

SPRING Airlines (601021 CH)

Short-term shocks do not change long-term value

China | Airlines | Company Report

26 May 2020

Investment Summary

Company profile & Shareholding Structure

Spring Airlines, the leader of the low-cost airlines in China, is the first private low-cost airlines in China. It was founded in 2004 and its base is in Shanghai. The company completed its shareholding reform in 2010, raised RMB1.75 billion in an IPO on the Shanghai Stock Exchange in 2015, and raised RMB3.46 billion through a private placement of 116 million shares in 2018 to purchase aeroplanes and flight simulators.

The founder Mr. Wang Zhenghua holds 36% of the parent company's shares, which holding 63% of the company's, while the public shareholding accounts for 25%, with relatively concentrated ownership and stable shareholding structure.

More than Ten Years' Dedication make an industry leader

At the beginning after its founding in 2004, the company started with only two aeroplanes and mainly provided passenger services on domestic routes. The company began to operate international and regional routes in 2010, and to accelerate its development of international and regional routes in 2011. After over a decade's development, the company has begun to take shape. By April 2020, Spring Airlines has had a fleet of 96 aircraft, all of which are Airbus A320. Among them 45 were purchased by the company itself, one is financing leased and 50 are operating leased. As for route layout, by now the company has formed a domestic market layout with Shanghai as its main hub and Shenyang in Northeast China, Shijiazhuang in North China and Shenzhen in South China as its pivots, and an international market layout with Osaka in Japan, Jeju in South Korea and Bangkok in Thailand as the main overseas nodes. As at the end of 2019, the company operated a total of 210 routes, including 128 domestic routes, 69 international routes and 13 regional routes.

No matter in terms of the size of the fleet and the number of routes, or of the passenger traffic, Spring Airlines is far ahead in the domestic low-cost airline market..

Adherence to "Two Singles-Two Highs-Two Lows" Business Mode

The company's business mode can be generalized as "Two Singles", "Two Highs" and "Two Lows".

"Two Singles" refer to single model and single cabin. The company owns a fleet of single Airbus A320 series model, uniformly equipped with CFM engines. Using the same model and engine through centralized procurement can reduce the purchase and lease costs of aircraft and other aviation materials, maintenance costs and personnel training costs. The company's aircraft only contains only economy class seats, but no first class or business class seats. The number of available seats is increased by 15%-20%, which can effectively dilute the unit cost.

"Two Highs" refer to high P L /F and high aircraft utilization rate. The company raises its P L /F mainly through attracting travellers by its parent company, offering charter flights and providing special fares. And the company acquires high aircraft utilization rate through increasing the daily aircraft utilization rate by optimizing the route structure, extending flight time and speeding up the turnover, and diluting the fixed cost per unit.

"Two Lows" refer to low sales expenses and low administrative expenses. The company makes direct sales through self-built e-commerce way (accounting for 91.9% of its sales), instead of the AVIC system, as its main sales approach, which effectively reduces sales agency fees. It also makes full use of the resources which come from the third-party service providers and integrates business and financial ERP to record strict fee control management.

Buy (Initiation)

CMP CNY 33.3

(Closing price as at 22 May)

TARGET CNY 47 (+41%)

COMPANY DATA

O/S SHARES (MN) :	917
MARKET CAP (CNY MN) :	30518
52 - WK HI/LO (CNY):	47.7/ 28.88

SHARE HOLDING PATTERN, %

Shanghai Chunqiu International Travel Service (Group) Co., Ltd.	54.99
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PRICE VS. SHCOMP



Source: Phillip Securities (HK) Research

KEY FINANCIALS

CNY mn	FY18	FY19	FY20E	FY21E
Net Sales	13114	14804	11095	17562
Net Profit	1503	1841	386	2349
EPS, CNY	1.67	2.01	0.42	2.56
P/E, x	19.9	16.6	79.0	13.0
BVPS, CNY	14.53	16.40	16.72	19.00
P/BV, x	2.3	2.0	2.0	1.8
DPS (CNY)	0.20	0.20	0.10	0.30
Div. Yield (%)	0.6%	0.6%	0.3%	0.9%

Source: Company reports, Phillip Securities Est.

Research Analyst

ZhangJing (+ 86 21-51699400-103)

zhangjing@phillip.com.cn

Differentiating Competitive Advantages Build a "Barrier"

The unit operating cost of the company is 32%-37% lower than that of the other three major airlines. With a significant cost advantage, the company is able to launch products at lower prices. The company provided tickets with prices 30-45% lower than that of full-service airlines. Such advantage in cost effectiveness attracts numerous self-paying passengers who are more sensitive to prices as well as business travellers pursuing high cost effectiveness. Maximizing the use of existing assets has recorded efficient production operations. The company's yield and P L/ F are much higher than that of other domestic airlines, which reflects its excellent capabilities for operations.

The company's P L/ F is as follows, 90.56% in 2017, 89.01% in 2018 and 90.8% in 2019, nearly 10 ppts higher than 83.2%, the average level of domestic airlines. In 2019, the daily aircraft utilization rate of the company is 11.24hours, at least 1.5 hours higher than industry average. The sales expenses per unit are RMB0.0060, and the administration expenses per unit are RMB0.0042, much lower than that of the other listed companies comparable in the industry. Since 2011, the company has maintained double-digit returns on capital and net profit margins.

Steady Operation Brings Better Anti-risk Capabilities

In the company's revenue structure, the passenger transportation income accounts for 97%, the freight income 0.83%, and other income 2.2%. The proportion of domestic/international/regional routes in the layout is about 64:33:3. In 2019, the company recorded a revenue of RMB14.803 billion, increasing by 12.88% yoy; a net profit of RMB1,841 million, increasing by 22.5% yoy, and a net profit after deducting non-recurring profits and losses of RMB1,588 million, increasing by 30.42% yoy. In the whole year, the company recorded a total transportation turnover of 3.6 billion ton-kilometres, increasing by 14.5% yoy; and 39.69 billion passenger-kilometres, increasing by 14.4% yoy; and its P L/ F increased by 1.8 ppts yoy.

Suffering from the outbreak of COVID-19, in Q1 2020, the Company reported a revenue of RMB23,80 million, down by 34.5% yoy. Net loss attributable to the parent company was RMB230 million, down by 147.9% yoy. In Q1, the Company fleet capacity decreased by 35.7% yoy. Its P L/ F is 72.5%, down by 19.7% yoy. While, under the circumstance of epidemic prevention and control, the Company reduces its personnel amount and flight expenditures, implements a stricter budget to reduce expenditures, with its administration expenses decreasing by 45.7% yoy, R&D expenses increasing by 32.0% yoy, and finance expenses decreasing by 52.4% yoy.

A Vast Space for Medium and Long-term Low-Cost Airlines

China's low-cost airlines started developing late and are still in the early stages of development, with a low penetration rate. In 2018, the penetration rate of low-cost airlines is as follows: 56% in ASEAN countries, 50% in Europe, 32% in the United States, and only 11% in China. With the diversification of people's travel needs, the market potential is gradually emerging. Compared with overseas peer giants, the company has vast development space, and has the first-mover advantages and a "barrier", which help it to fully enjoy the industry dividend. We believe that short-term impact caused by the epidemic does not change the long-term investment value of the company.

Investment Thesis

Spring Airlines' pricing strategy takes into account cost additions and benchmark high-speed rail fares. At present, whether it is a popular route or a newly opened route, Spring Airlines' fare is very competitive compared with the high-speed rail line. With the gradual advancement of high-speed rail price increases, it is expected to raise the company's fare lower limit.

As for valuation, we expected diluted EPS of the Company to RMB 0.42/2.56 of 2020/2021. And we accordingly gave the target price to RMB47, respectively 112/18x P/E and 2.8/2.3x P/B for 2020/2021. "Buy" rating. (Closing price as at 22 May)

Risk

- Business cycle risk
- Risk of jet fuel price fluctuation
- Public health outbreak risk
- Exchange rate fluctuation risk

Forward P/E P/B Trend



Source: Bloomberg, Phillip Securities Hong Kong Research

Peer Comparison

Name	Market Cap (USD mil)	EPS - growth.%	P/E	ROE	Dividend yield	BEst EV / BEst EBITDA	EV/EBITDA (yr+1)	BEst P/E:2FY	BEst P/E:1FY	BEst P/B:1BF	BEst P/S:CY
Median	3372	5.64	65.24	4.21	0.86	20.79	9.03	12.91	166.5	1.58	2.07
Average	3372	5.64	65.24	4.21	0.86	20.79	9.03	12.91	166.5	1.58	2.07
SPRING AIRLINES CO LTD-A	4278	21.05	26.91	7.49	0.6	22.76	8.36	13.58	166.5	1.86	2.77
JUNEYAO AIRLINES CO LTD-A	2466	-9.77	103.6	0.92	1.12	18.82	9.7	12.24	N.A.	1.3	1.36
RYANAIR HOLDINGS PLC	12784	-25.15	18.96	12.75	N.A.	25.56	6.03	9.99	N.A.	2.43	1.36
Median	3257	-13.17	6.45	17.51	7.7	30.96	5.69	14.01	13.64	1.7	0.93
Average	3257	-13.17	6.45	17.51	7.7	30.96	5.69	14.01	13.64	1.7	0.93
EASYJET PLC	2761	-25.35	6.38	11.2	7.7	57.48	3.37	14.01	N.A.	0.86	0.6
WIZZ AIR HOLDINGS PLC	3753	-0.99	6.51	23.83	N.A.	4.43	8.01	N.A.	13.64	2.55	1.25
CONTROLADORA VUELA CIA DE-A	470	-72.82	17.4	N.A.	N.A.	8.07	6.27	56.35	N.A.	6.99	0.5
AIRASIA GROUP BHD	575	10.92	N.A.	-6.44	120	1.88	4.14	12.5	N.A.	0.67	0.27
NORWEGIAN AIR SHUTTLE AS	931	36.29	N.A.	-55.82	N.A.	13.49	8.26	N.A.	N.A.	0.17	0.26
Median	2541	12.9	7.09	12.63	1.82	0	6.49	15.14	0	0.61	0.66
Average	6951	11.98	6.12	13.67	1.82	0	6.23	64.81	0	0.84	0.92
SPIRIT AIRLINES INC	866	12.9	2.6	12.63	N.A.	N.A.	6.59	8.03	N.A.	0.42	0.48
JETBLUE AIRWAYS CORP	2541	22.28	7.09	8.96	N.A.	N.A.	5.6	171.27	N.A.	0.61	0.66
SOUTHWEST AIRLINES CO	17446	0.76	8.66	19.42	1.82	N.A.	6.49	15.14	N.A.	1.48	1.62

Source: Bloomberg, Phillip Securities Hong Kong Research

Financials

FYE DEC	FY17	FY18	FY19	FY20F	FY21F
Valuation Ratios					
P/E (X), adj.	21.1	19.9	16.6	79.0	13.0
P/B (X)	3.1	2.3	2.0	2.0	1.8
Dividend Yield (%)	0.6%	0.6%	0.6%	0.3%	0.9%
Per share data (RMB)					
EPS, (Basic)	1.58	1.67	2.01	0.42	2.56
EPS, (Diluted)	1.58	1.67	2.01	0.42	2.56
DPS	0.19	0.20	0.20	0.10	0.30
BVPS	10.57	14.53	16.40	16.72	19.00
Growth & Margins (%)					
Growth					
Revenue	30.1%	19.5%	12.9%	-25.1%	58.3%
EBIT	234.0%	11.9%	20.9%	-76.4%	446.2%
Net Income, adj.	32.7%	19.1%	22.5%	-79.0%	508.0%
Margins					
Gross margin	12.1%	9.7%	11.4%	0.8%	13.6%
EBIT margin	16.3%	15.3%	16.4%	5.1%	17.8%
Net Profit Margin	11.5%	11.5%	12.4%	3.5%	13.4%
Key Ratios					
ROE	16.0%	13.8%	13.0%	2.5%	14.3%
Income Statement (RMB mn)					
Revenue	10971	13114	14804	11095	17562
Gross profit	1332	1270	1689	87	2388
EBIT	1789	2002	2421	571	3119
Profit before tax	1651	2002	2404	499	3082
Tax	390	499	566	119	737
Profit for the period	1262	1503	1838	380	2345
Minority interests	0	0	-3	-7	-3
Total capital share	801	917	917	917	917
Net profit	1262	1503	1841	386	2349

Source: PSR

(Closing price as at 22 May)

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

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 10, 330 Collins Street
Melbourne VIC 3000

Tel (+61) 3 8633 9803 Fax (+61) 3 8633 9899

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

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