

China / Hong Kong Company Update

Air China

Bloomberg: 753 HK EQUITY | 601111 CH EQUITY | Reuters: 0753.HK | Reuters: 601111.SH

Refer to important disclosures at the end of this report

DBS Group Research . Equity

18 Jan 2024

H: BUY (Upgrade from HOLD)

Last Traded Price (18 Jan 2024): HK\$4.61 (HSI : 15,277)
Price Target 12-mth: HK\$5.60 (21.5% upside) (Prev HK\$6.30)

A: BUY (Upgrade from HOLD)

Last Traded Price (18 Jan 2024): RMB7.31 (CSI300 Index : 3,229)
Price Target 12-mth: RMB8.30 (13.5% upside) (Prev RMB9.30)

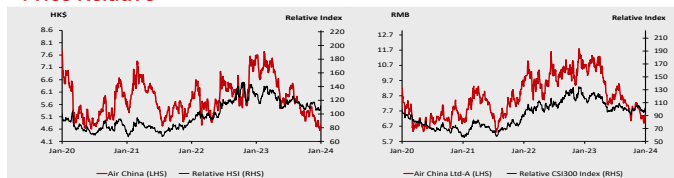
Analyst

Paul YONG +65 6682 3712 paulyong@dbs.com

What's New

- Upgrade to BUY from HOLD with revised TP of HK\$5.60
- Solid earnings momentum to sustain over next two years on capacity growth and wider margins from a low base
- Trim FY24F EBITDA forecast on more gradual resumption of international passenger capacity, partially offset by higher yields
- Valuations attractive at close to five-year pre-pandemic average, following >35% correction in share price the past year

Price Relative



Forecasts and Valuation (H Shares)

FY Dec (RMBm)	2022A	2023F	2024F	2025F
Turnover	56,272	148,940	167,164	187,667
EBITDA	(14,210)	28,977	40,780	43,636
Pre-tax Profit	(45,877)	(1,261)	9,874	12,250
Net Profit	(38,617)	(400)	7,154	8,825
Net Pft (Pre Ex) (core profit)	(38,617)	(400)	7,154	8,825
Net Profit Gth (Pre-ex) (%)	(132.1)	99.0	N/A	23.4
EPS (RMB)	(2.66)	(0.02)	0.44	0.54
EPS Gth (%)	(132.1)	99.1	N/A	23.4
DPS (HK\$)	0.00	0.00	0.00	0.00
BV Per Share (HK\$)	1.76	2.56	3.04	3.63
PE (X)	nm	nm	9.6	7.8
P/Cash Flow (X)	nm	2.4	2.1	1.9
P/Free CF (X)	nm	5.2	5.4	4.7
EV/EBITDA (X)	nm	9.7	6.6	5.9
Net Div Yield (%)	0.0	0.0	0.0	0.0
P/Book Value (X)	2.6	1.8	1.5	1.3
Net Debt/Equity (X)	10.1	5.9	4.5	3.4
ROAE(%)	(90.9)	(1.3)	17.1	17.7
Earnings Rev (%)		(65)	(10)	New
Consensus EPS (RMB)		0.06	0.60	0.68
Other Broker Recs:		B:13	S:2	H:3

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

Upswing in earnings ahead

Investment Thesis

Chinese flag carrier with the most extensive international network. As part of the Star Alliance group, Air China has its primary hub in the Beijing capital and boasts a key advantage in global connectivity, commanding a 27% share of China's total international traffic in 2019. It is the only Chinese network carrier serving all six continents across the globe, with a particularly strong presence in the profitable China-to-Europe and China-to-North America routes. Additionally, Air China also holds a 30.0% stake in Cathay Pacific, one of Asia's leading network carriers.

Solid earnings momentum to sustain over next two years on capacity growth from a low base. We anticipate Air China would see a convincing turnaround this year and ride the upswing in earnings, propelled by a meaningful recovery in international passenger traffic and resilient passenger yields. Despite potential constraints on capacity growth due to the P&W GTF engine issues affecting c.8% of its fleet, the group is poised to achieve an unparalleled growth in earnings over the next two years, surpassing pre-pandemic levels.

Undemanding valuations for superior earnings trajectory. We believe that its valuations are significantly more attractive, at close to its five-year pre-pandemic average, particularly with the expectation of superior earnings growth over the next two years, following a >35% correction of the company's share price over the past year. A stronger-than-expected generation of cash flows will enable the group to deleverage swiftly and repair its battered balance sheet.

Upgrade Air China to BUY with revised TP of HK\$5.60 (HK\$6.30 previously), based on 6.8x EV/EBITDA (FY24F), which is 0.5SD above its five-year pre-pandemic average. The upgrade in our recommendation reflects Air China's robust earnings trajectory over the next two years on attractive valuations. Our A-share TP is derived by applying a 70% valuation premium to its H-share.

Key Risks

Macroeconomic headwinds could curtail the recovery in Air China's passenger traffic and keep a lid on yields, while **elevated jet fuel prices** could weigh on operating margins.

At A Glance

Issued Capital - H shares (m shs)	4,563
- Non H shrs (m shs)	9,962
H shs as a % of Total	31
Total Mkt Cap (HK\$m/US\$m)	99,674 / 12,744
Major Shareholders (%)	
China National Aviation Holding Corp. Ltd.	56.4
China National Aviation Corp (Group) Ltd.	11.4
Major H Shareholders (As % of H shares)	
Cathay Pacific Airways Ltd	57.7
H Shares-Free Float (%)	42.3
3m Avg. Daily Val. (US\$m)	5.1
GICS Industry: Industrials / Transportation	

Air China

WHAT'S NEW

Upswing in earnings ahead

Our 2024 outlook report for the [airline sector](#) highlights that macroeconomic indicators still largely favour the sector, though we expect to see a diverging earnings outlook across regions and business segments. This underpins our expectation of global passenger traffic hitting 105%-110%/115%-120% of 2019's level in 4Q24/4Q25. Across the three major regions, we are most positive about airlines in Asia Pacific, as we expect them to demonstrate stronger earnings momentum, underpinned by relatively higher capacity growth and wider margins, with the Chinese airlines likely to see the biggest upswing in earnings. While valuation multiples for Asian airlines might appear high, they are commensurate with the region's stronger earnings potential. Our top picks are Cathay Pacific (CX) and China Southern Airlines (CSA).

However, we lowered our FY24F net profit estimates by 10-20% for the three Chinese airlines, reflecting a more moderate resumption of international passenger capacity and a more gradual improvement in unit costs owing to slower capacity growth. Nonetheless, we expect the Chinese airlines to deliver strong earnings growth ahead. Following a stellar performance in 3Q23, marking their first profitable quarter since the pandemic, the Chinese airlines are poised to sustain and amplify this upswing, potentially leading the sector in earnings growth, in our view.

Air China's share price has corrected more than 35% over the past year, the most among the three Chinese flag carriers, and we believe that its valuations are attractive, at close to its five-year pre-pandemic average, particularly with the expectation of unmatched earnings growth over the next two years. Therefore we upgrade Air China to BUY. As we roll over our valuation base to FY24F and adjust our valuation peg due to the multiple contractions in the airline sector, we set our new TP at HK\$5.60, based on 6.8x EV/EBITDA (FY24F), which is 0.5SD above its five-year pre-pandemic average.

Company Background

Founded in 1988 and headquartered in Beijing, Air China is the sole flag carrier of China. It completed its listing on the Hong Kong and London stock exchanges in 2004. Air China joined the Star Alliance in 2007, with its main hub in Beijing and secondary hubs in Shanghai and Chengdu.

Valuation table

(in RMB millions unless specified otherwise)	Value	Comments
EBITDA	40,780	FY24F
EV/EBITDA multiple peg (x)	6.8	0.5 standard deviation above five-year pre-pandemic average
Enterprise value	278,526	
Less: net debt	(215,785)	As at June 23
Add: negative minority interests	2,020	As at June 23
Add: JVs and assocs	14,100	
Equity value	78,862	
Number of shares outstanding (m)	16,201	
Value per share (HK\$)	5.60	

Source: DBS Bank estimates

Air China

Historical PB band



Source: Thomson Reuters, DBS HK

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Key Assumptions

FY Dec	2021A	2022A	2023F	2024F	2025F
ASK (m p-km)	152,444.5	96,212.4	298,691.7	340,427.1	378,657.1
RPK (m p-km)	104,625.6	60,354.6	218,806.6	262,332.2	306,242.1
Passenger Load Factor (%)	68.6	62.7	73.3	77.1	80.9
Passenger Yield (RMB cts per RPK)	55.7	63.5	61.4	57.5	55.1
All-in Jet Fuel Price (US\$/bbl)	84.5	129.6	117.7	107.0	112.4

Source: Company, DBS HK

Segmental Breakdown (RMB m)

FY Dec	2021A	2022A	2023F	2024F	2025F
Revenues (RMB m)					
Passenger	58,317	38,296	134,240	150,733	168,759
Cargo	11,113	10,085	3,892	4,899	6,734
Others	9,172	7,892	10,808	11,532	12,175
Total	78,602	56,272	148,940	167,164	187,667

Source: Company, DBS HK

Air China

Income Statement (RMB m)

FY Dec	2021A	2022A	2023F	2024F	2025F
Revenue	78,602	56,272	148,940	167,164	187,667
Cost of Goods Sold	(95,465)	(91,716)	(144,381)	(152,268)	(171,468)
Gross Profit	(16,862)	(35,444)	4,558	14,896	16,199
Other Opng (Exp)/Inc	0	0	0	0	0
Operating Profit	(16,862)	(35,444)	4,558	14,896	16,199
Other Non Opng (Exp)/Inc	1,235	(4,089)	(1,500)	0	0
Associates & JV Inc	(816)	(101)	2,741	2,175	2,401
Net Interest (Exp)/Inc	(5,383)	(6,244)	(7,061)	(7,197)	(6,351)
Dividend Income	0	0	0	0	0
Exceptional Gain/(Loss)	0	0	0	0	0
Pre-tax Profit	(21,826)	(45,877)	(1,261)	9,874	12,250
Tax	3,003	703	680	(1,309)	(1,674)
Minority Interest	2,187	6,556	180	(1,411)	(1,751)
Preference Dividend	0	0	0	0	0
Net Profit	(16,635)	(38,617)	(400)	7,154	8,825
Net Profit before Except.	(16,635)	(38,617)	(400)	7,154	8,825
EBITDA	4,072	(14,210)	28,977	40,780	43,636
Growth					
Revenue Gth (%)	6.4	(28.4)	164.7	12.2	12.3
EBITDA Gth (%)	(55.9)	N/A	N/A	40.7	7.0
Opg Profit Gth (%)	51.0	110.2	(112.9)	226.8	8.8
Net Profit Gth (%)	(15.5)	(132.1)	99.0	N/A	23.4
Margins & Ratio					
Gross Margins (%)	(21.5)	(63.0)	3.1	8.9	8.6
Opg Profit Margin (%)	(21.5)	(63.0)	3.1	8.9	8.6
Net Profit Margin (%)	(21.2)	(68.6)	(0.3)	4.3	4.7
ROAE (%)	(24.0)	(90.9)	(1.3)	17.1	17.7
ROA (%)	(5.7)	(13.0)	(0.1)	2.3	2.9
ROCE (%)	(6.5)	(13.5)	1.7	4.8	5.3
Div Payout Ratio (%)	N/A	N/A	N/A	0.0	0.0
Net Interest Cover (x)	(3.1)	(5.7)	0.6	2.1	2.6

Source: Company, DBS HK

Interim Income Statement (RMB m)

FY Dec	1H2021	2H2021	1H2022	2H2022	1H2023
Revenue	39,953	38,649	25,400	30,872	63,683
Cost of Goods Sold	(45,996)	(49,469)	(42,373)	(49,343)	(64,581)
Gross Profit	(6,043)	(10,820)	(16,973)	(18,471)	(898)
Other Oper. (Exp)/Inc	0	0	0	0	0
Operating Profit	(6,043)	(10,820)	(16,973)	(18,471)	(898)
Other Non Opng (Exp)/Inc	563	672	(2,240)	(1,849)	(1,565)
Associates & JV Inc	(1,309)	493	(814)	714	1,354
Net Interest (Exp)/Inc	(2,617)	(2,766)	(3,049)	(3,195)	(3,251)
Exceptional Gain/(Loss)	0	0	0	0	0
Pre-tax Profit	(9,405)	(12,421)	(23,076)	(22,801)	(4,360)
Tax	1,734	1,269	862	(159)	316
Minority Interest	889	1,298	2,777	3,779	597
Net Profit	(6,781)	(9,854)	(19,437)	(19,181)	(3,447)
Net profit bef Except.	(6,781)	(9,854)	(19,437)	(19,181)	(3,447)
Growth					
Revenue Gth (%)	26.8	(8.7)	(36.4)	(20.1)	150.7
Opg Profit Gth (%)	(9.6)	141.1	180.9	70.7	(94.7)
Net Profit Gth (%)	28.2	(98.5)	(186.6)	(94.7)	82.3
Margins					
Gross Margins (%)	(15.1)	(28.0)	(66.8)	(59.8)	(1.4)
Opg Profit Margins (%)	(15.1)	(28.0)	(66.8)	(59.8)	(1.4)
Net Profit Margins (%)	(17.0)	(25.5)	(76.5)	(62.1)	(5.4)

Source: Company, DBS HK

Air China

Balance Sheet (RMB m)

FY Dec	2021A	2022A	2023F	2024F	2025F
Net Fixed Assets	220,415	225,393	238,237	232,353	226,916
Invt in Associates & JVs	12,220	12,714	15,456	17,631	20,032
Other LT Assets	35,349	34,627	34,627	34,627	34,627
Cash & ST Invt	17,044	11,437	11,584	9,329	8,923
Inventory	2,050	2,558	3,264	3,206	3,085
Debtors	2,991	1,649	5,305	6,870	8,227
Other Current Assets	8,312	6,601	6,601	6,601	6,601
Total Assets	298,381	294,979	315,074	310,617	308,411
ST Debt	54,737	60,043	52,114	44,614	37,114
Creditors	12,591	10,936	17,342	18,319	19,538
Other Current Liab	24,292	21,504	25,009	26,009	27,009
LT Debt	129,467	169,744	172,735	165,235	157,735
Other LT Liabilities	11,463	11,224	11,926	11,926	11,926
Shareholder's Equity	61,369	23,577	38,177	45,331	54,156
Minority Interests	4,463	(2,049)	(2,229)	(818)	933
Total Cap. & Liab.	298,381	294,979	315,074	310,617	308,411
Non-Cash Wkg. Capital	(23,530)	(21,632)	(27,182)	(27,652)	(28,635)
Net Cash/(Debt)	(167,160)	(218,350)	(213,264)	(200,520)	(185,926)
Debtors Turn (avg days)	13.8	15.0	8.5	13.3	14.7
Creditors Turn (avg days)	61.5	60.9	43.0	51.5	48.0
Inventory Turn (avg days)	9.6	11.9	8.9	9.3	8.0
Asset Turnover (x)	0.3	0.2	0.5	0.5	0.6
Current Ratio (x)	0.3	0.2	0.3	0.3	0.3
Quick Ratio (x)	0.2	0.1	0.2	0.2	0.2
Net Debt/Equity (X)	2.5	10.1	5.9	4.5	3.4
Net Debt/Equity ex MI (X)	2.7	9.3	5.6	4.4	3.4
Capex to Debt (%)	2.2	3.0	6.7	9.5	11.3
Z-Score (X)	NA	NA	NA	NA	NA

Source: Company, DBS HK

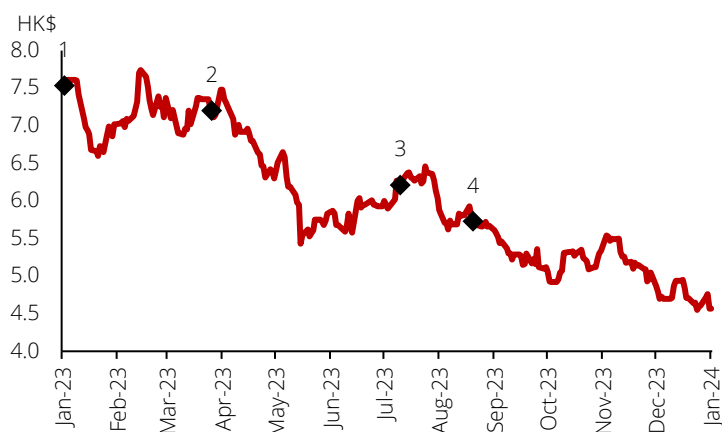
Cash Flow Statement (RMB m)

FY Dec	2021A	2022A	2023F	2024F	2025F
Pre-Tax Profit	(21,826)	(45,877)	(1,261)	9,874	12,250
Dep. & Amort.	20,935	21,234	24,419	25,884	27,437
Tax Paid	(3)	703	680	(1,309)	(1,674)
Assoc. & JV Inc/(loss)	816	101	(2,741)	(2,175)	(2,401)
(Pft)/ Loss on disposal of FAs	0	0	0	0	0
Chg in Wkg.Cap.	9,325	(1,903)	5,550	471	983
Other Operating CF	(2,116)	2,402	1,500	0	0
Net Operating CF	7,130	(23,341)	28,147	32,744	36,594
Capital Exp.(net)	(4,061)	(7,000)	(15,000)	(20,000)	(22,000)
Other Invt.(net)	0	0	0	0	0
Invt in Assoc. & JV	0	0	0	0	0
Div from Assoc & JV	2	0	0	0	0
Other Investing CF	(394)	219	0	0	0
Net Investing CF	(4,453)	(6,781)	(15,000)	(20,000)	(22,000)
Div Paid	(27)	0	0	0	0
Chg in Gross Debt	7,005	20,000	(28,000)	(15,000)	(15,000)
Capital Issues	0	0	15,000	0	0
Other Financing CF	491	4,677	0	0	0
Net Financing CF	7,469	24,677	(13,000)	(15,000)	(15,000)
Currency Adjustments	(50)	118	0	0	0
Chg in Cash	10,097	(5,327)	147	(2,256)	(406)
Opg CFPS (RMB)	(0.15)	(1.48)	1.39	1.99	2.20
Free CFPS (RMB)	0.21	(2.09)	0.81	0.79	0.90

Source: Company, DBS HK

Air China

H Share - Target Price & Ratings 12-mth History



S.No.	Date	Closing Price	Target Price	Rating
1	19-Jan-23	HK\$7.53	HK\$7.20	HOLD
2	12-Apr-23	HK\$7.26	HK\$7.60	HOLD
3	27-Jul-23	HK\$6.22	HK\$6.60	HOLD
4	6-Sep-23	HK\$5.80	HK\$6.30	HOLD

Source: DBS HK

Analyst: Paul YONG

A Share - Target Price & Ratings 12-mth History



S.No.	Date	Closing Price	Target Price	Rating
1	19-Jan-23	RMB10.69	RMB10.60	HOLD
2	12-Apr-23	RMB10.96	RMB11.20	HOLD
3	27-Jul-23	RMB9.05	RMB9.50	HOLD
4	6-Sep-23	RMB8.58	RMB9.30	HOLD

Source: DBS HK

Analyst: Paul YONG

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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Sources for all charts and tables are DBS HK unless otherwise specified.

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DBS Bank (Hong Kong) Limited

13th Floor One Island East, 18 Westlands Road, Quarry Bay, Hong Kong

Tel: (852) 3668-4181, Fax: (852) 2521-1812

Air China

DBS Regional Research Offices

HONG KONG

DBS Bank (Hong Kong) Ltd

Contact: Dennis Lam

13th Floor One Island East,
18 Westlands Road, Quarry Bay, Hong Kong

Tel: 852 3668 4181

Fax: 852 2521 1812

e-mail: dbsvhk@dbs.com

SINGAPORE

DBS Bank Ltd

Contact: Andy Sim

12 Marina Boulevard,
Marina Bay Financial Centre Tower 3
Singapore 018982

Tel: 65 6878 8888

e-mail: groupresearch@dbs.com

Company Regn. No. 196800306E

INDONESIA

PT DBS Vickers Sekuritas (Indonesia)

Contact: Maynard Priajaya Arif

DBS Bank Tower
Ciputra World 1, 32/F
Jl. Prof. Dr. Satrio Kav. 3-5
Jakarta 12940, Indonesia

Tel: 62 21 3003 4900

Fax: 6221 3003 4943

e-mail: indonesiaresearch@dbs.com

THAILAND

DBS Vickers Securities (Thailand) Co Ltd

Contact: Chanpen Sirithanarattanakul

989 Siam Pivat Tower Building,
9th, 14th-15th Floor

Rama 1 Road, Pathumwan,

Bangkok Thailand 10330

Tel. 66 2 857 7831

Fax: 66 2 658 1269

e-mail: research@th.dbs.com

Company Regn. No 0105539127012

Securities and Exchange Commission, Thailand