

# China Southern Airlines (1055.HK)

## Bigger Market Brought by Expanded China-Australia Traffic Rights

Hong Kong | Air | Update Report

19 December 2016

### Nearly 40% Increase in Result in the First Three Quarters

China Southern Airlines reported total revenue of RMB86.628 billion in the first three quarters, slightly up by 1.5% YoY, and its net profit attributable to the parent company amounted to RMB6.441 billion, soared by 38% YoY, growing fastest among the Big three Carriers in China. EPS in the first three quarters was RMB0.66, and EPS in Q1, Q2 and Q3 was RMB0.27, RMB0.04 and RMB0.34, respectively, rocketed by 41%, -73% and 180% YoY, respectively, from last year's RMB0.19, RMB0.16 and RMB0.12, respectively.

### Declined Fuel Costs: Biggest Contributor

Thanks to the extremely low oil prices in Q1, the average jet fuel price in the first three quarters declined by almost 30% YoY. China Southern Airlines had the largest fleet and the lowest cost of jet fuel among the three airline giants in China, strongly promoting the company's growth in main business performance, with the gross profit margin in the first three quarters reaching the record high.

### Less Financial Expenses, Continuously Optimized Debt Structure

China Southern Airlines was the toughest reformer adjusting debt structure among China's three airline giants. Over the period, by issuing RMB bonds and short-term financing bills, as well as repaying short-term and long-term US dollar loans, the company swapped its US-dollar-denominated obligations for RMB-denominated obligations, optimizing the debt structure. The US-dollar-obligations reduced from 93% in late 2014 to 61% in late 2015 and around 49% in 2016. According to current rate, it is estimated that every 1% RMB depreciation will contribute to a mere reduction of RMB310 million in the company's net profit, representing a further decrease in risk exposure. Moreover, the company's debt-to-asset ratio fell from 73.4% in late last year to 70.8% in this year through debt payment. Under the influence, the company's financial expenses in the first three quarters of 2016 plummeted by 33.9% YoY.

### Bigger Market Brought by Expanded China-Australia Traffic Rights

Recently Chinese government and its Australian counterpart signed an agreement on traffic right expansion, fully opening the China-Australia third and fourth traffic rights (the aircraft to unload and carry passengers, mails or goods within the territory of each country) and expanding the fifth traffic right to fly via the third country. After many years of development on China-Australia routes, China Southern Airlines, taking the lion share of the market with 36%, will benefit from opening skies to the greatest extent. Meanwhile, its Guangzhou-centered hub network strategy will once again gain momentum.

## 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.

In accordance with the latest data, we adjust the estimate of the Company's EPS to RMB0.59/0.74 in 2016 and 2017. The "Buy" rating is maintained. The target price is HK\$5.24, equivalent to 8/6.5x and 1/0.9x estimated P/E ratio and P/B ratio, respectively, in 2016 and 2017.

## BUY (Maintain)

CMP: HKD 4.09

(Closing price as at 15 Dec)

TARGET: HKD 5.24 (+28%)

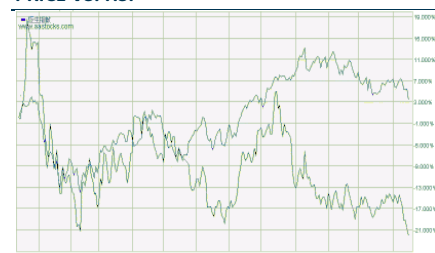
### COMPANY DATA

O/S SHARES (MN) :	9819
MARKET CAP (HKD MN) :	11431
52 - WK HI/LO (HKD):	6.25 / 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	114,126	122,051
Net Profit	1,777	3,736	5,758	7,306
EPS, CNY	0.18	0.38	0.59	0.74
P/E, x	17.8	9.0	6.2	5.1
BVPS, CNY	3.64	3.98	4.53	5.31
P/BV, x	0.9	0.9	0.8	0.7
DPS (CNY)	0.04	0.08	0.11	0.15
Div. Yield (%)	1.3%	2.3%	3.0%	4.0%

Source: Company reports, Phillip Securities Est.

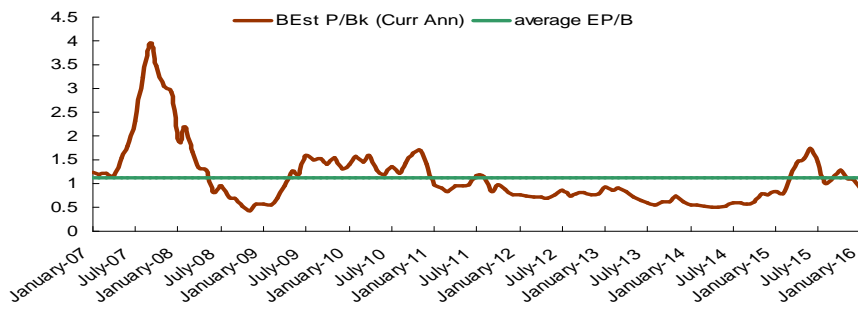
Research Analyst

**ZhangJing**

(+ 86 51699400-103)

zhangjing@phillip.com.cn

**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
<b>Valuation Ratios</b>							
P/E (X), adj.	6.4	12.3	15.9	17.8	9.0	6.2	5.1
P/B (X)	1.01	0.98	0.92	0.89	0.86	0.80	0.71
Dividend Yield (%)	6.0%	1.5%	1.2%	1.3%	2.3%	3.0%	4.0%
<b>Per share data (RMB)</b>							
EPS, reported	0.52	0.27	0.20	0.18	0.38	0.59	0.74
EPS, adj.	0.52	0.27	0.20	0.18	0.38	0.59	0.74
DPS	0.2	0.05	0.04	0.04	0.08	0.11	0.15
BV/PS	3.28	3.34	3.50	3.64	3.98	4.53	5.31
<b>Growth &amp; Margins (%)</b>							
<b>Growth</b>							
Revenue	18.2%	10.1%	-1.0%	10.2%	2.8%	2.2%	6.9%
EBIT	-53.5%	17.1%	-70.4%	214.4%	183.0%	18.2%	-6.0%
Net Income, adj.	-11.8%	-48.7%	-24.2%	-10.5%	110.2%	54.1%	26.9%
<b>Margins</b>							
EBIT margin	4.8%	5.1%	1.5%	4.4%	12.0%	13.9%	12.2%
Net Profit Margin	5.7%	2.6%	2.0%	1.6%	3.3%	5.0%	6.0%
D/E	38.4%	18.7%	19.8%	23.8%	21.0%	18.8%	20.2%
<b>Key Ratios</b>							
ROE (%)	15.9%	8.1%	5.9%	5.1%	10.0%	13.8%	15.1%
ROA (%)	3.9%	1.8%	1.3%	1.0%	2.0%	2.9%	3.4%

<b>Income Statement (RMB mn)</b>							
Revenue	90,395	99,514	98,547	108,584	111,652	114,126	122,051
Operating expenses	(87,063)	(95,877)	(98,280)	(106,026)	(101,492)	(101,806)	(110,831)
Other Gains-net	1,021	1,462	1,243	2,190	3,278	3,569	3,710
Profit from operations	4,353	5,099	1,510	4,748	13,438	15,889	14,930
Non-operating income/expense	2,577	(361)	1,974	(1,682)	(7,320)	(7,147)	(3,984)
Profit before tax	6,930	4,738	3,484	3,066	6,118	8,742	10,946
Tax	(840)	(954)	(734)	(668)	(1,300)	(1,853)	(2,321)
Profit for the period	6,090	3,784	2,750	2,398	4,818	6,889	8,626
Minority interests	(980)	(1,165)	(764)	(621)	(1,082)	(1,131)	(1,320)
Total capital share	9,818	9,818	9,818	9,818	9,818	9,818	9,818
<b>Net profit</b>	<b>5,110</b>	<b>2,619</b>	<b>1,986</b>	<b>1,777</b>	<b>3,736</b>	<b>5,758</b>	<b>7,306</b>

Source: PSR

(Financial figures as at 15 December 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 $\pm$ 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

#### GENERAL DISCLAIMER

This publication is prepared by Phillip Securities (Hong Kong) Ltd ("Phillip Securities"). By receiving or reading this publication, you agree to be bound by the terms and limitations set out below.

This publication shall not be reproduced in whole or in part, distributed or published by you for any purpose. Phillip Securities shall not be liable for any direct or consequential loss arising from any use of material contained in this publication.

The information contained in this publication has been obtained from public sources which Phillip Securities has no reason to believe are unreliable and any analysis, forecasts, projections, expectations and opinions (collectively the "Research") contained in this publication are based on such information and are expressions of belief only. Phillip Securities has not verified this information and no representation or warranty, express or implied, is made that such information or Research is accurate, complete or verified or should be relied upon as such. Any such information or Research contained in this publication is subject to change, and Phillip Securities shall not have any responsibility to maintain the information or Research made available or to supply any corrections, updates or releases in connection therewith. In no event will Phillip Securities be liable for any special, indirect, incidental or consequential damages which may be incurred from the use of the information or Research made available, even if it has been advised of the possibility of such damages.

Any opinions, forecasts, assumptions, estimates, valuations and prices contained in this material are as of the date indicated and are subject to change at any time without prior notice.

This material is intended for general circulation only and does not take into account the specific investment objectives, financial situation or particular needs of any particular person. The products mentioned in this material may not be suitable for all investors and a person receiving or reading this material should seek advice from a financial adviser regarding the suitability of such products, taking into account the specific investment objectives, financial situation or particular needs of that person, before making a commitment to invest in any of such products.

This publication should not be relied upon as authoritative without further being subject to the recipient's own independent verification and exercise of judgment. The fact that this publication has been made available constitutes neither a recommendation to enter into a particular transaction nor a representation that any product described in this material is suitable or appropriate for the recipient. Recipients should be aware that many of the products which may be described in this publication involve significant risks and may not be suitable for all investors, and that any decision to enter into transactions involving such products should not be made unless all such risks are understood and an independent determination has been made that such transactions would be appropriate. Any discussion of the risks contained herein with respect to any product should not be considered to be a disclosure of all risks or a complete discussion of such risks.

Nothing in this report shall be construed to be an offer or solicitation for the purchase or sale of a security. Any decision to purchase securities mentioned in this research should take into account existing public information, including any registered prospectus in respect of such security.

#### Disclosure of Interest

Analyst Disclosure: Neither the analyst(s) preparing this report nor his associate has any financial interest in or serves as an officer of the listed corporation covered in this report.

Firm's Disclosure: Phillip Securities does not have any investment banking relationship with the listed corporation covered in this report nor any financial interest of 1% or more of the market capitalization in the listed corporation. In addition, no executive staff of Phillip Securities serves as an officer of the listed corporation.

#### Availability

The information, tools and material presented herein are not directed, intended for distribution to or use by, any person or entity in any jurisdiction or country where such distribution, publication, availability or use would be contrary to the applicable law or regulation or which would subject Phillip Securities to any registration or licensing or other requirement, or penalty for contravention of such requirements within such jurisdiction.

Information contained herein is based on sources that Phillip Securities (Hong Kong) Limited ("PSHK") believed to be accurate. PSHK does not bear responsibility for any loss occasioned by reliance placed upon the contents hereof. PSHK (or its affiliates or employees) may have positions in relevant investment products. For details of different product's risks, please visit the Risk Disclosures Statement on <http://www.phillip.com.hk>.

© 2016 Phillip Securities (Hong Kong) Limited

**Contact Information (Regional Member Companies)**
**SINGAPORE**
**Phillip Securities Pte Ltd**

250 North Bridge Road, #06-00 Raffles City Tower,  
Singapore 179101  
Tel : (65) 6533 6001 Fax: (65) 6535 3834  
[www.phillip.com.sg](http://www.phillip.com.sg)

**INDONESIA**
**PT Phillip Securities Indonesia**

ANZ Tower Level 23B, Jl Jend Sudirman Kav 33A,  
Jakarta 10220, Indonesia  
Tel (62) 21 5790 0800 Fax: (62) 21 5790 0809  
[www.phillip.co.id](http://www.phillip.co.id)

**THAILAND**
**Phillip Securities (Thailand) Public Co. Ltd.**

15th Floor, Vorawat Building, 849 Silom Road,  
Silom, Bangrak, Bangkok 10500 Thailand  
Tel (66) 2 2268 0999 Fax: (66) 2 2268 0921  
[www.phillip.co.th](http://www.phillip.co.th)

**UNITED STATES**
**Phillip Futures Inc.**

141 W Jackson Blvd Ste 3050  
The Chicago Board of Trade Building  
Chicago, IL 60604 USA  
Tel (1) 312 356 9000 Fax: (1) 312 356 9005

**MALAYSIA**
**Phillip Capital Management Sdn Bhd**

B-3-6 Block B Level 3, Megan Avenue II,  
No. 12, Jalan Yap Kwan Seng, 50450 Kuala Lumpur  
Tel (60) 3 2162 8841 Fax (60) 3 2166 5099  
[www.poems.com.my](http://www.poems.com.my)

**CHINA**
**Phillip Financial Advisory (Shanghai) Co. Ltd.**

No 436 Heng Feng Road, Green Tech Tower Unit 604  
Shanghai 200 070  
Tel (86) 21 5169 9400 Fax: (86) 21 6091 1155  
[www.phillip.com.cn](http://www.phillip.com.cn)

**FRANCE**
**King & Shaxson Capital Ltd.**

3rd Floor, 35 Rue de la Bienfaisance  
75008 Paris France  
Tel (33) 1 4563 3100 Fax : (33) 1 4563 6017  
[www.kingandshaxson.com](http://www.kingandshaxson.com)

**AUSTRALIA**
**PhillipCapital Australia**

Level 12, 15 William Street,  
Melbourne, Victoria 3000, Australia  
Tel: (61) 3 9618 8238 Fax: (61) 3 9200 2277  
[www.phillipcapital.com.au](http://www.phillipcapital.com.au)

**HONG KONG**
**Phillip Securities (HK) Ltd**

11/F United Centre 95 Queensway Hong Kong  
Tel (852) 2277 6600 Fax: (852) 2868 5307  
[www.phillip.com.hk](http://www.phillip.com.hk)

**JAPAN**
**Phillip Securities Japan, Ltd**

4-2 Nihonbashi Kabutocho, Chuo-ku  
Tokyo 103-0026  
Tel: (81) 3 3666 2101 Fax: (81) 3 3664 0141  
[www.phillip.co.jp](http://www.phillip.co.jp)

**INDIA**
**PhillipCapital (India) Private Limited**

No. 1, 18th Floor, Urmi Estate, 95 Ganpatrao Kadam Marg,  
Lower Parel West, Mumbai 400013  
Tel: (9122) 2300 2999 Fax: (9122) 6667 9955  
[www.phillipcapital.in](http://www.phillipcapital.in)

**UNITED KINGDOM**
**King & Shaxson Ltd.**

6th Floor, Candlewick House, 120 Cannon Street  
London, EC4N 6AS  
Tel (44) 20 7929 5300 Fax: (44) 20 7283 6835  
[www.kingandshaxson.com](http://www.kingandshaxson.com)

**SRI LANKA**
**Asha Phillip Securities Limited**

Level 4, Millennium House, 46/58 Navam Mawatha,  
Colombo 2, Sri Lanka  
Tel: (94) 11 2429 100 Fax: (94) 11 2429 199  
[www.ashaphillip.net/home.htm](http://www.ashaphillip.net/home.htm)