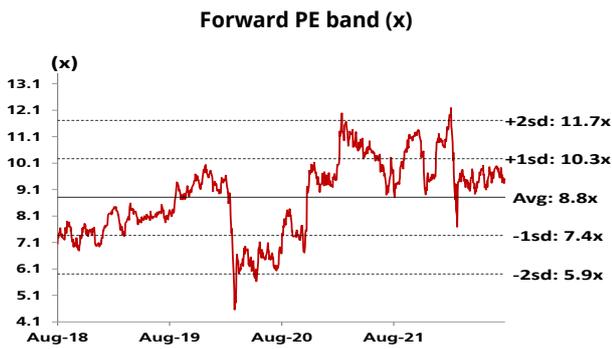
- **Revised capex guidance to US\$2.0bn in FY22, down from US\$3.0bn previously.** BOCA's capital spending in 1HFY22 only amounted to US\$0.6bn, and the lessor now expects to only invest around US\$1.4bn in aircraft in 2HFY22 due to delivery delays among the OEMs. Coupled with BOCA's strong operating cash flow of US\$717m, net debt dipped slightly to US\$16.3bn in 1HFY22 from US\$16.7bn in 2HFY21.
- **Impairments were recorded on non-Russian aircraft as well.** BOCA incurred US\$47m of asset impairment losses against other aircraft in 1HFY22.
- **Bad debt impairment losses have subsided.** BOCA recognised US\$5.9m of impairment losses on its receivables in 1HFY22, a significant improvement compared to US\$62.8m in 1HFY21. The lessor's cash collection inched higher to 96.9% in 1HFY22, as compared to 95.9% in 1HFY21.
- **We now project BOCA to dip into the red in FY22F with a minor net loss; cut FY23F net profit estimate by 11%.** Our negative earnings revision reflects the loss of revenue and asset impairment losses related to its Russian fleet. While BOCA's lease rate in 1HFY22 was below our expectations, we anticipate lease rates to recover from 2HFY22F given that there will be fewer aircraft off lease and collection rates should continue to improve. Our revised FY23F net profit estimate still points to a significant rebound in BOCA's earnings, to close to 2019's level. Apart from higher lease rates, a more pronounced increase in aircraft assets in FY23F as aircraft production bottlenecks are resolved and absence of aircraft impairment losses will drive a rebound in earnings.
- **Maintain BUY with unchanged TP of HK\$76.** Despite the massive hit to BOCA's equity base from the asset write-offs in 1HFY22, our TP is maintained at HK\$76 as we roll forward our valuation peg to 1.2x FY22/23F book value from 1.2x FY22F book value previously. We still like BOCA given its promising recovery prospects and attractive valuation of 1.0x P/BV (FY23F), which is around 1.0 standard deviation below its five-year average. Furthermore, there could be further upside to its book value once the insurance claims on its Russian aircraft are resolved.

BOC Aviation Ltd

Company Background

BOC Aviation (BOCA) is the largest Asia-headquartered aircraft operating lessor, as measured by the value of owned aircraft. Founded in 1993, BOCA had aircraft assets with a net book value of US\$19.1bn at the end of June 2022 and has recorded 28 consecutive years of cumulative profit in excess of US\$5.0bn since inception. The company is also among the world's top five operating lessors by value of owned aircraft.

Historical PE and PB band



Source: Thomson Reuters, DBS HK

BOC Aviation Ltd

Key Assumptions

FY Dec	2019A	2020A	2021A	2022F	2023F
Net book value of aircraft (US\$ m)	16,760.0	18,850.4	19,642.9	19,812.5	21,457.5
Lease rate factor (%)	10.6	10.0	9.6	9.4	10.0
Sale of aircraft at net book value (US\$ m)	1,182.8	267.4	925.0	900.0	1,200.0
Trading gain margin (%)	11.4	16.6	4.7	6.0	9.0
Cost of Debt (%)	3.3	3.0	2.7	2.8	3.0

Source: Company, DBS HK

Segmental Breakdown (US\$ m)

FY Dec	2019A	2020A	2021A	2022F	2023F
Revenues (US\$ m)					
Lease Rental Income	1,704	1,784	1,865	1,845	2,063
Interest and Fee Income	99	177	177	150	125
Net gain on sale of aircraft	134	44	44	54	108
Others	38	48	97	238	30
Total	1,976	2,054	2,183	2,286	2,326

Source: Company, DBS HK

Income Statement (US\$ m)

FY Dec	2019A	2020A	2021A	2022F	2023F
Revenue	1,976	2,054	2,183	2,286	2,326
Cost of Goods Sold	(724)	(777)	(916)	(956)	(1,016)
Gross Profit	1,252	1,277	1,267	1,330	1,311
Other Opng (Exp)/Inc	0	0	0	0	0
Operating Profit	1,252	1,277	1,267	1,330	1,311
Other Non Opg (Exp)/Inc	0	0	(74)	(223)	0
Associates & JV Inc	0	0	0	0	0
Net Interest (Exp)/Inc	(453)	(483)	(490)	(503)	(557)
Dividend Income	0	0	0	0	0
Exceptional Gain/(Loss)	(25)	(231)	(64)	(608)	10
Pre-tax Profit	775	563	639	(4)	763
Tax	(73)	(53)	(77)	0	(92)
Minority Interest	0	0	0	0	0
Preference Dividend	0	0	0	0	0
Net Profit	702	510	561	(4)	672
Net Profit before Except.	725	719	618	531	663
EBITDA	1,862	1,953	1,959	1,917	2,196
Growth					
Revenue Gth (%)	14.5	3.9	6.3	4.7	1.8
EBITDA Gth (%)	16.1	4.9	0.3	(2.1)	14.6
Opg Profit Gth (%)	18.0	2.0	(0.8)	5.0	(1.4)
Net Profit Gth (%)	13.2	(27.4)	10.1	N/A	N/A
Margins & Ratio					
Gross Margins (%)	63.4	62.2	58.0	58.2	56.3
Opg Profit Margin (%)	63.4	62.2	58.0	58.2	56.3
Net Profit Margin (%)	35.5	24.8	25.7	(0.2)	28.9
ROAE (%)	16.0	10.9	11.2	(0.1)	12.7
ROA (%)	3.7	2.4	2.4	0.0	2.7
ROCE (%)	6.1	5.4	4.8	5.7	4.8
Div Payout Ratio (%)	35.0	35.0	35.0	N/A	35.0
Net Interest Cover (x)	2.8	2.6	2.6	2.6	2.4

Source: Company, DBS HK

BOC Aviation Ltd

Balance Sheet (US\$ m)

FY Dec	2019A	2020A	2021A	2022F	2023F
Net Fixed Assets	19,003	22,161	22,364	22,308	24,224
Invts in Associates & JVs	0	0	0	0	0
Other LT Assets	22	752	843	843	843
Cash & ST Invts	612	408	485	447	384
Inventory	0	0	0	0	0
Debtors	125	130	151	100	50
Other Current Assets	3	119	37	32	32
Total Assets	19,764	23,568	23,879	23,730	25,534
ST Debt	1,715	1,746	1,850	1,850	1,850
Creditors	208	189	202	211	215
Other Current Liab	217	222	154	164	174
LT Debt	11,591	14,953	14,866	14,966	16,166
Other LT Liabilities	1,452	1,682	1,542	1,463	1,617
Shareholder's Equity	4,581	4,777	5,266	5,076	5,513
Minority Interests	0	0	0	0	0
Total Cap. & Liab.	19,764	23,568	23,879	23,730	25,534

Source: Company, DBS HK

Cash Flow Statement (US\$ m)

FY Dec	2019A	2020A	2021A	2022F	2023F
Pre-Tax Profit	775	563	639	(4)	763
Dep. & Amort.	610	676	766	810	885
Tax Paid	(32)	(1)	82	(30)	(40)
Assoc. & JV Inc/(loss)	0	0	0	0	0
(Pft)/ Loss on disposal of FAs	0	0	0	0	0
Chg in Wkg.Cap.	(150)	(131)	(62)	71	64
Other Operating CF	(38)	219	(126)	758	(55)
Net Operating CF	1,164	1,326	1,298	1,605	1,617
Capital Exp.(net)	(1,932)	(4,255)	(1,055)	(1,547)	(2,693)
Other Invts.(net)	0	0	0	0	0
Invts in Assoc. & JV	0	0	0	0	0
Div from Assoc & JV	0	0	0	0	0
Other Investing CF	0	0	0	0	0
Net Investing CF	(1,932)	(4,255)	(1,055)	(1,547)	(2,693)
Div Paid	(224)	(246)	(158)	(197)	(186)
Chg in Gross Debt	1,036	3,295	(6)	100	1,200
Capital Issues	0	0	0	0	0
Other Financing CF	(15)	35	(1)	0	0
Net Financing CF	796	3,084	(165)	(97)	1,014
Currency Adjustments	0	0	0	0	0
Chg in Cash	29	156	77	(38)	(62)
Opg CFPS (US\$)	1.89	2.10	1.96	2.21	2.24
Free CFPS (US\$)	(1.11)	(4.22)	0.35	0.08	(1.55)

Source: Company, DBS HK

BOC Aviation Ltd

Target Price & Ratings History



S.No.	Date	Closing Price	12-mth Target Price	Rating
1:	20-Aug-21	HK\$60.60	HK\$84.00	Buy
2:	2-Mar-22	HK\$65.20	HK\$84.00	Buy
3:	15-Mar-22	HK\$51.10	HK\$76.00	Buy

Source: DBS HK

Analyst: Paul YONG

BOC Aviation Ltd

DBS HK recommendations are based on an Absolute Total Return* Rating system, defined as follows:

STRONG BUY (>20% total return over the next 3 months, with identifiable share price catalysts within this time frame)

BUY (>15% total return over the next 12 months for small caps, >10% for large caps)

HOLD (-10% to +15% total return over the next 12 months for small caps, -10% to +10% for large caps)

FULLY VALUED (negative total return, i.e., > -10% over the next 12 months)

SELL (negative total return of > -20% over the next 3 months, with identifiable share price catalysts within this time frame)

*Share price appreciation + dividends

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