

Travelsky Technology (696.HK)

Operating profit significantly below forecasts due to the surge in costs, but should see an improvement in margin later

9 April 2019

Hong Kong | TMT | Company Report

Investment Summary

Travelsky Technology is the largest provider of the aviation information systems in China, which developed systems, such as flight control, air ticket distribution, check-in, boarding and load planning, accounting, settlement and clearing system, and aviation logistic. Based on DCF valuation, we derived a TP of HK\$25.47, implied a P/E of 25.2x and 22.4x in 2018/19F. We update to a “Buy” rating with a potential upside of 29.3%. (Closing price at 4 Apr 2019)

Operating profit significantly below forecasts due to the surge in costs

The Group announced its 2018 annual results, where the revenue grew by 11% to RMB 7.47 billion, generally in line with our estimates, just 0.79% below. In terms of segments, Aviation information technology services, Accounting, settlement and clearing services and Data network and others in 2018 was below our forecasts by 3.2%, 5.8% and 2.8% respectively, whereas System integration services was far above by 21.2%.

The operating profit dropped by 6.2% to RMB 2.32 billion, way below our forecasts, around 12.6%. The difference in operating profit is mainly attributed to the larger increase in cost than expected, such as technical support and maintenance fees, commission and promotion expenses as well as other operating expenses.

The management explained that the rise in commission and promotion expenses is due to the increase in commission rebate to airports and its third-party payment subsidiary as well as promotion expenses in the oversea distribution market. In relation to the rebate to airport and third-party payment subsidiary, as the rebate will grow corresponding to the volume, and there would be an increase in discount as the volume scales up. Regarding promotion expenses, since the oversea distribution market is open for competition, the Group will require to maintain its competitiveness by providing more promotions.

Besides, the rise in other operating expenses was caused by the relocation to new operating centre. It is believed the other operating expenses will remain at the current level, as there are additional expenses after moving into the operating centre, such as security expenses, water and electricity expenses and the property related cost, and the management team claimed the proportion of one-off expenses for the relocation was not that high.

Buy

CMP HKD 19.70

(Closing price at 4 Apr 2019)

TARGET HKD 25.47 (+29.3%)

COMPANY DATA

O/S SHARES (MN) :	2,926
MARKET CAP (HKDMN) :	18,371
52 - WK HI/LO (HKD):	25 / 17.06

SHARE HOLDING PATTERN , %

China TravelSky	29.29
China Eastern	12.21
Air China	9.81
China Southern	9.18

PRICE PERFORMANCE , %

	1M	3M	1Y
Travelsky	-15.63	-0.2	-8.37
HSI	3.10	15.87	0.31

RETURN VS. HSI



Source: Aastocks, Phillip Securities (HK) Research

KEY FINANCIALS

RMB mn	FY17	FY18	FY19F	FY20F
Revenue	6,734	7,472	8,243	9,152
Net Profit	2,319	2,382	2,625	2,946
EPS, RMB	0.768	0.795	0.876	0.981
PER, x	22.15	21.42	19.46	17.34
BVPS, RMB	5.27	5.81	6.38	7.02
P/BV, x	3.23	2.93	2.67	2.42
ROE, %	15.4	14.3	14.3	14.6

Source: Company reports, Phillip Securities Est.

Research Analyst

Terry Li (2277 6527)

terryli@phillip.com.hk

In light of this, we expect to see commissions and promotion expenses as percentage of revenue increase in the future. As the distribution market of foreign airlines is opened for competitions and the flights of China Airlines further expand overseas, the Group will need to increase its investment in overseas distribution markets. On the contrary, we expect that other operating cost percentage of revenue will gradually decline in the future, because the operating costs of the operation centers are relatively fixed. As the revenue rises, it is believed that the proportion will also fall. As a result, we estimate that the decrease in the proportion of other operating costs is greater than the increase in that of commission and promotion expenses, we believe that operating profit margin will gradually improve.

Satisfactory operation data in January and February

The bookings on Chinese Commercial Airlines in January and February grew by 13.6% and 10.5% YoY respectively, and the aggregate growth was 12% YoY. The bookings on Foreign & Regional Commercial Airlines dropped by 9.6% YoY in January, but rebound in February by 34.5% YoY, and the aggregate growth reached 7.4% YoY. The operation data shows that the growth of bookings on Chinese Commercial Airlines and Foreign Commercial Airlines remains strong.

Valuation

We adopted the DCF model for valuation, where we assume the discount rate to be 9.76%, and terminal growth to be 2.5%, with FCFE forecast to 2028F. We derived a TP of HK\$25.47, implied a P/E of 25.2x and 22.4x in 2019/20F, 6.3% lower than our previous TP. In view of the plunge in stock price, we update to a “Buy” rating with a potential upside of 29.3%. (HKD/CNY=0.864)

Figure: DCF model

(RMB million)	2019F	2020F	2021F	2022F	2023F	2024F	2025F	2026F	2027F	2028F
EBITDA	3,508	3,909	4,395	4,996	5,720	6,444	7,160	7,841	8,407	8,684
Adjust for										
CAPEX, net	(1,148)	(1,114)	(1,227)	(1,333)	(1,947)	(1,248)	(2,019)	(1,951)	(1,763)	(1,575)
Change in working capital	952	(25)	(29)	(35)	(40)	(42)	(44)	(45)	(43)	(34)
Tax	<u>(358)</u>	<u>(402)</u>	<u>(455)</u>	<u>(521)</u>	<u>(620)</u>	<u>(703)</u>	<u>(786)</u>	<u>(889)</u>	<u>(956)</u>	<u>(992)</u>
Free Cash Flow	2,954	2,369	2,684	3,107	3,113	4,450	4,310	4,957	5,645	6,083

Assumptions

Terminal growth	2.5%
Risk-free rate	3.28%
Equity Risk Premium	5.89%
Beta	1.10
WACC	9.76%

Enterprise Value	56,609
+ Net cash (debt)	4,346
- Minority (Market value)	(1,580)
+/- Other items	4,704
Equity value	64,397

Number of shares	2,926
HKD/CNY	0.864
Equity value per share (HK\$)	25.47

Source: Company report, Phillip Securities (HK) Research

Figure: Sensitivity test

		Terminal growth rate						
		1.00%	1.50%	2.00%	2.50%	3.00%	3.50%	4.00%
	8.26%	27.6	29.15	30.54	32.17	34.12	36.47	39.37
	8.76%	26.08	27.09	28.24	29.57	31.14	33	35.26
	9.26%	24.45	25.3	26.26	27.37	28.65	30.15	31.94
WACC	9.76%	23.02	23.74	24.55	25.47	26.53	27.76	29.2
	10.26%	21.74	22.36	23.05	23.83	24.71	25.73	26.91
	10.76%	20.61	21.14	21.73	22.39	23.14	23.99	24.97
	11.26%	19.58	20.04	20.55	21.12	21.76	22.48	23.29

Source: Company report, Phillip Securities (HK) Research

Risk

1. Economic downturn
2. Aviation system market opening up
3. Airlines develop their own systems

Financials

FYE DEC	FY15	FY16	FY17	FY18	FY19F	FY20F
Valuation Ratios						
P/E (X), adj	26.02	20.57	22.15	21.42	19.46	17.34
P/B (X)	4.20	3.61	3.23	2.93	2.67	2.42
Dividend Yield (%)	1.0%	1.3%	1.5%	1.6%	1.8%	2.1%
Per share data (RMB)						
EPS, (Basic)	0.654	0.827	0.768	0.795	0.875	0.981
EPS, (Diluted)	0.654	0.827	0.768	0.795	0.875	0.981
DPS (HKD)	0.205	0.259	0.305	0.312	0.363	0.408
BVPS	4.05	4.71	5.27	5.81	6.38	7.02
Growth & Margins (%)						
Growth						
Revenue	2.5%	13.7%	8.2%	11.0%	10.3%	11.0%
EBIT	39.2%	24.6%	13.6%	-6.2%	17.8%	11.7%
Net Profit	16.6%	25.9%	-6.7%	2.7%	10.2%	12.2%
Margins						
EBIT margin	31.9%	35.0%	36.7%	31.0%	33.1%	33.3%
Net Profit Margin	36.1%	39.9%	34.4%	31.9%	31.8%	32.2%
Key Ratios						
ROA	14.3%	15.1%	12.0%	11.2%	11.3%	11.4%
ROE	17.3%	18.9%	15.4%	14.3%	14.3%	14.6%
Income statement (RMB mn)						
Revenue	5,472	6,223	6,734	7,472	8,243	9,152
EBIT	1,748	2,177	2,473	2,319	2,732	3,052
Operating profit	2,180	2,706	2,509	2,430	2,780	3,105
EBT	2,870	2,632	2,650	2,983	3,347	3,788
Net Profit	1,974	2,486	2,319	2,382	2,625	2,946
Minority Interest	59	64	70	57	66	74
Net profit for owners	1,914	2,421	2,249	2,325	2,560	2,872

Source: Company, Phillip Securities (HK) Research

Exchange rate (0.864) is HKDCNY1Y forward contract price on Apr 4 from Wind.

(Financial figures as at 4 April 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

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>.

© 2019 Phillip Securities (Hong Kong) Limited

Contact Information (Regional Member Companies)

SINGAPORE

Phillip Securities Pte Ltd
Raffles City Tower
250, North Bridge Road #06-00
Singapore 179101
Tel : (65) 6533 6001
Fax : (65) 6535 6631
Website: www.poems.com.sg

HONG KONG

Phillip Securities (HK) Ltd
Exchange Participant of the Stock Exchange of Hong Kong
11/F United Centre 95 Queensway
Hong Kong
Tel (852) 22776600
Fax (852) 28685307
Websites: www.phillip.com.hk

INDONESIA

PT Phillip Securities Indonesia
ANZ Tower Level 23B,
Jl Jend Sudirman Kav 33A
Jakarta 10220 – Indonesia
Tel (62-21) 57900800
Fax (62-21) 57900809
Website: 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) 6351700 / 22680999
Fax (66-2) 22680921
Website: www.phillip.co.th

UNITED KINGDOM

King & Shaxson Capital Limited
6th Floor, Candlewick House,
120 Cannon Street,
London, EC4N 6AS
Tel (44-20) 7426 5950
Fax (44-20) 7626 1757
Website: www.kingandshaxson.com

AUSTRALIA

PhillipCapital Australia
Level 10, 330 Collins Street,
Melbourne, VIC 3000, Australia
Tel (613) 86339803
Fax (613) 86339899
Website: www.phillipcapital.com.au

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 (603) 21628841
Fax (603) 21665099
Website: www.poems.com.my

JAPAN

PhillipCapital Japan K.K.
Nagata-cho Bldg.,
8F, 2-4-3 Nagata-cho,
Chiyoda-ku, Tokyo 100-0014
Tel (81-3) 35953631
Fax (81-3) 35953630
Website: www.phillip.co.jp

CHINA

Phillip Financial Advisory (Shanghai) Co. Ltd
No 436 Hengfeng Road,
Greentech Unit 604,
Postal code 200070
Tel (86-21) 51699400
Fax (86-21) 63532643
Website: www.phillip.com.cn

FRANCE

King & Shaxson Capital Limited
3rd Floor, 35 Rue de la Bienfaisance 75008
Paris France
Tel (33-1) 45633100
Fax (33-1) 45636017
Website: 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