EQUITY RESEARCH

China Southern Airlines (1055.HK)

Firm Long-term Growth despite Short-term Fluctuation

Hong Kong | Air | Update Report

8 JUNE 2016

Last Year`s Result in Line with Expectations

China Southern Airlines (CSA)` full-year revenue for 2015 reached RMB111.6 billion, a YoY increase of 2.8%; net profit attributable to the company`s shareholders stood at RMB3.76 billion, a YoY soar of 110.2%, over a double. The earnings per share marked RMB0.38 and the dividend per share stood at RMB0.08 with a payout ratio of 21%. The result was in line with expectations.

A Slump in US-Dollar-Denominated Obligations with Dropping Elasticity of Exchange Rate

As it was stated previously, the towering US-dollar-denominated obligations caused the net foreign exchange loss to reach RMB5.95 billion in 2015, worst of the big three airlines. However, the company swapped large amount of US-dollar-denominated obligations for RMB-denominated obligations to reduce US-dollar-obligations from 93% of late 2014 to 61% of late 2015, boasting the toughest reformer of the big three airlines. According to current scale, it is estimated that every 1% RMB depreciation will contribute to a mere reduction of RMB440 million in the company`s net profit, representing a notable decrease in risk exposure.

With respect to borrowings, the company has repaid about 10 billion, with the debt-to-asset ratio fell by 4 percentage points to 73%. It also swapped the floating interest rate for fixed interest rate to mitigate the potential adverse impacts from US`s move to raise rates. Though the cash on hand has reduced about 10 billion, considering the bank`s credit can reach as much as 131 billion, the management believes the flow capital can cover the operating and capital expenditures.

Growing Performance of Q1 with a Soar of 41% in Earnings

Performance of Q1 kept growing. The total incoming were stable in 2016 while the attributable net profit soared by 41% over last year to RMB2.683 billion, and EPS stood at RMB0.27, mainly due to the lower oil price and RMB appreciation.

Investment thesis

The swing of oil prices and exchange rates will cause the fluctuation of airline companies` results in the short run. But we are convinced that, with the counter-cyclical feature, the booming outbound tourism and domestic long-distance tourism will embrace great potential for development in China. The Company is going to lift its proportion of international routes at Shenzhen Bao`an Airport within 2 years. The expansion of Guangzhou Baiyun Airport by 2018 will break the bottleneck of its handling capacity, which is favorable to build the company`s service network with Guangzhou at the core.

In accordance with the latest data, we adjust the estimate of the Company`s EPS to RMB0.58/0.79 in 2016 and 2017. The "Buy" rating is maintained. The target price is HK$5.66, equivalent to 8/6x and 1/0.9x estimated P/E ratio and P/B ratio, respectively, in 2016 and 2017. (Closing price as at 6 June 2016)

BUY (Maintain)

CMP: HKD 4.67

(Closing price as at 6 June 2016)

TARGET: HKD 5.66 (+21%)

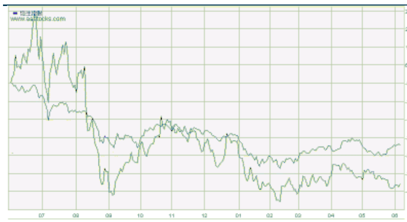
COMPANY DATA

O/S SHARES (MN) :	9819
MARKET CAP (HKD MN) :	13052
52 - WK HI/LO (HKD):	10.36 / 4.00

SHARE HOLDING PATTERN, %

China Southern Air Holding Company	53.13
HKSCC Nominees Limited	17.83

PRICE VS. HSI



Source: Phillip Securities (HK) Research

KEY FINANCIALS

CNY mn	FY14	FY15	FY16E	FY17E
Net Sales	108,584	111,652	120,126	130,651
Net Profit	1,777	3,736	5,686	7,715
EPS, CNY	0.18	0.38	0.58	0.79
P/E, x	20.3	10.3	6.8	5.0
BVPS, CNY	3.64	3.98	4.48	5.25
P/BV, x	1.0	1.0	0.9	0.8
DPS (CNY)	0.04	0.08	0.11	0.15
Div. Yield (%)	1.2%	2.0%	2.8%	3.8%

Source: Company reports, Phillip Securities Est.

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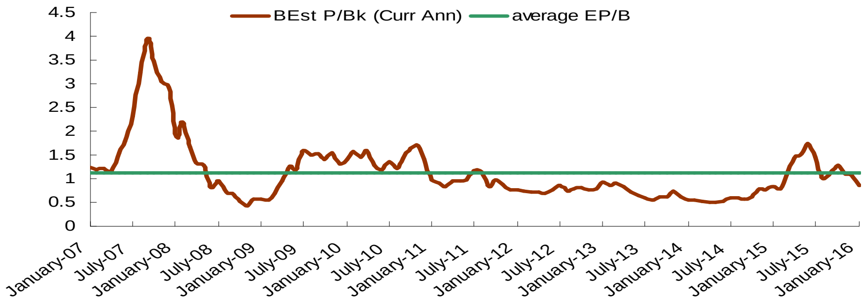
CSA`s Forward P/B in ten years



Source: Bloomberg, Phillip Securities Hong Kong Research

Risk

Traffic demand languished for the deterioration of macro-economy;
The depreciation of the RMB against USD would bring exchange loss;
Oil prices rose exceeded forecast.
War, terrorist attacks, SARS and other emergencies;
Irrational inter-industrial price war;

Financials

FYE DEC	FY11	FY12	FY13	FY14	FY15	FY16F	FY17F
Valuation Ratios							
P/E (X), adj.	7.3	14.0	18.1	20.3	10.3	6.8	5.0
P/B (X)	1.15	1.12	1.05	1.01	0.98	0.88	0.75
Dividend Yield (%)	5.3%	1.3%	1.1%	1.2%	2.0%	2.8%	3.8%
Per share data (RMB)							
EPS, reported	0.52	0.27	0.20	0.18	0.38	0.58	0.79
EPS, adj.	0.52	0.27	0.20	0.18	0.38	0.58	0.79
DPS	0.2	0.05	0.04	0.04	0.08	0.11	0.15
BVPS	3.28	3.34	3.50	3.64	3.98	4.48	5.25
Growth & Margins (%)							
Growth							
Revenue	18.2%	10.1%	-1.0%	10.2%	2.8%	7.6%	8.8%
EBIT	-53.5%	17.1%	-70.4%	214.4%	183.0%	5.9%	12.3%
Net Income, adj.	-11.8%	-48.7%	-24.2%	-10.5%	110.2%	52.2%	35.7%
Margins							
EBIT margin	4.8%	5.1%	1.5%	4.4%	12.0%	11.9%	12.2%
Net Profit Margin	5.7%	2.6%	2.0%	1.6%	3.3%	4.7%	5.9%
D/E	38.4%	18.7%	19.8%	23.8%	21.0%	19.0%	19.1%
Key Ratios							
ROE (%)	15.9%	8.1%	5.9%	5.1%	10.0%	13.7%	16.2%
ROA (%)	3.9%	1.8%	1.3%	1.0%	2.0%	2.9%	3.5%

Income Statement (RMB mn)							
Revenue	**90,395**	**99,514**	**98,547**	**108,584**	**111,652**	**120,126**	**130,651**
Operating expenses	(87,063)	(95,877)	(98,280)	(106,026)	(101,492)	(109,351)	(118,278)
Other Gains-net	1,021	1,462	1,243	2,190	3,278	3,461	3,615
Profit from operations	4,353	5,099	1,510	4,748	13,438	14,236	15,988
Non-operating income/expense	2,577	(361)	1,974	(1,682)	(7,320)	(5,331)	(4,509)
Profit before tax	6,930	4,738	3,484	3,066	6,118	8,905	11,479
Tax	(840)	(954)	(734)	(668)	(1,300)	(1,888)	(2,433)
Profit for the period	6,090	3,784	2,750	2,398	4,818	7,017	9,045
Minority interests	(980)	(1,165)	(764)	(621)	(1,082)	(1,331)	(1,330)
Total capital share	9,818	9,818	9,818	9,818	9,818	9,818	9,818
Net profit	**5,110**	**2,619**	**1,986**	**1,777**	**3,736**	**5,686**	**7,715**

Source: PSR

(Financial figures as at 6 June 2016)

PHILLIP RESEARCH STOCK SELECTION SYSTEMS

Total Return	Recommendation	Rating	Remarks
>+20%	Buy	1	>20% upside from the current price
+5% to +20%	Accumulate	2	+5% to +20%upside from the current price
-5% to +5%	Neutral	3	Trade within ± 5% from the current price
-5% to -20%	Reduce	4	-5% to -20% downside from the current price
<-20%	Sell	5	>20%downside from the current price

We do not base our recommendations entirely on the above quantitative return bands. We consider qualitative factors like (but not limited to) a stock`s risk reward profile, market sentiment, recent rate of share price appreciation, presence or absence of stock price catalysts, and speculative undertones surrounding the stock, before making our final recommendation

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