

China / Hong Kong Company Update

China Southern Airlines

Bloomberg: 1055 HK Equity | Reuters: 1055.HK | 600029 CH Equity | Reuters: 600029.SH

Refer to important disclosures at the end of this report

DBS Group Research . Equity

18 Jan 2024

H: BUY

Last Traded Price (18 Jan 2024): HK\$3.10 (HSI : 15,392)
Price Target 12-mth: HK\$4.50 (45.2% upside) (Prev HK\$5.60)

A: BUY

Last Traded Price (18 Jan 2024): RMB5.92 (CSI300 Index : 3,275)
Price Target 12-mth: RMB6.30 (6.4% upside) (Prev RMB7.90)

Analyst

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What's New

- CSA could benefit from domestic passenger yields strengthening in the near term as capacity is deployed to international routes
- Poised to expand capacity quicker than peers given largest orderbook and minimal impact from P&W GTF engine issues
- Trim FY24F EBITDA forecast on more gradual resumption of international passenger capacity, partially offset by higher yields
- Maintain BUY with revised TP of HK\$4.50

Record earnings ahead

Investment Thesis

Largest Chinese carrier with a dominant foothold in domestic market and significant presence in freighter segment. The China Southern Airlines (CSA) group is the biggest airline group in China, with the most extensive route network in the country and the highest number of regional route bases among Chinese airlines. The group's primary hubs are in Guangzhou and Beijing, enabling it to enjoy a strong position in the highly populated and prosperous southern and central regions of China. CSA also has stronger branding than its key competitors in China, with a higher Skytrax rating. Additionally, CSA has the largest cargo operations in China, with 16 freighter aircraft serving 13 international cargo routes.

Poised to grow capacity and capture more market share in the medium term.

CSA is strategically positioned to not only restore but swiftly expand its capacity in the next few years, as it boasts the largest aircraft orderbook and anticipates a limited impact from the P&W GTF engine issues (roughly only 5% of its fleet is likely to be grounded). We expect the group to be able to gain further market share in both the domestic and international markets, backed by its sizeable workforce and aggressive delivery slots. Consequently, we foresee CSA's earnings growth outperforming that of its peers over the medium term.

Long-awaited normalisation of passenger traffic for the Chinese carriers to materialise in FY24F; valuations are attractive for the exceptional earnings growth ahead. We are positive about the Chinese airlines, as they are likely to see the biggest upswing in earnings, underpinned by relatively higher capacity growth and wider margins compared to global peers. CSA is trading at 5.8x EV/EBITDA (FY24F), close to its five-year pre-pandemic average, which is undemanding, in our view, given the remarkable earnings growth it is set to deliver.

Maintain BUY with revised TP of HK\$4.50 (vs. HK\$5.60 previously) as we roll over our valuations to FY24F and adjust our valuation peg due to the multiple contractions in the airline sector. Our H-share TP is based on 6.7x EV/EBITDA (FY24F), which is close to 1SD above its five-year pre-pandemic average. Our A-share TP is derived by applying a 70% valuation premium to its H-share.

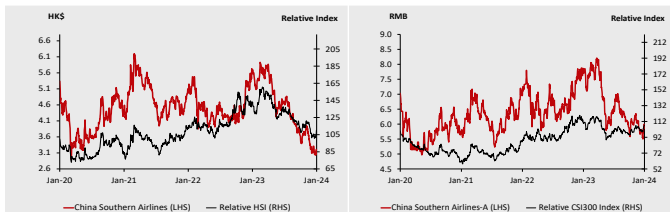
Key Risks

Macroeconomic headwinds could curtail CSA's passenger traffic recovery and keep a lid on yields, while **elevated jet fuel prices** could weigh on operating margins.

At A Glance

| | |
|---|------------------|
| Issued Capital - H shares (m shs) | 4,644 |
| - Non H shrs (m shs) | 13,477 |
| H shs as a % of Total | 26 |
| Total Mkt Cap (HK\$m/US\$m) | 100,090 / 12,797 |
| Major Shareholders (%) | |
| China Southern Air Holding Company Limited | 69.8 |
| Major H Shareholders (As % of H shares) | |
| China Southern Air Holding Company Limited | 57.0 |
| American Airlines Group Inc | 5.8 |
| H Shares-Free Float (%) | 37.1 |
| 3m Avg. Daily Val. (US\$m) | 3.86 |
| GICS Industry: Industrials / Transportation | |

Price Relative



Forecasts and Valuation (H Shares)

| FY Dec (RMBm) | 2022A | 2023F | 2024F | 2025F |
|--------------------------------|----------|---------|---------|---------|
| Turnover | 87,059 | 159,287 | 171,351 | 189,430 |
| EBITDA | 1,724 | 33,819 | 39,991 | 42,542 |
| Pre-tax Profit | (31,550) | 1,507 | 8,122 | 9,993 |
| Net Profit | (32,699) | 665 | 5,541 | 6,984 |
| Net Pft (Pre Ex) (core profit) | (32,568) | 61 | 5,541 | 6,984 |
| Net Profit Gth (Pre-ex) (%) | (254.7) | N/A | 9,003.2 | 26.0 |
| EPS (RMB) | (1.86) | 0.03 | 0.24 | 0.30 |
| EPS Gth (%) | (148.6) | N/A | 637.2 | 26.0 |
| DPS (HK\$) | 0.00 | 0.00 | 0.00 | 0.00 |
| BV Per Share (HK\$) | 2.48 | 2.74 | 3.00 | 3.32 |
| PE (X) | nm | 89.4 | 12.1 | 9.6 |
| P/Cash Flow (X) | nm | 1.8 | 1.8 | 1.7 |
| P/Free CF (X) | nm | 3.4 | 5.4 | 4.7 |
| EV/EBITDA (X) | 149.7 | 6.9 | 5.8 | 5.1 |
| Net Div Yield (%) | 0.0 | 0.0 | 0.0 | 0.0 |
| P/Book Value (X) | 1.3 | 1.1 | 1.0 | 0.9 |
| Net Debt/Equity (X) | 3.5 | 2.2 | 1.8 | 1.5 |
| ROAE (%) | (59.9) | 1.3 | 8.9 | 10.2 |

| | | | |
|---------------------|------|------|------|
| Earnings Rev (%) | NA | (11) | New |
| Consensus EPS (RMB) | 0.06 | 0.47 | 0.64 |
| Other Broker Recs: | B:10 | S:0 | H:4 |

Source of all data on this page: Company, DBS Bank (Hong Kong) Limited ("DBS HK"), Thomson Reuters

China Southern Airlines

WHAT'S NEW

Unprecedented levels of profitability ahead

Our 2024 outlook report for the [airline sector](#) highlights that macroeconomic indicators still largely favour the sector, though we expect to see a diverging earnings outlook across regions and business segments. This underpins our expectation of global passenger traffic hitting 105%-110%/115%-120% of 2019's level in 4Q24/4Q25. Across the three major regions, we are most positive about airlines in Asia Pacific, as we expect them to demonstrate stronger earnings momentum, underpinned by relatively higher capacity growth and wider margins, with the Chinese airlines likely to see the biggest upswing in earnings. While the valuation multiples for Asian airlines might appear high, they are commensurate with the region's stronger earnings potential. Our top picks are Cathay Pacific (CX) and China Southern Airlines (CSA).

However, we lowered our FY24F net profit estimates by 10-20% for the three Chinese airlines, reflecting a more moderate resumption of international passenger capacity and a more gradual improvement in unit costs owing to slower capacity growth. Nonetheless, we expect the Chinese airlines to deliver strong earnings growth. Following a stellar performance in 3Q23, marking their first profitable quarter since the pandemic, the Chinese airlines are poised to sustain and amplify this upswing, potentially leading the sector in earnings growth, in our view.

We maintain BUY for CSA, as we roll over our valuation base to FY24F and adjust our valuation peg due to the multiple contractions in the airline sector. Our new TP of HK\$4.50 is based on 6.7x EV/EBITDA (FY24F), which is close to 1SD above its five-year pre-pandemic average. CSA's share price has corrected almost 25% over the past year and we believe that its valuations are attractive at this juncture, for it has a clear path to normalisation and bright earnings prospects.

Company Background

China Southern Airlines (CSA) was established in 1989 and debuted on the New York and Hong Kong exchanges in 1997. In 2003, the company was also listed on the Shanghai Stock Exchange. CSA is based in Guangzhou, Guangdong Province with Baiyun International Airport as its main hub.

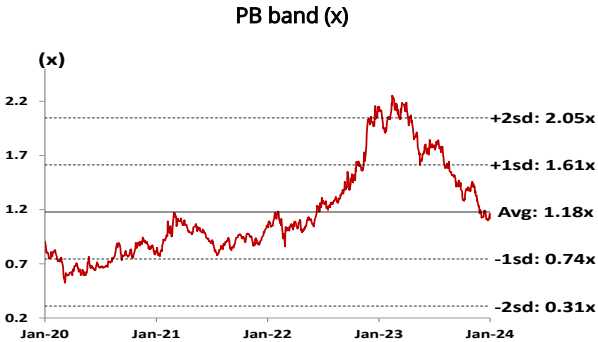
Valuation table

| (in RMB millions unless specified otherwise) | Value | Comments |
|--|-----------|---|
| EBITDA | 39,991 | FY24F |
| EV/EBITDA multiple peg (x) | 6.7 | 1.0 standard deviation above five-year pre-pandemic average |
| Enterprise value | 267,942 | |
| Less: net debt | (189,040) | As at June 23 |
| Less: minority interests | (14,506) | As at June 23 |
| Add: JVs and assocs | 6,330 | As at June 23 |
| Equity value | 70,726 | |
| Number of shares outstanding (m) | 18,121 | |
| Value per share (HK\$) | 4.50 | |

Source: DBS Bank estimates



Historical PB band



Source: Thomson Reuters, DBS HK

China Southern Airlines

Key Assumptions

| FY Dec | 2021A | 2022A | 2023F | 2024F | 2025F |
|-----------------------------------|-----------|-----------|-----------|-----------|-----------|
| ASK (m p-km) | 213,921.8 | 153,845.1 | 316,217.5 | 352,465.3 | 405,508.8 |
| RPK (m p-km) | 152,426.3 | 102,077.7 | 246,947.2 | 284,391.4 | 332,212.2 |
| Passenger Load Factor (%) | 71.3 | 66.4 | 78.1 | 80.7 | 81.9 |
| Passenger Yield (RMB cts per rpk) | 49.5 | 58.8 | 55.3 | 52.8 | 50.5 |
| All-in jet fuel price (US\$/bbl) | 82.4 | 130.5 | 115.5 | 105.0 | 110.3 |

Source: Company, DBS HK

Segmental Breakdown (RMB m)

| FY Dec | 2021A | 2022A | 2023F | 2024F | 2025F |
|-------------------------|----------------|---------------|----------------|----------------|----------------|
| Revenues (RMB m) | | | | | |
| Passenger | 75,392 | 60,017 | 136,625 | 150,020 | 167,781 |
| Cargo and Mail | 19,887 | 20,884 | 15,272 | 13,572 | 13,502 |
| Others | 6,365 | 6,158 | 7,390 | 7,759 | 8,147 |
| Total | 101,644 | 87,059 | 159,287 | 171,351 | 189,430 |

Source: Company, DBS HK

Income Statement (RMB m)

| FY Dec | 2021A | 2022A | 2023F | 2024F | 2025F |
|----------------------------|-----------------|-----------------|--------------|---------------|---------------|
| Revenue | 101,644 | 87,059 | 159,287 | 171,351 | 189,430 |
| Cost of Goods Sold | (113,726) | (115,262) | (157,433) | (164,923) | (182,129) |
| Gross Profit | (12,082) | (28,203) | 1,854 | 6,429 | 7,301 |
| Other Opng (Exp)/Inc | 4,767 | 5,661 | 6,000 | 6,300 | 6,615 |
| Operating Profit | (7,315) | (22,542) | 7,854 | 12,729 | 13,916 |
| Other Non Opg (Exp)/Inc | 1,575 | (3,619) | (1,400) | 0 | 0 |
| Associates & JV Inc | 280 | 291 | 400 | 450 | 500 |
| Net Interest (Exp)/Inc | (5,527) | (5,549) | (5,951) | (5,057) | (4,423) |
| Dividend Income | 0 | 0 | 0 | 0 | 0 |
| Exceptional Gain/(Loss) | (2,923) | (131) | 604 | 0 | 0 |
| Pre-tax Profit | (13,910) | (31,550) | 1,507 | 8,122 | 9,993 |
| Tax | 2,894 | (2,166) | (343) | (1,381) | (1,709) |
| Minority Interest | (1,090) | 1,017 | (500) | (1,200) | (1,300) |
| Preference Dividend | 0 | 0 | 0 | 0 | 0 |
| Net Profit | (12,106) | (32,699) | 665 | 5,541 | 6,984 |
| Net Profit before Except. | (9,183) | (32,568) | 61 | 5,541 | 6,984 |
| EBITDA | 16,926 | 1,724 | 33,819 | 39,991 | 42,542 |
| Growth | | | | | |
| Revenue Gth (%) | 9.8 | (14.3) | 83.0 | 7.6 | 10.6 |
| EBITDA Gth (%) | 1.1 | (89.8) | 1,861.6 | 18.3 | 6.4 |
| Opg Profit Gth (%) | (6.8) | 208.2 | (134.8) | 62.1 | 9.3 |
| Net Profit Gth (%) | (11.6) | (170.1) | N/A | 733.4 | 26.0 |
| Margins & Ratio | | | | | |
| Gross Margins (%) | (11.9) | (32.4) | 1.2 | 3.8 | 3.9 |
| Opg Profit Margin (%) | (7.2) | (25.9) | 4.9 | 7.4 | 7.3 |
| Net Profit Margin (%) | (11.9) | (37.6) | 0.4 | 3.2 | 3.7 |
| ROAE (%) | (17.6) | (59.9) | 1.3 | 8.9 | 10.2 |
| ROA (%) | (3.7) | (10.3) | 0.2 | 1.8 | 2.3 |
| ROCE (%) | (2.5) | (7.9) | 2.2 | 3.9 | 4.5 |
| Div Payout Ratio (%) | N/A | N/A | 0.0 | 0.0 | 0.0 |
| Net Interest Cover (x) | (1.3) | (4.1) | 1.3 | 2.5 | 3.1 |

Source: Company, DBS HK

China Southern Airlines

Interim Income Statement (RMB m)

| FY Dec | 1H2021 | 2H2021 | 1H2022 | 2H2022 | 1H2023 |
|-------------------------|----------------|----------------|-----------------|-----------------|----------------|
| Revenue | 51,576 | 50,068 | 40,817 | 46,242 | 71,830 |
| Cost of Goods Sold | (56,465) | (57,261) | (53,349) | (61,913) | (72,204) |
| Gross Profit | (4,889) | (7,193) | (12,532) | (15,671) | (374) |
| Other Oper. (Exp)/Inc | 1,832 | 2,935 | 1,968 | 3,693 | 1,807 |
| Operating Profit | (3,057) | (4,258) | (10,564) | (11,978) | 1,433 |
| Other Non Opg (Exp)/Inc | 793 | 782 | (2,052) | (1,567) | (1,347) |
| Associates & JV Inc | 178 | 102 | 156 | 135 | 297 |
| Net Interest (Exp)/Inc | (2,810) | (2,717) | (2,739) | (2,810) | (2,751) |
| Exceptional Gain/(Loss) | (205) | (2,718) | 69 | (200) | 604 |
| Pre-tax Profit | (5,101) | (8,809) | (15,130) | (16,420) | (1,764) |
| Tax | 1,134 | 1,760 | 3,144 | (5,310) | (717) |
| Minority Interest | (723) | (367) | 496 | 521 | (396) |
| Net Profit | (4,690) | (7,416) | (11,490) | (21,209) | (2,877) |
| Net profit bef Except. | (4,485) | (4,698) | (11,559) | (21,009) | (3,481) |
| Growth | | | | | |
| Revenue Gth (%) | 32.4 | (6.6) | (20.9) | (7.6) | 76.0 |
| Opg Profit Gth (%) | (55.6) | 345.4 | 245.6 | 181.3 | (113.6) |
| Net Profit Gth (%) | 42.7 | (178.0) | (145.0) | (186.0) | 75.0 |
| Margins | | | | | |
| Gross Margins (%) | (9.5) | (14.4) | (30.7) | (33.9) | (0.5) |
| Opg Profit Margins (%) | (5.9) | (8.5) | (25.9) | (25.9) | 2.0 |
| Net Profit Margins (%) | (9.1) | (14.8) | (28.2) | (45.9) | (4.0) |

Source: Company, DBS HK

China Southern Airlines

Balance Sheet (RMB m)

| FY Dec | 2021A | 2022A | 2023F | 2024F | 2025F |
|-------------------------------|----------------|----------------|----------------|----------------|----------------|
| Net Fixed Assets | 261,382 | 255,771 | 245,806 | 242,544 | 239,918 |
| Invt in Associates & JVs | 5,978 | 6,206 | 6,606 | 7,056 | 7,556 |
| Other LT Assets | 17,985 | 16,815 | 16,815 | 16,815 | 16,815 |
| Cash & ST Invt | 22,748 | 20,598 | 35,383 | 27,772 | 22,023 |
| Inventory | 1,652 | 1,387 | 1,874 | 2,142 | 2,368 |
| Debtors | 2,858 | 2,619 | 3,186 | 3,427 | 3,789 |
| Other Current Assets | 10,608 | 8,850 | 8,850 | 8,850 | 8,850 |
| Total Assets | 323,211 | 312,246 | 318,521 | 308,606 | 301,318 |
| ST Debt | 78,718 | 107,135 | 107,135 | 107,135 | 107,135 |
| Creditors | 1,328 | 1,537 | 2,081 | 2,239 | 2,475 |
| Other Current Liab | 30,944 | 32,786 | 38,452 | 41,638 | 45,830 |
| LT Debt | 120,298 | 107,407 | 88,807 | 68,807 | 48,807 |
| Other LT Liabilities | 7,415 | 8,022 | 8,022 | 8,022 | 8,022 |
| Shareholder's Equity | 67,851 | 41,275 | 59,440 | 64,981 | 71,965 |
| Minority Interests | 16,657 | 14,084 | 14,584 | 15,784 | 17,084 |
| Total Cap. & Liab. | 323,211 | 312,246 | 318,521 | 308,606 | 301,318 |
| Non-Cash Wkg. Capital | (17,154) | (21,467) | (26,623) | (29,458) | (33,298) |
| Net Cash/(Debt) | (176,268) | (193,944) | (160,559) | (148,170) | (133,919) |
| Debtors Turn (avg days) | 9.7 | 11.5 | 6.7 | 7.0 | 7.0 |
| Creditors Turn (avg days) | 6.3 | 5.7 | 5.0 | 5.7 | 5.6 |
| Inventory Turn (avg days) | 7.0 | 6.1 | 4.5 | 5.3 | 5.4 |
| Asset Turnover (x) | 0.3 | 0.3 | 0.5 | 0.5 | 0.6 |
| Current Ratio (x) | 0.3 | 0.2 | 0.3 | 0.3 | 0.2 |
| Quick Ratio (x) | 0.2 | 0.2 | 0.3 | 0.2 | 0.2 |
| Net Debt/Equity (X) | 2.1 | 3.5 | 2.2 | 1.8 | 1.5 |
| Net Debt/Equity ex MI (X) | 2.6 | 4.7 | 2.7 | 2.3 | 1.9 |
| Capex to Debt (%) | 8.1 | 3.0 | 8.2 | 13.6 | 16.7 |
| Z-Score (X) | NA | NA | NA | NA | NA |

Source: Company, DBS HK

Cash Flow Statement (RMB m)

| FY Dec | 2021A | 2022A | 2023F | 2024F | 2025F |
|--------------------------------|-----------------|----------------|-----------------|-----------------|-----------------|
| Pre-Tax Profit | (13,910) | (31,550) | 1,507 | 8,122 | 9,993 |
| Dep. & Amort. | 24,241 | 24,266 | 25,965 | 27,263 | 28,626 |
| Tax Paid | (462) | (844) | 40 | 217 | 267 |
| Assoc. & JV Inc/(loss) | (280) | (291) | (400) | (450) | (500) |
| (Pft)/ Loss on disposal of FAs | 0 | 0 | 0 | 0 | 0 |
| Chg in Wkg.Cap. | (1,315) | 2,138 | 4,773 | 1,237 | 1,864 |
| Other Operating CF | (586) | 3,831 | 1,400 | 0 | 0 |
| Net Operating CF | 7,688 | (2,450) | 33,285 | 36,389 | 40,251 |
| Capital Exp.(net) | (16,147) | (6,500) | (16,000) | (24,000) | (26,000) |
| Other Invt.(net) | 0 | 0 | 0 | 0 | 0 |
| Invt in Assoc. & JV | 0 | 0 | 0 | 0 | 0 |
| Div from Assoc & JV | 263 | 0 | 0 | 0 | 0 |
| Other Investing CF | 64 | 649 | 0 | 0 | 0 |
| Net Investing CF | (15,820) | (5,851) | (16,000) | (24,000) | (26,000) |
| Div Paid | 0 | 0 | 0 | 0 | 0 |
| Chg in Gross Debt | 3,711 | 3,000 | (20,000) | (20,000) | (20,000) |
| Capital Issues | 1,128 | 4,500 | 17,500 | 0 | 0 |
| Other Financing CF | (653) | (76) | 0 | 0 | 0 |
| Net Financing CF | 4,186 | 6,658 | (2,500) | (20,000) | (20,000) |
| Currency Adjustments | (17) | 76 | 0 | 0 | 0 |
| Chg in Cash | (3,963) | (1,567) | 14,785 | (7,611) | (5,749) |
| Opg CFPS (RMB) | 0.56 | (0.26) | 1.37 | 1.49 | 1.63 |
| Free CFPS (RMB) | (0.52) | (0.51) | 0.83 | 0.53 | 0.60 |

Source: Company, DBS HK

China Southern Airlines

H Share - Target Price & Ratings 12-mth History

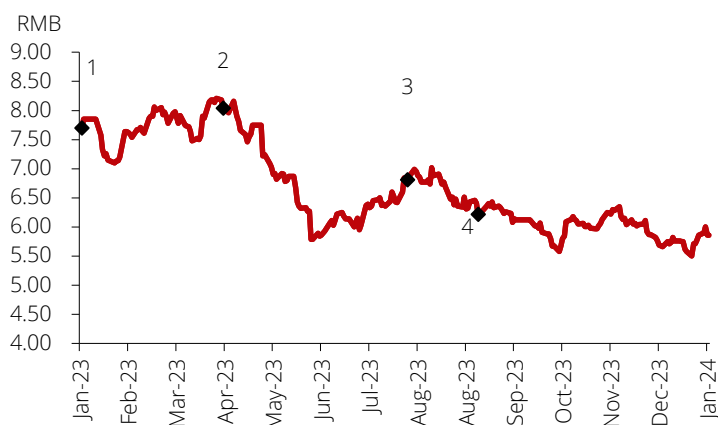


| S.No. | Date | Closing Price | 12-mth Target Price | Rating |
|-------|-----------|---------------|---------------------|--------|
| 1: | 19-Jan-23 | HK\$5.57 | HK\$6.50 | Buy |
| 2: | 11-Apr-23 | HK\$5.81 | HK\$7.00 | Buy |
| 3: | 27-Jul-23 | HK\$4.75 | HK\$5.60 | Buy |
| 4: | 6-Sep-23 | HK\$4.19 | HK\$5.60 | Buy |

Source: DBS HK

Analyst: Paul YONG

A Share - Target Price & Ratings 12-mth History



| S.No. | Date | Closing Price | 12-mth Target Price | Rating |
|-------|-----------|---------------|---------------------|--------|
| 1: | 19-Jan-23 | RMB7.70 | RMB9.40 | Buy |
| 2: | 11-Apr-23 | RMB8.18 | RMB9.90 | Buy |
| 3: | 27-Jul-23 | RMB6.77 | RMB7.90 | Buy |
| 4: | 6-Sep-23 | RMB6.41 | RMB7.90 | Buy |

Source: DBS HK

Analyst: Paul YONG

China Southern Airlines

DBS HK recommendations are based on an Absolute Total Return* Rating system, defined as follows:

STRONG BUY (>20% total return over the next 3 months, with identifiable share price catalysts within this time frame)

BUY (>15% total return over the next 12 months for small caps, >10% for large caps)

HOLD (-10% to +15% total return over the next 12 months for small caps, -10% to +10% for large caps)

FULLY VALUED (negative total return, i.e., > -10% over the next 12 months)

SELL (negative total return of > -20% over the next 3 months, with identifiable share price catalysts within this time frame)

*Share price appreciation + dividends

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Sources for all charts and tables are DBS HK unless otherwise specified.

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China Southern Airlines

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