

China Southern Airlines (1055.HK)

The Low Season of the Fourth Quarter under Great Expectations

Hong Kong | Air | Update Report

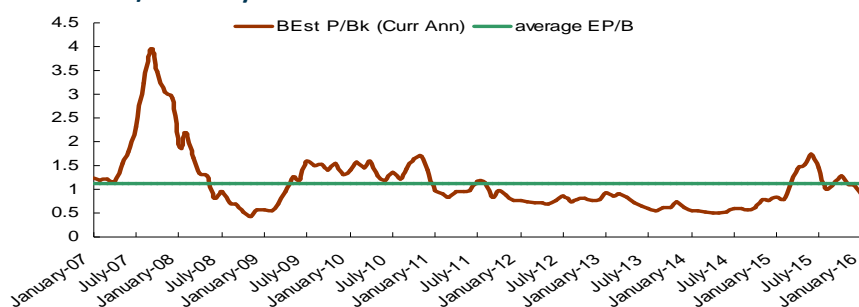
Investment summary

- Nearly 10% Increase in Net Profit in the First Three Quarters
- Business Data Leading in Three Airline Giants
- The Low Season of the Fourth Quarter under Great Expectations

Investment thesis

On the premise of the improvement of the supply and demand pattern, we expressed cautious optimism for the promotion of the industry next year. In August, CSA raised H-shares and introduced U.S. airline strategy investors, which was expected to help to develop the company's Euro-American flight. At the same time, the company's project of raising RMB13.3 billion is moving forward, which will further increase assets when finished. In accordance with the latest data, we adjust the estimate of the Company's EPS to RMB0.71/0.86 in 2017 and 2018. The target price is HK\$8.45, equivalent to 10/8.3x and 1.4/1.25x estimated P/E ratio and P/B ratio, respectively, in 2017 and 2018. The "accumulate" rating is given.

CSA's Forward P/B in ten years



Source: Bloomberg, Phillip Securities Hong Kong Research

Nearly 10% Increase in Net Profit in the First Three Quarters

China Southern Airlines (CSA) reported a total revenue of RMB96.12 billion in the first three quarters, up by 11% yoy, and its net profit attributable to the parent company amounted to RMB7.05 billion, soared by 9.5% yoy, with the smallest growth among the three airline giants in China. The main reason was that the cardinal number during the same period of the previous year was high and the EPS was RMB0.71 while last year's EPS was RMB0.66 in the same period.

Three Factors Drive the High Growth of the Result

We thought that there were three major reasons for the steady growth of CSA's result.

1. The main business grew steadily. The macro-economy developed slowly but continued to recover. The demand of business travelers and tourism residents was rising steadily.
2. Fuel costs remained stable and the international crude oil prices fluctuated in the range of USD40-55 per barrel, providing a stable and low-cost advantage for airline companies.
3. The depreciation trend in these three years has changed and the stabilization of the RMB rate has greatly improved the exchange gain of airline companies since 2017.

6 December 2017

Accumulate (Downgrade)

CMP: HKD 7.15

(Closing price as at 4 Dec 2017)

TARGET: HKD 8.45 (+18%)

COMPANY DATA

O/S SHARES (MN) :	10088
MARKET CAP (HKD MN) :	21918
52 - WK HI/LO (HKD):	7.5 / 3.99

SHARE HOLDING PATTERN, %

China Southern Air Holding Company	50.3
HKSCC Nominees Limited	17.43

PRICE VS. HSI



Source: Phillip Securities (HK) Research

KEY FINANCIALS

CNY mn	FY15	FY16	FY17E	FY18E
Net Sales	111,652	114,981	129,051	138,606
Net Profit	3,736	5,045	7,199	8,631
EPS, CNY	0.38	0.51	0.71	0.86
P/E, x	15.7	12.4	8.5	7.1
BVPS, CNY	3.98	4.43	5.10	5.69
P/BV, x	1.5	1.4	1.2	1.1
DPS (CNY)	0.08	0.10	0.15	0.18
Div. Yield (%)	1.3%	1.6%	4.7%	5.6%

Source: Company reports, Phillip Securities Est.

Research Analyst
ZhangJing
 (+ 86 51699400-103)
 zhangjing@phillip.com.cn

Oil & RMB Rate Load Shifting

Another characteristic of airlines' result this year is that the result's difference between low season and peak season was smaller. CSA's EPS in Q1, Q2 and Q3 was RMB0.16, RMB0.12, RMB0.42, respectively, reduced by 42%, rocketed by 177% and 29% yoy, respectively, from last year's RMB0.27, RMB0.04, and RMB0.34, respectively. The very low oil price during 2016Q1 is the leading force of the decline of the result in 2017Q1. The rapid growth of RMB rate in 2017Q2 and Q3 greatly improved the exchange gain of airlines this year, with RMB902 million financial costs, down by 76.42% yoy for CSA in 9M2017.

Costs Well-controlled

The company's costs were controlled well and the cost ratio continued to reduce. The sales cost in the first three quarter was RMB4.918 billion, up by 6.15% yoy, accounting for 5.12% in the revenue decreased by 0.23 ppts yoy; the administration expenses were RMB2.328 billion, up by 5.77% yoy, accounting for 2.42% in the revenue decreased by 0.12 ppts yoy. As at the end of September 2017, the scale of the fleets of the company, compared with last year's, had a net increase of 39 to 741 aircraft, including 265 self-owned aircraft, 210 finance lease aircraft and 266 operation lease aircraft; according to the capacity introduction plan, there is going to be a net increase of 16 aircraft in Q4.

Operating Data Leading in Three Airline Giants

In the first three quarters in 2017, CSA's passenger traffic and capacity (RPK/ASK) were up by 11.5% yoy and 9.2% yoy, respectively, whose growth rates were up by 4.0 ppts and 1.2 ppts, compared to the same period of the previous year. The P L /F were up by 1.7% to 82.2% yoy, which was the highest among the three airline giants. In October 2017, CSA's RPK/ASK was up by 10.5% and 9.9% yoy, respectively, and P L /F was 82.00%, slightly up by 0.43 ppts.

The Low Season of the Fourth Quarter under Great Expectations

In order to control the frequent flight delays, the CAAC announced a more strict time scheme and controls industry capacity delivery from the perspective of flight supply. The situation of low supply and high demand in front-line airports was more prominent, which helped the airline companies to raise the ticket price. Seen from the latest booking situation, business travelers' demand was obvious. The ticket price level of domestic flight was improved compared with the same period last year and the cardinal number of international flight during the same period of the previous year was low due to irresistible factors. We expected that airline companies can have better results in the low season of the fourth quarter.

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	FY13	FY14	FY15	FY16	FY17F	FY18F
Valuation Ratios						
P/E (X), adj.	27.8	31.2	15.7	12.4	8.5	7.1
P/B (X)	1.61	1.55	1.51	1.44	1.18	1.06
Dividend Yield (%)	0.7%	0.8%	1.3%	1.6%	4.7%	5.6%
Per share data (RMB)						
EPS, reported	0.20	0.18	0.38	0.51	0.71	0.86
EPS, adj.	0.20	0.18	0.38	0.51	0.71	0.86
DPS	0.04	0.04	0.08	0.10	0.15	0.18
BV/PS	3.50	3.64	3.98	4.43	5.10	5.69
Growth & Margins (%)						
Growth						
Revenue	-1.0%	10.2%	2.8%	3.0%	12.2%	7.4%
EBIT	-70.4%	214.4%	183.0%	-6.1%	-10.7%	29.8%
Net Income, adj.	-24.2%	-10.5%	110.2%	35.0%	42.7%	19.9%
Margins						
EBIT margin	1.5%	4.4%	12.0%	11.0%	8.7%	10.5%
Net Profit Margin	2.0%	1.6%	3.3%	4.4%	5.6%	6.2%
D/E	19.8%	23.8%	21.0%	19.5%	21.0%	21.0%
Key Ratios						
ROE (%)	5.9%	5.1%	10.0%	12.2%	15.4%	16.1%
ROA (%)	1.3%	1.0%	2.0%	2.6%	3.4%	3.8%
Income Statement (RMB mn)						
Revenue	98,547	108,584	111,652	114,981	129,051	138,606
Operating expenses	(98,280)	(106,026)	(101,492)	(106,204)	(121,972)	(128,421)
Other Gains-net	1,243	2,190	3,278	3,836	4,180	4,427
Profit from operations	1,510	4,748	13,438	12,613	11,259	14,612
Non-operating income/expense	1,974	(1,682)	(7,320)	(4,951)	(864)	(2,196)
Profit before tax	3,484	3,066	6,118	7,662	10,395	12,416
Tax	(734)	(668)	(1,300)	(1,763)	(2,396)	(2,866)
Profit for the period	2,750	2,398	4,818	5,899	7,999	9,550
Minority interests	(764)	(621)	(1,082)	(854)	(800)	(919)
Total capital share	9,818	9,818	9,818	9,818	10,088	10,088
Net profit	1,986	1,777	3,736	5,045	7,199	8,631

Source: PSR

(Financial figures as at 4 December 2017)

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>.

© 2017 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

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

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

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

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

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

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

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

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

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

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

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