EQUITY RESEARCH

PhillipCapital

Air China (753.HK)

FR 2018Q3 short-of-expectation

Hong Kong | Air | Update Report

22 November 2018

Hold (Downgrade)

CMP HKD 7.28

(Closing price as at 20 November 2018)

TARGET HKD 7.39 (+1.5%)

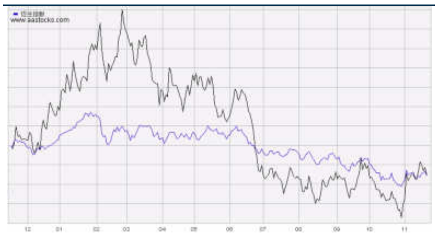
COMPANY DATA

O/S SHARES (MN) :	14525
MARKET CAP (HKD MN) :	33216
52 - WK HI/LO (HKD):	12.86/ 5.87

SHARE HOLDING PATTERN, %

China National Aviation Holding Company	51.7
Cathay Pacific Airways Limited	18

PRICE VS. HSI



Source: Phillip Securities (HK) Research

KEY FINANCIALS

CNY mn	FY16	FY17	FY18E	FY19E
Net Sales	115145	124026	138953	153598
Net Profit	6809	7245	6721	10233
EPS, CNY	0.55	0.54	0.46	0.70
P/E, x	17.0	16.4	14.0	9.2
BVPS, CNY	5.30	6.39	6.49	7.02
P/BV, x	1.8	1.4	1.0	0.9
DPS (CNY)	0.11	0.12	0.10	0.15
Div. Yield (%)	1.1%	1.3%	1.5%	2.3%

Source: Company reports, Phillip Securities Est.

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

Investment Summary

Air China`s third-quarter results were lower than expected, resulting in a decrease of 6.4% in net profit for the first nine months of this year. The main reasons are the fuel cost and the exchange losses. According to the latest hypothesis of the oil cost and exchange rate, we revised our estimate 2018/2019 net profit and the target price is adjusted to HKD7.39. “Hold” rating is given. (Closing price as at 20 November 2018)

Earn 30% less yoy in the third quarter

During the first three quarters of 2018, Air China (AC) recorded operating revenue of RMB102.88 billion, up by 12.1% yoy, and a net profit attributable to shareholders of RMB6,937 million, down by 16.2% yoy. On a closer look, during the third quarter, the company recorded operating revenue of RMB38,638 million, up by 12.3% yoy, and a net profit attributable to shareholders of RMB3,469 million, a year-on-year decrease of 30%. During the H1 of this year, AC`s revenue and attributable profit grew by 12% and 4.05%, respectively.

Expenditure: rising oil prices and exchange losses dragged down performance

During the third quarter, AC`s gross margin was down by approximately 4.8 percentage points, as operating costs increased by RMB4.6 billion, representing a yoy increase of 18%, and this exceeded the revenue growth. The increase in costs was mainly due to the rising fuel costs driven by rising jet fuel prices, resulting in total costs soaring nearly by RMB3.5 billion or 36.5%. Despite the unfavorable conditions of rising oil prices, the company continues to strengthen production management and resource control, reduce production costs and increase efficiency by optimizing productivity, thus bringing down the cost of unit non-aviation oil by 2.3%.

In addition, due to expanding exchange losses caused by the depreciation of RMB, financial expenses have increased substantially and resulted in total expenses up by 129% yoy (equivalent to RMB3.08 billion in value).

Revenue: the price hike effect is emerging, and the operational efficiency continues to be improved

During the third quarter, the company`s passenger transport capacity increased by 9.24% yoy, of which domestic, international and regional routes increased by 5.7%, 13.55% and 2.9% yoy, respectively. Passenger turnover increased by 9.41% yoy compared with the same period in 2017. Specifically, domestic, international and regional routes increased by 6.22%, 12.7% and 1.22% yoy, respectively. The passenger load factor was 81.7%, representing a slight yoy increase of 0.13 percentage point.

In an attempt to make full use of the reform opportunity aiming to promote the marketization of domestic civil aviation industry, the company has been adjusting fare prices of more than 100 domestic routes, and increasing the overall fare level in the third quarter by 2 percentage points, as well as continuing to market its value-added products (such as pay for selecting seats and flight upgrade, which contribute to additional sales). The company also strengthened its sales force across various e-commerce channels to increase revenue, expand client base, promote innovations in business model and improve operational efficiency.

It is worth mentioning that during the third quarter, Cathay Pacific, in which the company owns a participating stake, has significantly reduced losses, which contributed to an increase in AC`s investment income from RMB485 million to RMB596 million, effectively smoothing the fluctuations in the results.

The external conditions are generally positive in the face of a tight balance between supply and demand

On the supply side, in order to ensure the punctuality rate of flights, the regulatory authorities still maintain strict control over the time limits of civil aviation resources, and could possibly introduce stricter safety standards in the future, which will benefit large-scale aviation enterprises. AC plans to purchase 68 aircraft in 2019, discard 19, amounting to a net increase of 49. At the level of the parent company, AC plans to purchase 40 aircraft, discard 10, amounting to a net increase of 30. Meanwhile, the company will adopt more wide-body aircraft for its core lines so as to earn more tickets income per route. At present, the international oil price has fallen to a new low in the past year, which will greatly ease the pressure on aviation fuel costs. With regards to exchange losses caused by the depreciation of RMB, AC`s dollar-denominated debt has dropped from 48.8% to 35%, and the future exchange rate elasticity will continue to decrease as the company reimburses debts.

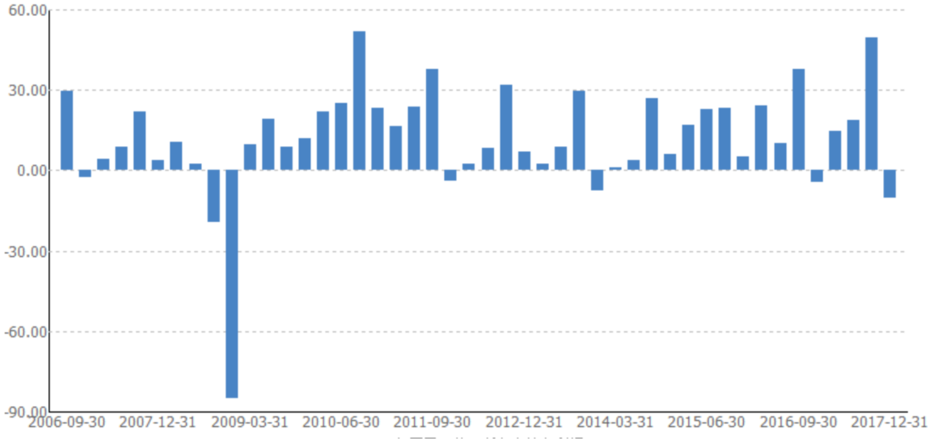
Valuation & Investment thesis

According to the latest hypothesis of the oil cost and exchange rate, we revised our estimate 2018/2019 net profit of AC to be 6.72/10.23 billion RMB. The target price is adjusted to HKD7.39, estimates 14.2x/9.3x P/E and 1/0.9x P/B in 2018/2019. “Hold” rating is given.

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;
Highspeed railway diversion

Net profit by quarterly (100million RMB)



Source: Wind, Phillip Securities Hong Kong Research

Historical Best P/E, P/B Band

Source: Bloomberg, Phillip Securities Hong Kong Research

Financials

FYE DEC	FY15	FY16	FY17	FY18F	FY19F
Valuation Ratios					
P/E (X), adj.	10.6	11.7	11.3	14.0	9.2
P/B (X)	1.3	1.2	0.95	1.00	0.92
Dividend Yield (%)	1.8%	1.7%	1.9%	1.5%	2.3%
Dividend payout ratio (%)	18.6%	19.4%	21.4%	21.6%	21.3%
Per share data (RMB)					
EPS, reported	0.57	0.55	0.54	0.46	0.70
EPS, adj.	0.57	0.55	0.54	0.46	0.70
DPS	0.107	0.108	0.115	0.100	0.150
BVPS	4.86	5.30	6.39	6.49	7.02
Growth & Margins (%)					
Growth					
Revenue	3.9%	4.6%	7.7%	12.0%	10.5%
EBIT	111.6%	2.2%	-35.2%	31.7%	18.5%
Net Income, adj.	83.3%	-3.6%	6.4%	-7.2%	52.2%
Margins					
EBIT margin	15.6%	15.2%	9.2%	10.8%	11.6%
Net Profit Margin	6.4%	5.9%	5.8%	4.8%	6.7%
Key Ratios					
ROE (%)	12.39%	10.90%	9.36%	7.45%	10.43%
Income Statement (RMB mn)					
Revenue	**110,057**	**115,145**	**124,026**	**138,953**	**153,598**
Operating expenses	(94,505)	(97,612)	(112,270)	(124,664)	(136,801)
-Jet fuel cost	(24,043)	(21,982)	(28,409)	(36,790)	(42,860)
Profit from operations	15,552	17,533	11,756	14,289	16,797
Financial costs	(7,817)	(7,342)	107	(5,218)	(2,968)
Share of profits and losses of associates	1,620	22	(376)	698	958
Profit before tax	9,355	10,213	11,486	9,769	14,787
Tax	(1,846)	(2,454)	(2,845)	(2,247)	(3,505)
Profit for the period	7,509	7,759	8,642	7,522	11,283
Minority interests	446	950	1,397	801	1,050
Net profit	**7,063**	**6,809**	**7,245**	**6,721**	**10,233**

Source: PSR

(Financial figures as at 20 November 2018)

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

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.

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

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

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

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

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

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

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

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

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

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

AUSTRALIA
PhillipCapital Australia
Level 10, 330 Collins Street
Melbourne, Victoria 3000, Australia
Tel: (61) 3 86339803 Fax: (61) 3 86339899
www.phillipcapital.com.au

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

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