

# China Southern Airlines-H (1055 HK)

## Weather the harsh winter of the industry

The Company's 2019 annual results was in line with our and consensus estimates. Under the pandemic, the Company's cost control measures will help it weather the harsh winter of the industry. We expect net loss for FY20E to be RMB 2,975mn, and BVPS to decrease to RMB 4.19. Based on 0.8x P/B, we lower TP to HK\$ 3.73. The stock is currently trading at 0.7x 2020E P/B, lower than historical average. Downgrade to HOLD.

- 2019 annual results in line.** The Company announced 2019 annual results. RPK increased 9.9% YoY, in line with guidance. Passenger load factor increased 0.37ppt to 82.81%. Passenger yield remained flat at RMB 0.49 per RPK. Revenue increased 7.4% YoY to RMB 154.3bn, in line with our and consensus estimates. Impacted by the adoption of IFRS 16, interest expenses increased 82.5% YoY to RMB 5.8bn. As a result, net profit attributable decreased 8.8% YoY to RMB 2.6bn, missed our and consensus estimates. The Board did not recommend any payment of final cash dividend for FY19.
- Operational highlights. (1)** The Company strengthened cost controls. Fuel consumption per ton kilometer decreased 3.95% YoY. We believe cost control measures will help the Company weather the harsh winter of the industry. **(2)** The Company successfully transited 13 routes to the new Daxing Airport. By Mar 2021, the Company's market share in Daxing Airport will reach 43%.
- Demand recovery faces great uncertainties.** According to the Ministry of Transport, on 31 Mar, civil aviation carried 487,600 passengers, less than 30% of the same day last year. Due to insufficient air travel demand, passenger load and yield both dropped. Looking forward, listed airlines generally expect domestic demand to resume steady growth around May or Jun, and that international demand to be more uncertain. Due to the uncertainty of demand recovery, listed airlines did not give 2020E guidance. **We assume:** domestic RPK growth in 1/2/3/4Q 20E is -50%/-5%/5%/10% YoY, respectively; international and regional RPK growth in 2020E is -50% YoY; passenger load factor decreases 10ppt YoY; passenger yield decreases RMB 0.1 YoY.
- Valuation.** After oil price tumbled in 1Q20, we expect oil expenses to decrease 46.8% YoY to RMB 22.8bn. We expect net loss for FY20E to be RMB 2,975mn, and BVPS to decrease to RMB 4.19. Based on 0.8x P/B, we lower TP to HK\$ 3.73. The stock is currently trading at 0.7x 2020E P/B, lower than historical average. Downgrade to HOLD.

### Earnings Summary

| (YE 31 Dec)              | FY18A   | FY19A   | FY20E   | FY21E   | FY22E   |
|--------------------------|---------|---------|---------|---------|---------|
| Traffic revenue (RMB mn) | 138,064 | 148,117 | 96,711  | 106,135 | 117,017 |
| YoY growth (%)           | 13.3    | 7.3     | (34.7)  | 9.7     | 10.3    |
| Net income (RMB mn)      | 2,895   | 2,640   | (2,975) | 1,502   | 3,396   |
| EPS (RMB)                | 0.27    | 0.22    | (0.22)  | 0.10    | 0.22    |
| YoY growth (%)           | (55.0)  | (20.3)  | (200.2) | (145.4) | 126.1   |
| Consensus EPS (RMB)      | N/A     | N/A     | (0.19)  | 0.42    | 0.21    |
| P/E (x)                  | 11.0    | 13.8    | (13.8)  | 30.4    | 13.4    |
| P/B (x)                  | 0.6     | 0.6     | 0.7     | 0.7     | 0.7     |
| Yield (%)                | 1.7     | 0.0     | 0.0     | 0.4     | 0.9     |
| ROE (%)                  | 5.0     | 4.1     | (4.6)   | 2.3     | 5.1     |
| Net gearing (%)          | 153     | 237     | 142     | 114     | 104     |

Source: Company data, Bloomberg, CMBIS estimates

**HOLD (Down)**

|               |          |
|---------------|----------|
| Target Price  | HK\$3.73 |
| (Previous TP) | HK\$6.08 |
| Up/Downside   | +12.5%   |
| Current Price | HK\$3.32 |

### China Airline Sector

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#### Stock Data

|                          |                  |
|--------------------------|------------------|
| Mkt Cap (HK\$ mn)        | 60,820           |
| Avg 3 mths t/o (HK\$ mn) | 135.87           |
| 52w High/Low (HK\$)      | 8.47/2.89        |
| Total Issued Shares (mn) | <b>3,666 (H)</b> |
|                          | 8,601 (A)        |

Source: Bloomberg

#### Shareholding Structure

|  |        |
|--|--------|
| China Southern Air Holding Limited Company | 50.54% |
| Qatar Airways                              | 5.00%  |
| American Airlines                          | 2.21%  |

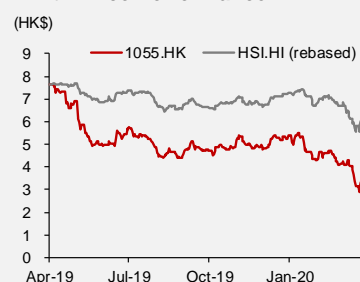
Source: Company data

#### Share Performance

|       | Absolute | Relative |
|-------|----------|----------|
| 1-mth | -19.4%   | -9.0%    |
| 3-mth | -38.3%   | -24.3%   |
| 6-mth | -30.3%   | -22.0%   |

Source: Bloomberg

#### 12-mth Price Performance



Source: Bloomberg

#### Auditor: KPMG

#### Related Reports

- "Solid operating results; positive 4Q19 outlook" – 1 Nov 2019
- "Fundamentals remained healthy" – 29 Aug 2019
- "Dual hubs" strategy stimulates capacity growth" – 31 Jul 2019

**Figure 1: 2019 results**

| RMB mn                            | 2019             | 2018             | YoY          |
|-----------------------------------|------------------|------------------|--------------|
| <b>Operating revenue</b>          | <b>154,322</b>   | <b>143,623</b>   | <b>7.4%</b>  |
| Traffic revenue                   | 148,117          | 138,064          | 7.3%         |
| Passenger                         | 138,502          | 128,038          | 8.2%         |
| Cargo and mail                    | 9,615            | 10,026           | -4.1%        |
| Other operating revenue           | 6,205            | 5,559            | 11.6%        |
| <b>Operating expenses</b>         | <b>(148,608)</b> | <b>(140,242)</b> | <b>6.0%</b>  |
| Jet fuel costs                    | (42,814)         | (42,922)         | -0.3%        |
| Operating lease charges           | (1,412)          | (8,726)          | -83.8%       |
| Flight personnel costs            | (12,709)         | (11,467)         | 10.8%        |
| Depreciation & amortization       | (24,620)         | (14,308)         | 72.1%        |
| Other operating expenses          | (67,053)         | (62,819)         | 6.7%         |
| Other net income                  | 5,124            | 5,438            | -5.8%        |
| <b>EBIT</b>                       | <b>10,838</b>    | <b>8,819</b>     | <b>22.9%</b> |
| Exchange gain/(loss)              | (1,477)          | (1,853)          | -20.3%       |
| Other non-operating profit/(loss) | (5,306)          | (2,602)          | 103.9%       |
| <b>Pre-tax profit</b>             | <b>4,055</b>     | <b>4,364</b>     | <b>-7.1%</b> |
| Income tax                        | (971)            | (1,000)          | -2.9%        |
| Minority interests                | (444)            | (469)            | -5.3%        |
| <b>Net profit</b>                 | <b>2,640</b>     | <b>2,895</b>     | <b>-8.8%</b> |

Source: Company data, CMBIS

**Figure 2: Earnings revision**

| RMB mn                  | New     |         | Old     |         | Diff    |        |
|-------------------------|---------|---------|---------|---------|---------|--------|
|                         | FY20E   | FY21E   | FY20E   | FY21E   | FY20E   | FY21E  |
| Traffic revenue         | 96,711  | 106,135 | 157,293 | 163,084 | -38.5%  | -34.9% |
| Passenger               | 88,467  | 97,547  | 147,900 | 154,333 | -40.2%  | -36.8% |
| Cargo and mail          | 8,245   | 8,587   | 9,394   | 8,752   | -12.2%  | -1.9%  |
| Total operating revenue | 103,537 | 113,643 | 163,422 | 169,520 | -36.6%  | -33.0% |
| EBITDAR                 | 19,519  | 23,977  | 40,270  | 39,763  | -51.5%  | -39.7% |
| Net profit              | (2,975) | 1,502   | 7,485   | 6,551   | -139.7% | -77.1% |

Source: Company data, CMBIS estimates

## Financial Summary

### Income statement

| YE 31 Dec (RMB mn)                | FY18A            | FY19A            | FY20E            | FY21E            | FY22E            |
|-----------------------------------|------------------|------------------|------------------|------------------|------------------|
| <b>Operating revenue</b>          | <b>143,623</b>   | <b>154,322</b>   | <b>103,537</b>   | <b>113,643</b>   | <b>125,275</b>   |
| Traffic revenue                   | 138,064          | 148,117          | 96,711           | 106,135          | 117,017          |
| Passenger                         | 128,038          | 138,502          | 88,467           | 97,547           | 107,622          |
| Cargo and mail                    | 10,026           | 9,615            | 8,245            | 8,587            | 9,395            |
| Other operating revenue           | 5,559            | 6,205            | 6,826            | 7,508            | 8,259            |
| <b>Operating expenses</b>         | <b>(140,242)</b> | <b>(148,608)</b> | <b>(106,624)</b> | <b>(112,601)</b> | <b>(121,965)</b> |
| Jet fuel costs                    | (42,922)         | (42,814)         | (22,767)         | (31,136)         | (33,335)         |
| Operating lease charges           | (8,726)          | (1,412)          | (843)            | (19)             | (20)             |
| Flight personnel costs            | (11,467)         | (12,709)         | (10,891)         | (11,064)         | (12,164)         |
| Depreciation & amortization       | (14,308)         | (24,620)         | (16,197)         | (17,080)         | (17,849)         |
| Other operating expenses          | (62,819)         | (67,053)         | (55,927)         | (53,302)         | (58,598)         |
| Other net income                  | 5,438            | 5,124            | 5,380            | 5,649            | 5,932            |
| <b>EBIT</b>                       | <b>8,819</b>     | <b>10,838</b>    | <b>2,293</b>     | <b>6,691</b>     | <b>9,242</b>     |
| Finance expenses, net             | (3,077)          | (5,771)          | (6,220)          | (4,837)          | (4,478)          |
| Exchange gain/(loss)              | (1,853)          | (1,477)          | 0                | 0                | 0                |
| Other non-operating profit/(loss) | 475              | 465              | 452              | 452              | 452              |
| <b>Pre-tax profit</b>             | <b>4,364</b>     | <b>4,055</b>     | <b>(3,476)</b>   | <b>2,307</b>     | <b>5,216</b>     |
| Income tax                        | (1,000)          | (971)            | -                | (552)            | (1,249)          |
| Minority interests                | (469)            | (444)            | 500              | (253)            | (571)            |
| <b>Net profit</b>                 | <b>2,895</b>     | <b>2,640</b>     | <b>(2,975)</b>   | <b>1,502</b>     | <b>3,396</b>     |

### Cash flow summary

| YE 31 Dec (RMB mn)                 | FY18A           | FY19A           | FY20E           | FY21E           | FY22E           |
|------------------------------------|-----------------|-----------------|-----------------|-----------------|-----------------|
| <b>Pre-tax profit</b>              | <b>4,364</b>    | <b>4,055</b>    | <b>(3,476)</b>  | <b>2,307</b>    | <b>5,216</b>    |
| Depreciation and amortization      | 14,308          | 24,620          | 16,197          | 17,080          | 17,849          |
| Other adjustments                  | 4,800           | 7,079           | 6,051           | 4,668           | 4,309           |
| Changes in working capital         | (2,298)         | 1,321           | 1,387           | 1,456           | 1,529           |
| Taxation and others                | (5,786)         | (6,548)         | (6,220)         | (5,389)         | (5,727)         |
| <b>Operating activities</b>        | <b>15,388</b>   | <b>30,527</b>   | <b>13,939</b>   | <b>20,121</b>   | <b>23,176</b>   |
| Capital expenditure                | (24,033)        | (25,000)        | (23,750)        | (22,563)        | (21,434)        |
| Other investing activities         | 3,516           | 2,219           | 2,321           | 2,427           | 2,539           |
| <b>Investing activities</b>        | <b>(20,517)</b> | <b>(22,781)</b> | <b>(21,429)</b> | <b>(20,135)</b> | <b>(18,895)</b> |
| Equity raised                      | 10,908          | -               | 10,000          | 20,000          | -               |
| Changes in borrowings              | (4,653)         | 58,616          | (37,541)        | (15,881)        | (948)           |
| Dividends paid                     | (1,107)         | (706)           | 105             | (53)            | (270)           |
| Others                             | 72              | -               | -               | -               | -               |
| <b>Financing activities</b>        | <b>5,220</b>    | <b>57,910</b>   | <b>(27,436)</b> | <b>4,067</b>    | <b>(1,217)</b>  |
| <b>Net change in cash</b>          | <b>91</b>       | <b>65,656</b>   | <b>(34,927)</b> | <b>4,053</b>    | <b>3,063</b>    |
| Cash at the beginning of the year  | 6,826           | 6,928           | 72,584          | 37,657          | 41,710          |
| Exchange difference                | 11              | -               | -               | -               | -               |
| <b>Cash at the end of the year</b> | <b>6,928</b>    | <b>72,584</b>   | <b>37,657</b>   | <b>41,710</b>   | <b>44,773</b>   |

### Balance sheet

| YE 31 Dec (RMB mn)                   | FY18A          | FY19A          | FY20E          | FY21E          | FY22E          |
|--------------------------------------|----------------|----------------|----------------|----------------|----------------|
| <b>Non-current assets</b>            | <b>222,877</b> | <b>290,190</b> | <b>277,601</b> | <b>279,757</b> | <b>280,035</b> |
| Property, plant and equipment        | 170,692        | 84,788         | 100,515        | 105,052        | 107,245        |
| Construction in progress             | 37,791         | 39,222         | 29,613         | 27,046         | 24,943         |
| Right-of-use assets                  | -              | 153,211        | 134,317        | 134,317        | 134,317        |
| Other non-current assets             | 14,394         | 12,969         | 13,156         | 13,343         | 13,530         |
| <b>Current assets</b>                | <b>24,072</b>  | <b>16,738</b>  | <b>52,328</b>  | <b>56,381</b>  | <b>59,444</b>  |
| Cash and cash equivalents            | 6,928          | 1,849          | 37,657         | 41,710         | 44,773         |
| Other current assets                 | 17,144         | 14,889         | 14,671         | 14,671         | 14,671         |
| <b>Total assets</b>                  | <b>246,949</b> | <b>306,928</b> | <b>329,929</b> | <b>336,138</b> | <b>339,479</b> |
| <b>Current liabilities</b>           | <b>83,687</b>  | <b>95,490</b>  | <b>98,471</b>  | <b>100,257</b> | <b>100,122</b> |
| Borrowings                           | 38,741         | 37,543         | 29,935         | 26,717         | 26,525         |
| Current portion of lease liabilities | 9,555          | 19,998         | 22,914         | 21,200         | 21,098         |
| Other current liabilities            | 35,391         | 37,949         | 45,621         | 52,340         | 52,499         |
| <b>Non-current liabilities</b>       | <b>84,793</b>  | <b>134,109</b> | <b>154,018</b> | <b>156,812</b> | <b>156,601</b> |
| Borrowings                           | 15,676         | 13,637         | 10,874         | 9,705          | 9,635          |
| Lease liabilities                    | 62,666         | 114,076        | 131,749        | 121,970        | 121,386        |
| Other non-current liabilities        | 6,451          | 6,396          | 11,396         | 25,137         | 25,580         |
| <b>Total liabilities</b>             | <b>168,480</b> | <b>229,599</b> | <b>252,489</b> | <b>257,068</b> | <b>256,722</b> |
| Share capital                        | 12,267         | 12,267         | 15,334         | 15,334         | 15,334         |
| Reserves                             | 52,990         | 51,839         | 48,864         | 50,215         | 53,272         |
| <b>Shareholders' Equity</b>          | <b>65,257</b>  | <b>64,106</b>  | <b>64,198</b>  | <b>65,549</b>  | <b>68,606</b>  |
| Non-controlling interests            | 13,212         | 13,223         | 13,242         | 13,521         | 14,151         |
| <b>Total equity</b>                  | <b>78,469</b>  | <b>77,329</b>  | <b>77,440</b>  | <b>79,070</b>  | <b>82,757</b>  |

### Key ratios

| YE 31 Dec                   | FY18A | FY19A | FY20E | FY21E | FY22E |
|-----------------------------|-------|-------|-------|-------|-------|
| <b>Operating metrics</b>    |       |       |       |       |       |
| ASK YoY (%)                 | 12.0  | 9.4   | -11.6 | 10.5  | 10.5  |
| RPK YoY (%)                 | 12.4  | 9.9   | -22.2 | 10.9  | 10.9  |
| Passenger load factor (%)   | 82.4  | 82.8  | 72.9  | 73.1  | 73.4  |
| Passenger yield (RMB cents) | 49.4  | 48.6  | 39.9  | 39.7  | 39.5  |
| Passenger revenue YoY (%)   | 13.5  | 8.2   | -36.1 | 10.3  | 10.3  |
| Cargo revenue YoY (%)       | 10.4  | -4.1  | -14.3 | 4.2   | 9.4   |
| Operating margin            | 6.1   | 7.0   | 2.2   | 5.9   | 7.4   |
| EBITDAR margin              | 22.5  | 24.0  | 18.9  | 21.1  | 21.8  |
| Net profit margin           | 2.0   | 1.7   | -2.9  | 1.3   | 2.7   |
| <b>B/S ratios (%)</b>       |       |       |       |       |       |
| Total debt / Total equity   | 161.4 | 239.6 | 190.7 | 166.7 | 158.2 |
| Net debt / Total equity     | 152.6 | 237.2 | 142.1 | 114.0 | 104.1 |
| <b>Returns (%)</b>          |       |       |       |       |       |
| ROE                         | 5.0   | 4.1   | -4.6  | 2.3   | 5.1   |
| ROA                         | 1.2   | 1.0   | -0.9  | 0.5   | 1.0   |
| <b>Per share (RMB)</b>      |       |       |       |       |       |
| EPS                         | 0.27  | 0.22  | -0.22 | 0.10  | 0.22  |
| DPS                         | 0.05  | -     | -     | 0.01  | 0.03  |
| BVPS                        | 5.32  | 5.23  | 4.19  | 4.27  | 4.47  |

Source: Company data, CMBIS estimates

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