

China Southern Airlines (1055.HK)

Sharp decrease in fuel prices since 18Q4 conducive to the release of results

Hong Kong | Air | Update Report

29 November 2018

Investment summary

Revenue decrease of 40% in the first three quarters

China Southern` revenue in the first three quarters of 2018 was RMB108.89 billion, up 13.3% yoy, and its net attributable profit was RMB4,175 million, down 40.8% yoy. In the third quarter, China Southern reported revenue of RMB41.33 billion, up 15.4% or RMB5.53 billion yoy, while its net attributable profit fell to RMB2,038 million, down 52.4% yoy.

Oil prices hampered results significantly

In the third quarter, the operating cost of China Southern reported an increase of 21.2% or RMB5.97 billion yoy, which is 8 points higher than the increase in revenue, dragging down the gross margin by 3.9 percentage points to 17.7%. Specifically, fuel costs accounted for the largest part, with fuel costs soaring by 48% or RMB3.8 billion in the third quarter, reflecting an increase of about 40% in average fuel prices and an increase of 8% in fuel consumption. However, excluding fuel, the non-oil cost only increased by 11%, and the non-oil cost per ASK decreased by 2.6 percentage points, reflecting that the refined management of the company has yielded impressive results in reducing costs, increasing benefits and raising prices.

Large fluctuation in exchange gain/loss

Since the beginning of this year, the exchange gains and losses caused by the fluctuating RMB exchange rate has greatly impacted the results. In the first and second quarters, China Southern recorded exchange gains of RMB1.37 billion and exchange losses of RMB1.79 billion, respectively. Due to the devaluation of the RMB, China Southern recorded about RMB1.59 billion in exchange losses in the third quarter, compared with RMB690 million in exchange gains in the same period last year. A total of RMB2.01 billion exchange losses occurred in the first three quarters and RMB1.25 billion exchange gains were recorded in the same period last year.

Through such tools as US dollar liability hedging and currency swaps, China Southern plans to continue to reduce the proportion of US dollar liabilities, so as to lessen the impact of exchange gains and losses. Currently, the proportion of dollar liabilities in the company`s total interest-bearing liabilities has dropped to 24% from 32% of midyear, and is expected to continue to decline to over 20% by the end of the year.

Accelerated release of transport capacity and steadily increased demand

CSA has accelerated the release of its transport capacity, in which the increase of international and regional air routes is higher than that of domestic air routes, especially during the rush in July/August. Specifically, some of the transport capacity comes from the increased seats due to the modification to cabins. There is a greater demand for domestic air routes. In the first three quarters, CSA`s overall available seat kilometers (ASK) increased by 12% Y-o-Y, and its revenue passenger kilometers (RPK) increased by 12.8%. Its passenger load factor (P L /F) was 82.8%, up by 0.5 percentage point Y-o-Y; specifically, the P L /F of the domestic, international and regional air routes was up by 0.65 percentage point, up by 0.29 percentage point, and down by 0.46 percentage point, respectively. According to the plan for the introduction of transport capacity, it is expected that CSA will have a net increase of 39 aircraft in the fourth quarter. In 2019, it will have a net increase of 67 aircraft. The Company plans to invest more newly added transport capacity in domestic air routes, sharing the industry dividend brought by the increased ticket prices in China.

Accumulate (Maintain)

CMP HKD 5.3

(Closing price as at 27 November 2018)

TARGET HKD 6.07 (+14.5%)

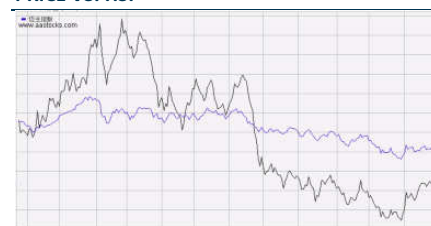
COMPANY DATA

O/S SHARES (MN) :	10088
MARKET CAP (HKD MN) :	19432
52 - WK HI/LO (HKD):	11 /3.98

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	FY16	FY17	FY18E	FY19E
Net Sales	114,981	127,806	147,606	165,686
Net Profit	5,045	5,961	4,545	8,089
EPS, CNY	0.51	0.59	0.37	0.66
P/E, x	9.2	7.6	12.7	7.2
BVPS, CNY	4.43	4.92	5.27	5.86
P/BV, x	1.1	0.9	0.9	0.8
DPS (CNY)	0.10	0.10	0.07	0.13
Div. Yield (%)	2.1%	2.2%	1.5%	2.8%

Source: Company reports, Phillip Securities Est.

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Sharp decrease in fuel prices since 18Q4 conducive to the release of results

In the fourth quarter, the international fuel prices have been decreased by about 30% from the high spot of the third quarter. Compared with the level of the same period last year, the international fuel prices are unlikely to increase largely within this year. Therefore, in the fourth quarter, CSA will have much lower pressure from costs. Meanwhile, the exchange rate of RMB does not continue to be depreciated in the fourth quarter. Instead, the exchange rate maintains a stable trend basically, which will release CSA's pressure from exchange gain/loss.

Before October 27, CSA adjusted the prices of 58 air routes. In the first half year, CSA adjusted the ticket price level of 21 air routes. CSA's P L /F and income level were both satisfactory. After the change from Winter to Spring, there will be 61 air routes to be adjusted and the dividend on the increased ticket prices remain to be released continually.

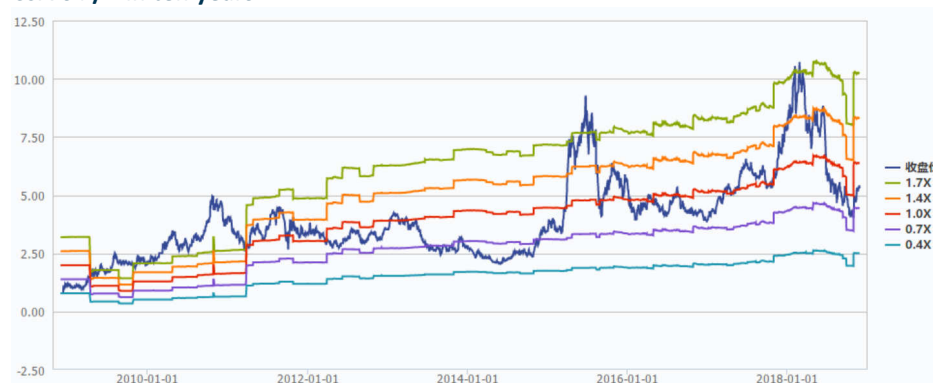
Investment thesis

As the overall external factors such as fuel price and RMB exchange ratio tend to stabilizing, we expressed cautious optimism for the promotion of the industry next year. The completion of additional issue, CSA's balance sheet had been strengthened. In accordance with the latest data, we adjust the estimate of the Company's EPS to RMB0.37/0.66 in 2018 and 2019. The target price is HK\$6.07, equivalent to 14.6/8.2x and 1.02/0.92x estimated P/E ratio and P/B ratio, respectively, in 2018 and 2019. The "accumulate" rating is maintain. (Closing price as at 27 November 2018)

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;

CSA's P/B in ten years



Source: Wind, Phillip Securities Hong Kong Research

Financials

FYE DEC	FY14	FY15	FY16	FY17	FY18F	FY19F
Valuation Ratios						
P/E (X), adj.	23.1	11.7	9.2	7.6	12.7	7.2
P/B (X)	1.15	1.12	1.07	0.91	0.89	0.80
Dividend Yield (%)	1.0%	1.8%	2.1%	2.2%	1.5%	2.8%
Per share data (RMB)						
EPS, reported	0.18	0.38	0.51	0.59	0.37	0.66
EPS, adj.	0.18	0.38	0.51	0.59	0.37	0.66
DPS	0.04	0.08	0.10	0.10	0.07	0.13
BVPS	3.64	3.98	4.43	4.92	5.27	5.86
Growth & Margins (%)						
Growth						
Revenue	10.2%	2.8%	3.0%	11.2%	15.5%	12.2%
EBIT	214.4%	183.0%	-6.1%	-27.4%	25.2%	20.6%
Net Income, adj.	-10.5%	110.2%	35.0%	18.2%	-23.8%	78.0%
Margins						
EBIT margin	4.4%	12.0%	11.0%	7.2%	7.8%	8.3%
Net Profit Margin	1.6%	3.3%	4.4%	4.7%	3.1%	4.9%
D/E	23.8%	21.0%	19.5%	16.9%	18.9%	19.7%
Key Ratios						
ROE (%)	5.1%	10.0%	12.2%	12.8%	8.0%	11.8%
ROA (%)	1.0%	2.0%	2.6%	2.8%	2.0%	3.3%
Income Statement (RMB mn)						
Revenue	108,584	111,652	114,981	127,806	147,606	165,686
Operating expenses	(106,026)	(101,492)	(106,204)	(123,098)	(140,644)	(156,390)
Other Gains-net	2,190	3,278	3,836	4,448	4,497	4,520
Profit from operations	4,748	13,438	12,613	9,156	11,459	13,816
Non-operating income/expense	(1,682)	(7,320)	(4,951)	(282)	(4,486)	(1,678)
Profit before tax	3,066	6,118	7,662	8,874	6,973	12,138
Tax	(668)	(1,300)	(1,763)	(1,976)	(1,609)	(2,801)
Profit for the period	2,398	4,818	5,899	6,898	5,364	9,336
Minority interests	(621)	(1,082)	(854)	(937)	(819)	(1,247)
Total capital share	9,818	9,818	9,818	10,088	12,267	12,267
Net profit	1,777	3,736	5,045	5,961	4,545	8,089

Source: PSR

(Financial figures as at 27 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 \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

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