

Bulletin:

China Airlines' Plan To Cut Capacity Will Reduce Rating Headroom

May 12, 2021

Taiwan Ratings Corp. said today that China Airlines Corp. (twBBB+/Negative/twA-2) can absorb the financial impact of its plan to trim cargo capacity for the next three months. However, the plan will also reduce rating headroom for the carrier.

On May 6, Taiwan's Central Epidemic Command Center announced strengthened quarantine regulations and related control measures for China Airlines' crew members. The tighter regulations negatively affect the number of flights China Airlines can schedule and could result in a likely reduction of the carrier's capacity by 10%-20%. However, we believe this will lead to an increase in the freight rate, given air freight demand remains strong. Moreover, we expect the global economic recovery and continued port congestion for seaborne trade to underpin strong demand for air cargo over the next two to three quarters. This could raise China Airline's cargo yield and partly offset the impact of lower tonnage over the period.

Nevertheless, there remains a high degree of uncertainty over China Airlines' performance over the next 12 months, largely due to continued challenges for governments to control the COVID-19 pandemic. A further escalation in domestic infection rates and more stringent quarantine requirements for China Airlines' crew members would add to the carrier's operational challenges and reduce operating cash flow generation, thus negatively affecting its rating headroom. Progress in the rate of global economic recovery which influences cargo demand and the degree of price reflection will also affect the airline's profitability. We believe cargo will continue to dominate China Airlines' performance in 2021, because overseas travel activities are likely to remain muted amid the pandemic's evolution. Our negative outlook on China Airlines reflects the aforementioned uncertainty and indicates a one in three chance of a rating downgrade over the next 12-24 months.

This report does not constitute a rating action.

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