

# CEA (670.HK)

## Oil Price/Exchange Trend Begins to Decompress Aviation Enterprises

Hong Kong | Air | Update Report

### Investment Summary:

#### Over 40% Decrease in Profit in the First Three Quarters

According to CEA's report of the first three quarters (Chinese Accounting Standards) in 2018, in the first three quarters of 2018, the company recorded revenue of RMB87,878 million, up by 13.4% Y-o-Y, and a net profit attribute to the parent company of RMB4.49 billion, down by 43.3% Y-o-Y. Among them, during the third quarter, the company recorded revenue of RMB33,456 million, up by 13.5% Y-o-Y, and a net profit attribute to shareholders of RMB2,207 million, down by 38.1% Y-o-Y.

#### Dragged by Oil Price/Exchange Rate/Cardinal Number

Firstly, due to the rising international oil prices in the first three quarters of 2018, CEA's operating cost increased by 13.4% Y-o-Y due to the sharp rise in fuel cost. Specifically, the increase in operating cost in the third quarter reached 15.7%, which dragged down the operating profit.

Secondly, the exchange rate of RMB against US dollar has been depreciating continuously since the end of the second quarter of 2018. By the end of the third quarter, the exchange rate level has depreciated by 5.92% compared with that at the beginning of the year, which not only wiped out the 3.4% increase in the first quarter, but also set a new low since China's exchange rate reform. The devaluation resulted in a great increase in the exchange losses of CEA. The financial expenses in the second and third quarters soared by 983% and 692% Y-o-Y, respectively, to RMB2.95 billion and RMB2.55 billion, which greatly eroded the net profit.

Thirdly, during the same period last year, CEA sold 100% of its stock rights of Eastern Air Logistics Co., Ltd. (EAL), earning RMB1.75 billion one-time profits, and resulting in a higher Y-o-Y cardinal number.

#### Under the Control of Capacity, Core Business Performance is Excellent with Rising P L/F

Benefiting from strong air demand in East China market, the demand of Xi'an/Kunming market recovered, and the main business of CEA increased significantly Y-o-Y. In the first three quarters of 2018, CEA completed 90.56 million passenger traffic, an increase of 9.6% Y-o-Y; RPK increased by 9.2% compared with the same period in the last year, with domestic, international and regional growth of 8.6%, 9.9% and 10.9%, respectively; ASK increased by 7.8% Y-o-Y, with domestic, international and regional growth of 8.4%, 6.9% and 7.8%, respectively. Additionally, the CAAC strictly controls the punctuality rate and flight time delivery, and the P L/F and fare level of CEA have risen: The P L/F during the period was 82.87%, up by 1.47 ppts Y-o-Y, which exceeds the P L/F of three major airlines; and the fare level has risen by 3.2% Y-o-Y.

#### Oil Price/Exchange Trend Begins to Decompress Aviation Enterprises

Since the fourth quarter of 2018, international oil prices have fallen by 30% from their peak, and the current level has also fallen by about 20% compared with that in the same period. It is expected that there will be little possibility of a sharp rise again. From the fourth quarter of 2018, the pressure on fuel costs of CEA will be greatly reduced.

In terms of exchange gains and losses, with the difficult progress of Sino-US trade negotiations, the RMB exchange rate in the fourth quarter of 2018 was stable and did not continue to depreciate. In the first quarter of 2019, the RMB exchange rate even showed a trend of appreciation, which was more than 1% higher than the cumulative appreciation at the end of last year. This will also greatly alleviate the pressure of exchange losses of the company.

21 January 2019

### Accumulate (Maintain)

CMP HKD 4.62

(Closing price as at 17 Jan 2019)

TARGET HKD 5.04 (+9.1%)

#### COMPANY DATA

O/S SHARES (MN):	14467
MARKET CAP (HKD MN):	21525
52 - WK HI/LO (HKD):	7.43/ 3.95

#### SHARE HOLDING PATTERN, %

China Eastern Air Group:	53.2
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#### PRICE VS. HSI



Source: Phillip Securities (HK) Research

#### KEY FINANCIALS

CNY mn	FY16	FY17	FY18E	FY19E
Net Sales	98904	102475	115690	128103
Net Profit	4498	6342	4948	7330
EPS, CNY	0.33	0.44	0.34	0.51
P/E, x	12.6	8.9	12.0	8.1
BVPS, CNY	3.58	3.83	4.05	4.58
P/BV, x	1.1	1.0	1.0	0.9
DPS (CNY)	0.10	0.05	0.03	0.06
Div. Yield (%)	2.4%	1.3%	0.7%	1.5%

Source: Company reports, Phillip Securities Est.

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

### Investment Thesis

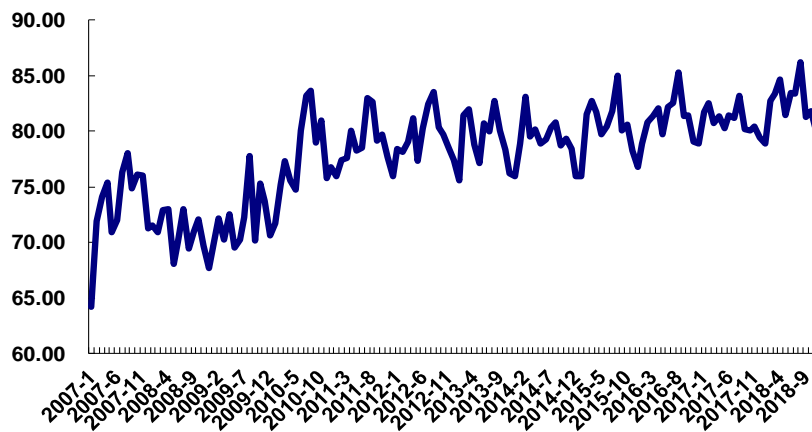
As a pioneer in the reform of mixed ownership in domestic civil aviation industry, CEA recently announced the introduction of private placement to strategic investors Juneyao Air and Juneyao Group. The funds raised will be used to purchase 18 aircraft/15 simulators/20 standby engines. We hope that the two parties will further cooperate with each other in route synergy and improvement of operational efficiency in the future, to consolidate Shanghai's market share and enhance profitability.

We expect the company's 2018/2019 EPS of RMB0.34/0.51. Given that possible improvement on efficiency after the mix reform, and the expected better ticket price in the future, we are optimistic about the Company's future result flexibility. Therefore, we set the target price at HK\$5.04, equivalent to 13.1X/8.8X estimated P/E in 2018/2019. Also, the "Accumulate" rating is given. (Closing price as at 17 Jan 2019)

### 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

Passenger Load Factor of CEA (%)



Source: Wind, Company, Phillip Securities Hong Kong Research

## Financials

FYE DEC	FY14	FY15	FY16	FY17	FY18F	FY19F
<b>Valuation Ratios</b>						
P/E (X), adj.	13.5	10.9	12.6	8.9	12.0	8.1
P/B (X)	1.5	1.3	1.1	1.0	1.0	0.9
Dividend Payout Yield (%)	0.0%	0.0%	30.7%	11.6%	8.8%	11.8%
Dividend Yield (%)	0.0%	0.0%	2.4%	1.3%	0.7%	1.5%
<b>Per share data (RMB)</b>						
EPS, reported	0.27	0.35	0.33	0.44	0.34	0.51
EPS, adj.	0.27	0.35	0.33	0.44	0.34	0.51
DPS	0.00	0.00	0.10	0.05	0.03	0.06
BVPS	2.36	2.92	3.58	3.83	4.05	4.58
<b>Growth &amp; Margins (%)</b>						
<b>Growth</b>						
Revenue	2.2%	4.2%	5.3%	3.6%	12.9%	10.7%
EBIT	276.8%	106.6%	-0.8%	-23.6%	19.6%	18.7%
Net Income, adj.	43.7%	33.0%	-0.9%	41.0%	-22.0%	48.1%
<b>Margins</b>						
EBIT margin	2.3%	-1.5%	0.3%	7.4%	0.7%	3.9%
Net Profit Margin	3.8%	4.8%	4.5%	6.2%	4.3%	5.7%
<b>Key Ratios</b>						
ROE (%)	13.8%	13.5%	12.2%	12.1%	8.7%	11.7%
<b>Income Statement (RMB mn)</b>						
Revenue	<b>90,185</b>	<b>93,969</b>	<b>98,904</b>	<b>102,475</b>	<b>115,690</b>	<b>128,103</b>
Operating expenses	(87,812)	(86,613)	(91,887)	(100,525)	(110,356)	(120,977)
Profit from operations	6,058	12,625	12,486	9,431	11,232	13,324
Non-operating income/expense	127	152	187	251	349	420
Profit before tax	4,113	5,667	6,497	8,610	6,200	9,376
Tax	(573)	(624)	(1,542)	(1,800)	(930)	(1,594)
Profit for the period	3,540	5,043	4,955	6,810	5,270	7,782
Minority interests	(130)	(506)	(457)	(468)	(321)	(451)
Total capital share	12,674	12,819	12,819	14,467	14,467	14,467
<b>Net profit</b>	<b>3,410</b>	<b>4,537</b>	<b>4,498</b>	<b>6,342</b>	<b>4,948</b>	<b>7,330</b>

Source: PSR

(Financial figures as at 17 January 2019)

### 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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**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)